



**SECURITIES AND EXCHANGE COMMISSION**  
**Washington, D.C. 20549**  
**Amendment No. 2**  
to  
**Form S-1**  
**REGISTRATION STATEMENT**  
**UNDER**  
**THE SECURITIES ACT OF 1933**  
**ELECTRO-OPTICAL SCIENCES, INC.**  
*(Exact name of registrant as specified in its charter)*

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

**3841**  
*(Primary standard industrial  
classification code number)*

**13-3986004**  
*(I.R.S. Employer  
Identification Number)*

**3 West Main Street, Suite 201**  
**Irvington, New York 10533**  
**(914) 591-3783**

*(Address, including zip code, and telephone number,  
including area code, of registrant's principal executive offices)*

**Joseph V. Gulfo, M.D.**  
**President and Chief Executive Officer**  
**Electro-Optical Sciences, Inc.**  
**3 West Main Street, Suite 201**  
**Irvington, New York 10533**  
**(914) 591-3783**

*(Name, address, including zip code, and telephone number, including area code, of agent for service)*

**Copies to:**

**Valerie A. Price, Esq.**  
**Dreier LLP**  
**499 Park Avenue**  
**New York, New York 10022**  
**(212) 328-6144 (phone)**  
**(212) 652-3789 (facsimile)**

**David C. Peck, Esq.**  
**Greenberg Traurig, LLP**  
**200 Park Avenue**  
**New York, New York 10166**  
**(212) 801-9200 (phone)**  
**(212) 801-6400 (facsimile)**

**Approximate date of proposed sale to the public:** As soon as practicable after the effective date of this Registration Statement.

If any of the securities being registered on this form are to be offered on a delayed or continuous basis pursuant to Rule 415 under the Securities Act of 1933, as amended (the "Securities Act") check the following box.

If this form is filed to register additional securities for an offering pursuant to Rule 462(b) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering.

If this form is a post-effective amendment filed pursuant to Rule 462(c) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering.

If this form is a post-effective amendment filed pursuant to Rule 462(d) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering.

If delivery of the prospectus is expected to be made pursuant to Rule 434, check the following box.

**CALCULATION OF REGISTRATION FEE**

| Title of Each Class of<br>Securities to be Registered | Proposed Maximum Aggregate<br>Offering Price(1) | Amount of<br>Registration Fee |
|---|---|-------------------------------|
| Common stock, par value \$0.001 per share             | \$34,500,000                                    | \$4,060.65(2)                 |

(1) Estimated solely for purposes of determining the registration fee pursuant to Rule 457(o) under the Securities Act.

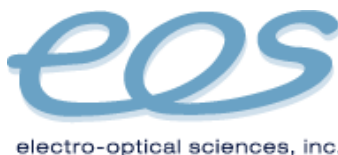
(2) \$3,884.10 previously paid.

**The registrant hereby amends this registration statement on such date or dates as may be necessary to delay its effective date until the registrant shall file a further amendment which specifically states that this registration statement shall thereafter become effective in accordance with Section 8(a) of the Securities Act or until the registration statement shall become effective on such date as the Securities and Exchange Commission, acting pursuant to said Section 8(a), may determine.**

The information in this prospectus is not complete and may be changed. We may not sell these securities until the registration statement filed with the Securities and Exchange Commission is effective. This prospectus is not an offer to sell these securities and it is not soliciting an offer to buy these securities in any state where the offer and sale is not permitted.

**SUBJECT TO COMPLETION, DATED AUGUST 8, 2005**

**PROSPECTUS**



**3,000,000 Shares**

## **Electro-Optical Sciences, Inc.**

### **Common Stock**

This is the initial public offering of 3,000,000 shares of common stock of Electro-Optical Sciences, Inc.

We expect the public offering price to be between \$8.00 and \$10.00 per share. There presently is no public market for our securities and we cannot ensure you that a market will develop. We have applied to list our common stock on the NASDAQ National Market under the symbol "MELA."

**Investing in our common stock is highly speculative and involves a high degree of risk. See "Risk Factors" beginning on Page 7.**

**Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities or passed upon the adequacy or accuracy of this prospectus. Any representation to the contrary is a criminal offense.**

|  | <u>Per Share</u> | <u>Total</u> |
|--|------------------|--------------|
| Public offering price  | \$               | \$           |
| Underwriting discounts and commissions                       | \$               | \$           |
| Proceeds, before expenses, to Electro-Optical Sciences, Inc. | \$               | \$           |

To the extent the underwriters sell more than 3,000,000 shares of common stock, the underwriters have the option to purchase up to an additional 450,000 shares from us at the public offering price less the underwriting discount, within 45 days from the date of this prospectus to cover over-allotments. The underwriters will also receive a non-accountable expense allowance in the amount of one percent (1%) of the total public offering price (excluding the over-allotment option). In addition, upon completion of this offering, the underwriters will receive warrants to purchase up to an aggregate of 225,000 shares of our common stock at an exercise price equal to 125% of the public offering price per share. The warrants will be exercisable commencing on the first anniversary of the date of this prospectus and ending on the fifth anniversary of the date of this prospectus.

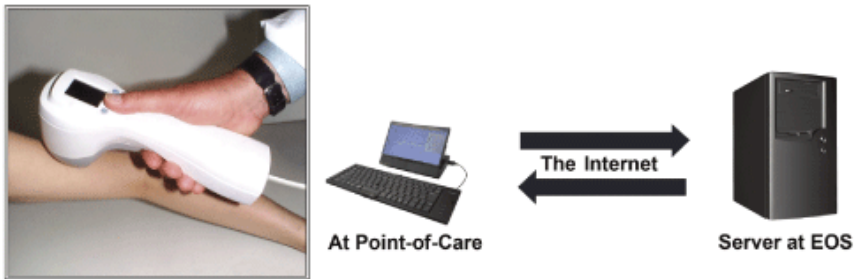
The underwriters expect to deliver the shares on or about \_\_\_\_\_, 2005.

**Ladenburg Thalmann & Co. Inc.**

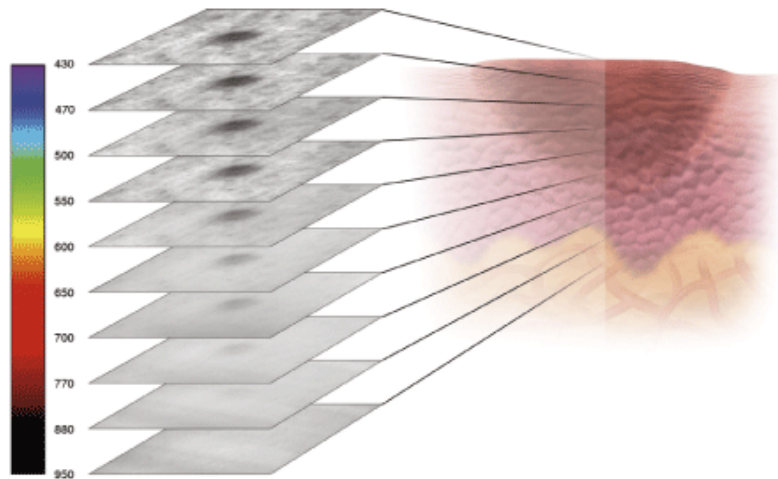
**Stanford Group Company**

The date of this prospectus is \_\_\_\_\_, 2005.

## The MelaFind® System



MelaFind® is a non-invasive system for assisting in the early detection of melanoma. The MelaFind® system is comprised of a point-of-care, hand-held imaging device that, in commercial use, is intended to be connected via the internet to a central server located at EOS. When marketed, a report will be transmitted to the physician's office containing MelaFind®'s recommendation of whether the lesion should be biopsied.



Traditional visual clinical examination is limited to the surface appearance of the suspicious pigmented skin lesion, whereas MelaFind® utilizes information derived from up to 2.5mm deep into the skin. MelaFind® uses an illuminator that shines 10 different specific wavelengths of light (from 430nm to 950nm), including near infra-red bands, which penetrate to varying depths of skin. The data are analyzed against our proprietary database of melanomas and benign lesions using our sophisticated algorithms.

---

## TABLE OF CONTENTS

|   |     |
|---|-----|
| Prospectus Summary  | 1   |
| Risk Factors  | 7   |
| Special Note Regarding Forward-Looking Statements                                     | 29  |
| Use of Proceeds   | 30  |
| Dividend Policy   | 30  |
| Capitalization  | 31  |
| Dilution  | 32  |
| Selected Financial Data   | 34  |
| Management's Discussion and Analysis of Financial Condition and Results of Operations | 36  |
| Our Business  | 44  |
| Management  | 65  |
| Related Party Transactions  | 75  |
| Principal Stockholders  | 77  |
| Description of Capital Stock  | 79  |
| Shares Eligible for Future Sale   | 82  |
| Material US Federal Income and Estate Tax Considerations for Non-US Holders           | 85  |
| Underwriting  | 88  |
| Legal Matters   | 90  |
| Experts   | 90  |
| Where You Can Find More Information   | 91  |
| Index to Financial Statements   | F-1 |

You should rely only on the information contained in this prospectus. We have not authorized anyone to provide you with information different from that contained in this prospectus. We are offering to sell shares of our common stock and seeking offers to buy shares of our common stock only in jurisdictions where offers and sales are permitted. The information contained in this prospectus is accurate only as of the date of this prospectus, regardless of the time of delivery of this prospectus or any sale of the common stock.

For investors outside the US: Neither we nor any of the underwriters have done anything that would permit this offering or possession or distribution of this prospectus in any jurisdiction where action for that purpose is required, other than in the US. You are required to inform yourselves about, and to observe any restrictions relating to, this offering and the distribution of this prospectus.

We obtained statistical data and certain other industry forecasts used throughout this prospectus from market research, publicly available information and industry publications. Industry publications generally state that they obtain their information from sources that they believe to be reliable, but they do not guarantee the accuracy and completeness of the information. Similarly, while we believe that the statistical and industry data and forecasts and market research used herein are reliable, we have not independently verified such data. We have not sought the consent of the sources to refer to their reports in this prospectus.

---

## PROSPECTUS SUMMARY

*This summary highlights information contained elsewhere in this prospectus. It does not contain all of the information you should consider before buying shares of our common stock. You should read this entire prospectus carefully, especially the "Risk Factors" section and our financial statements and the related notes appearing at the end of this prospectus, before deciding to invest in shares of our common stock. Unless otherwise stated or the context otherwise requires, reference in this prospectus to "EOS," "we," "us," "our" and similar references refer to Electro-Optical Sciences, Inc.*

### **Our Business**

We are a medical device company focused on the design and development of a non-invasive, point-of-care instrument to assist in the early diagnosis of melanoma. Our flagship product, MelaFind®, features a hand-held imaging device that emits multiple wavelengths of light to capture images of suspicious pigmented skin lesions and extract data. The data are then analyzed against our proprietary database of melanomas and benign lesions using our sophisticated algorithms in order to provide information to the physician and produce a recommendation of whether the lesion should be biopsied.

The components of the MelaFind® system include:

- a *hand-held imaging device*, which employs high precision optics and multi-spectral illumination (multiple colors of light including near infra-red);
- our *proprietary database* of pigmented skin lesions, which we believe to be the largest in the US;
- our *lesion classifiers*, which are sophisticated mathematical algorithms that extract lesion feature information and classify lesions; and
- a *central server* in our offices that is intended to perform quality control functions and provide reports to the physician and in commercial use, will be connected to physicians' offices via the internet.

We have entered into a binding Protocol Agreement with the US Food and Drug Administration (FDA), which is an agreement for the conduct of the pivotal trial in order to establish the safety and effectiveness of MelaFind®. We believe the presence of the Protocol Agreement significantly enhances our ability to expedite the FDA approval process. We stopped a study that was initiated in late 2004 under the Protocol Agreement due to technical difficulties with some of the MelaFind® clinical trial instruments. The FDA has provided confirmation that our plan to correct the technical issues and start a new pivotal trial to satisfy the Protocol Agreement is acceptable. Management estimates that the pivotal trial will commence in early 2006 at over 20 US clinical study sites, and anticipates premarket approval (PMA) to commercialize MelaFind® in 2007.

To date, we have not generated any revenues from MelaFind®. All of our historical revenues have come from activities and products that have since been discontinued, including our DIFOTI® product, a non-invasive imaging device for the detection of dental cavities. We decided to discontinue all operations associated with our DIFOTI® product, effective as of April 5, 2005, in order to focus our resources on the development and commercialization of MelaFind®.

### **The Market Opportunity**

Cancer of the skin has a higher incidence than all other cancers combined, and the rates are rising dramatically. In 2005, over 120,000 new cases of melanoma are projected. Melanoma is responsible for approximately 80% of skin cancer fatalities and is the deadliest of all skin cancers as there is currently no cure for advanced stage melanoma. However, early detection of melanoma can lead to virtually a 100% cure rate. Therefore, the need for medical practitioners to be able to examine individuals during a routine annual exam, resulting in early detection and treatment of skin cancer cannot be overstated. Advanced stage melanoma is costly to treat and is responsible for approximately 90% of the total spending on

melanoma treatment in the US, costing up to \$170,000 per patient. If diagnosed early, however, melanoma is almost always cured by simple resection at a cost of approximately \$1,800 per patient.

Melanoma is currently the subject of significant attention in the medical community. In part, this attention is due to the fact that it is the fastest growing cancer. It is also the most common cancer in young adults ages 20-30, and currently there are more new cases of melanoma than HIV/ AIDS. In women ages 25-30, melanoma is the primary cause of cancer death. In women ages 30-35, melanoma is the second leading cause of death after breast cancer. Recent published papers identify a strong correlation between breast cancer and melanoma.

Because early detection is critical to survival, the American Cancer Society recommends that individuals 40 years and older have complete skin examination on an annual basis. According to the 2000 US Census data, over 100 million Americans in the US are over age 40. Furthermore, there are more than 20 million individuals in the US who have dysplastic nevi, a type of pigmented skin lesion that when present is associated with an increased risk of melanoma. These individuals warrant more frequent observation.

### **Limitations of Current Melanoma Diagnosis**

Melanomas are mainly diagnosed by dermatologists and/or primary care physicians using only visual clinical evaluation. Physicians assess pigmented skin lesions using the “ABCDE” criteria, Asymmetry, Border irregularity, Color variation, Diameter greater than 6 mm, and Evolving — change in ABCD over time. This assessment is subjective and results in missed melanomas, as well as a ratio of benign lesions biopsied to melanomas confirmed that is highly variable and as high as 40 to 1 for dermatologists and as high as 50 to 1 for primary care physicians.

Dermatologists who specialize in the management of pigmented skin lesions may also use dermoscopy, a method of viewing lesions under magnification. Approximately 25% of dermatologists use dermoscopy. Although dermoscopy provides more information than unaided visual examination, mastery of the technique necessitates many years of training and experience. Proper use of dermoscopy can reduce the number of unnecessary biopsies of benign lesions, but even dermoscopy experts biopsy 3-10 benign lesions for every melanoma detected.

In contrast, MelaFind® delivers an objective assessment based on numerical scores assigned to the suspicious skin lesion under evaluation and does not require extensive physician training to operate. Further, visual clinical evaluation is limited to the surface appearance of the suspicious pigmented skin lesion, whereas MelaFind® utilizes information derived from up to 2.5 mm deep into the skin. In clinical trials to date, this objective assessment has resulted in a ratio of benign lesions biopsied to melanomas confirmed as low as almost 2 to 1.

### **Clinical Results to Date**

To date, MelaFind® has been studied on over 5,000 skin lesions from over 3,500 patients at over 20 clinical centers. Our clinical studies have demonstrated that MelaFind® missed fewer melanomas and produced fewer false positives than were experienced by study dermatologists, who are skin cancer specialists. The performance of a diagnostic is measured in terms of “sensitivity” (the ability to detect disease when disease is present) and “specificity” (the ability to exclude disease when disease is not present). In the largest blinded trial that we have performed to date on 352 suspicious pigmented skin lesions, MelaFind® did not miss a melanoma (measured sensitivity of 100%) and achieved 48.4% specificity, compared to the study dermatologists’ sensitivity of 96.4% and specificity of 28.4%.

We believe that with the assistance provided by MelaFind®, physicians could diagnose more melanomas at the earliest, curable stage, which would reduce both treatment costs and the number of unnecessary biopsies, and improve quality of life.

## Our Strategy

Our objective is for MelaFind® to become an integral part of the standard of care in melanoma detection. To achieve this objective, we are pursuing the following strategy:

- **Pursue timely FDA approval of MelaFind®:** We have entered into a binding Protocol Agreement with the FDA for the conduct of the pivotal trial of MelaFind®. Management estimates that the study will commence in early 2006 at over 20 US clinical study sites, and anticipates PMA approval to commercialize MelaFind® in 2007.
- **Establish MelaFind® as the leading technology for assisting in the detection of melanoma:** We have invested considerable capital and expertise into developing our core technology platform, which is protected by six US patents. We will continue to refine and optimize this technology to ensure that MelaFind® is the leading system for assisting in the detection of melanoma.
- **Obtain third party payor reimbursement to support our recurring revenue pricing model:** We intend to offer MelaFind® on a per patient basis, creating a recurring revenue stream. To do so, we will seek to obtain third party reimbursement as well as private pay alternatives. We are working with experts to create an evidence-based medicine evaluation model consistent with those used to support positive coverage decisions by the federal Centers for Medicare & Medicaid Services (CMS) and private payors for similar products. The value drivers in the model include the treatment and diagnostic cost savings associated with early detection (approximately \$168,000 per patient) and fewer biopsies. We believe that the use of MelaFind® could result in substantial savings to the US healthcare system.
- **Commercialize MelaFind® using multiple sales and marketing strategies:** Our sales and marketing effort will focus initially on “high volume/key opinion leader” dermatologists with specialties in the diagnosis and treatment of melanoma. To enter the larger US markets of general dermatologists, plastic surgeons, and primary care physicians, and for international markets, we intend to establish partnerships with pharmaceutical and/or diagnostic device companies with an established presence in these markets. While we believe obtaining a positive coverage decision from CMS may take an additional 18 to 36 months following PMA approval, and obtaining a positive coverage decision from private payors, managed care organizations and state Medicare administrative contractors may take at least 6 to 12 months following PMA approval, we intend to commence sales of MelaFind® immediately upon receiving PMA approval for physicians to offer MelaFind® to their patients on a self-pay basis.

## Company Information

We were incorporated under the laws of the State of New York in 1989 and subsequently reincorporated under the laws of the State of Delaware in 1997. Our executive offices are located at 3 West Main Street, Suite 201, Irvington, New York 10533. Our telephone number is (914) 591-3783. Our websites include [www.eo-sciences.com](http://www.eo-sciences.com) and [www.melafind.com](http://www.melafind.com). The information contained on our websites is not a part of this prospectus and should not be relied upon. We have included our website addresses in this document as inactive textual references only.

This prospectus contains references to our US registered trademarks: MelaFind®, DIFOTI®, and the corporate logo for “eos — electro-optical sciences, inc.” All other trademarks, tradenames and service marks appearing in this prospectus are the property of their respective owners.



## THE OFFERING

Common stock offered by us 3,000,000 shares

Common stock outstanding after the offering 9,513,164 shares

Use of proceeds We estimate that our net proceeds from this offering will be approximately \$23.5 million at an assumed initial public offering price of \$9.00 per share, which is the mid-point of our filing range, after deducting estimated underwriting discounts and commissions and offering expenses payable by us. We intend to use these net proceeds to fund our research and development activities, including our clinical studies, to build our sales and marketing capabilities, and for general corporate purposes, including working capital needs, facilities expansion and potential acquisitions. See "Use of Proceeds."

Risk factors You should read the "Risk Factors" section of this prospectus for a discussion of factors to consider carefully before deciding to invest in shares of our common stock.

Proposed NASDAQ National Market symbol MELA

The number of shares of our common stock to be outstanding after this offering is based on 6,513,164 shares outstanding as of June 30, 2005, and unless otherwise indicated, excludes:

- 899,875 shares of common stock issuable as of the date of this prospectus upon the exercise of outstanding stock options under our 2003 Stock Incentive Plan and our 1996 Stock Option Plan, respectively, at a weighted average exercise price of approximately \$0.64 per share;
- up to 1,000,000 shares of common stock reserved for future grants under our 2005 Stock Incentive Plan;
- 75,000 shares of common stock issuable upon exercise of outstanding warrants to purchase common stock at an exercise price of \$7.00 per share;
- 73,280 shares of common stock issuable upon exercise of outstanding warrants to purchase our Series C preferred stock (assuming conversion of our Series C preferred stock) at an exercise price of \$4.52 per share; and
- 225,000 shares of common stock issuable upon exercise of warrants to be issued to the underwriters upon completion of this offering at an exercise price equal to 125% of the public offering price per share.

Unless we specifically state otherwise, all information in this prospectus assumes:

- that all outstanding shares of our Series A preferred stock, Series B preferred stock and Series C preferred stock are converted into shares of our common stock prior to completion of this offering;
- that all outstanding warrants to purchase our common stock with an exercise price of \$13.00 per share have been exchanged for our common stock based on an exchange rate of one share of common stock for every two shares of common stock purchasable under such warrants in a cashless exchange. See the full discussion in "Related Party Transactions — Warrants to Purchase Common Stock";
- no exercise of the underwriters' over-allotment option;
- the adoption of our fourth amended and restated certificate of incorporation and third amended and restated bylaws; and
- a 1-for-2 reverse stock split of our common stock which was approved by our board of directors on May 13, 2005, effective upon the earlier of the conversion of our preferred stock or September 30, 2005.

## SUMMARY FINANCIAL DATA

The following summary financial data for the fiscal years ended December 31, 2002, 2003 and 2004 have been derived from our historical audited financial statements. The summary financial data for the six month periods ended June 30, 2004 and 2005 have been derived from our unaudited financial statements. The unaudited summary financial data include, in our opinion, all adjustments, consisting only of normal, recurring adjustments, necessary to present fairly the financial position and results of operations for the periods presented. Our historical results for any prior or interim period are not necessarily indicative of results to be expected for a full fiscal year or for any future period. The summary financial data shown below account for the revenues and related expenses for our DIFOTI® product, a non-invasive imaging device for the detection of dental cavities, as a discontinued operation. We decided to discontinue all operations associated with our DIFOTI® product, effective as of April 5, 2005, in order to focus our resources on the development and commercialization of MelaFind®. See the footnote to the Financial Statements relating to discontinued operations and assets held for sale included elsewhere in this prospectus. You should read this information together with our financial statements and the related notes appearing at the end of this prospectus and the “Management’s Discussion and Analysis of Financial Condition and Results of Operations” section of this prospectus.

|   | Year Ended December 31, |            |            | Six Months Ended<br>June 30, |            |
|---|-------------------------|------------|------------|------------------------------|------------|
|   | 2002                    | 2003       | 2004       | 2004                         | 2005       |
|   | (unaudited)             |            |            |                              |            |
| (In thousands, except share and per share data)   |                         |            |            |                              |            |
| <b>Statement of Operations Data:</b>  |                         |            |            |                              |            |
| Revenue from grants   | \$ 547                  | \$ —       | \$ —       | \$ —                         | \$ —       |
| Operating expenses:   |                         |            |            |                              |            |
| Cost of grant revenue   | 564                     | —          | —          | —                            | —          |
| General and administrative expenses   | 511                     | 1,034      | 1,234      | 639                          | 996        |
| Research and development  | 404                     | 828        | 1,892      | 693                          | 1,546      |
| Operating loss from continuing operations   | (932)                   | (1,862)    | (3,126)    | (1,332)                      | (2,542)    |
| Interest (income)/expense   | 8                       | 76         | 67         | 82                           | (63)       |
| Loss from continuing operations   | (940)                   | (1,938)    | (3,193)    | (1,414)                      | (2,479)    |
| Loss from discontinued operations   | (201)                   | (12)       | (426)      | (102)                        | (330)      |
| Net loss  | (1,141)                 | (1,950)    | (3,619)    | (1,516)                      | (2,809)    |
| Preferred stock deemed dividends  | 214                     | 322        | 676        | 243                          | 719        |
| Preferred stock accretion   | 180                     | 25         | 258        | 25                           | 647        |
| Stock distribution of preferred Series B shares   | —                       | 102        | —          | —                            | —          |
| Net loss attributable to common stockholders  | \$ (1,535)              | \$ (2,399) | \$ (4,553) | \$ (1,784)                   | \$ (4,175) |
| Net loss per share, basic and diluted:  |                         |            |            |                              |            |
| Continuing operations   | \$ (0.87)               | \$ (1.48)  | \$ (2.34)  | \$ (0.98)                    | \$ (2.13)  |
| Discontinued operations   | (0.13)                  | (0.01)     | (0.24)     | (0.06)                       | (0.18)     |
| Basic and diluted net loss per common share   | \$ (1.00)               | \$ (1.49)  | \$ (2.58)  | \$ (1.04)                    | \$ (2.31)  |
| Basic and diluted weighted average number of shares outstanding                                 | 1,534,760               | 1,614,897  | 1,766,608  | 1,722,743                    | 1,809,758  |
| Pro forma basic and diluted loss from continuing operations per common share (unaudited)(1)     |                         |            | \$ (0.80)  |                              | \$ (0.38)  |
| Pro forma basic and diluted weighted average number of common shares outstanding (unaudited)(1) |                         |            | 3,967,024  |                              | 6,513,164  |

- (1) Pro forma basic and diluted loss from continuing operations per common share reflects the effect of the assumed conversion of our preferred stock, as if this offering had occurred at the date of original issuance into 3,398,105 shares of our common stock for the year ended December 31, 2004 and six months ended June 30, 2005 which will occur upon closing of this public offering. Additionally, it is assumed that 2,610,643 warrants to purchase the company's common stock will be exchanged for a total of 1,305,321 shares of our common stock based on an exchange ratio of one share of our common stock for every two shares of our common stock purchasable under the warrants and will occur prior to the closing of this offering. The loss from continuing operations used in the computation of unaudited pro forma basic and diluted loss from continuing operations per share, has been adjusted to reverse the accretion on our preferred stock and also excludes the preferred stock dividends for the respective period.

The following table presents summary balance sheet data, derived from our historical audited financial statements, as of December 31, 2003 and December 31, 2004. The table also presents summary balance sheet data, derived from our historical unaudited financial statements, as of June 30, 2005:

- On an actual basis; and
- On an as adjusted basis to give effect to (1) the conversion of all outstanding shares of our convertible preferred stock into an aggregate of 3,398,105 shares of common stock upon the completion of this offering; (2) the exchange of 2,610,643 warrants to purchase the company's common stock for a total of 1,305,321 shares of our common stock based on an exchange ratio of one share of our common stock for every two shares of our common stock purchasable under the warrants that is assumed to occur prior to the closing of this offering; and (3) the sale of 3,000,000 shares of common stock in this offering at an assumed initial public offering price of \$9.00 per share, after deducting estimated underwriting discounts and commissions and offering expenses paid and payable by us.

|  | As of December 31, |          | As of June 30, 2005 |             |
|--|--------------------|----------|---------------------|-------------|
|  | 2003               | 2004     | Actual              | Pro Forma   |
|  | Actual             | Actual   |                     | As Adjusted |
|  |                    |          | (unaudited)         |             |
|  | (In thousands)     |          |                     |             |
| <b>Balance sheet data:</b>                       |                    |          |                     |             |
| Cash, cash equivalents and marketable securities | \$ 117             | \$ 6,703 | \$ 3,794            | \$ 27,274   |
| Working capital                                  | (433)              | 6,122    | 3,480               | 26,960      |
| Total assets                                     | 432                | 7,096    | 4,997               | 28,477      |
| Total liabilities                                | 650                | 691      | 1,245               | 1,245       |
| Redeemable convertible preferred stock           | 4,067              | 9,955    | 10,602              | —           |
| Total stockholders' (deficiency)/equity          | (4,285)            | (3,550)  | (6,850)             | \$ 27,232   |

## RISK FACTORS

*Investing in our common stock involves a high degree of risk. You should carefully consider the following risk factors, as well as the other information in this prospectus, before deciding whether to invest in shares of our common stock. If any of the following risks actually occur, our business, financial condition and results of operations would suffer. In that case, the trading price of our common stock would likely decline and you might lose all or part of your investment in our common stock.*

### **Risks Relating to Our Business**

***We currently do not have, and may never develop, any commercialized products.***

We currently do not have any commercialized products or any significant source of revenue. We have invested substantially all of our time and resources over the last five years in developing MelaFind®. MelaFind® will require additional development, clinical evaluation, regulatory approval, significant marketing efforts and substantial additional investment before it can provide us with any revenue. Our efforts may not lead to commercially successful products for a number of reasons, including:

- we may not be able to obtain regulatory approvals for MelaFind®, or the approved indication may be narrower than we seek;
- MelaFind® may not prove to be safe and effective in clinical trials;
- physicians may not receive any reimbursement from third-party payors, or the level of reimbursement may be insufficient to support widespread adoption of MelaFind®;
- we may experience delays in our development program;
- any products that are approved may not be accepted in the marketplace by physicians or patients;
- we may not have adequate financial or other resources to complete the development and commercialization of MelaFind® or other products;
- we may not be able to manufacture our products in commercial quantities or at an acceptable cost; and
- rapid technological change may make our technology and products obsolete.

We do not expect to be able to commercialize MelaFind® before 2007. If we are unable to develop, obtain regulatory approval for or successfully commercialize MelaFind®, we will be unable to generate revenue.

***We have not received, and may never receive, FDA approval to market MelaFind®.***

We do not have the necessary regulatory approvals to market MelaFind® in the US or in any foreign market. We have not filed, and currently do not have plans to file, for regulatory approval in any foreign market. We plan initially to launch MelaFind®, once approved, in the US. The regulatory approval process for MelaFind® in the US involves, among other things, successfully completing clinical trials and obtaining PMA approval from the FDA. We commenced the PMA application process for MelaFind® by filing a proposed outline for a Modular PMA application (a compilation of well-delineated components submitted separately) on September 30, 2002. The PMA process requires us to prove the safety and effectiveness of MelaFind® to the FDA's satisfaction. This process is expensive and uncertain, and requires detailed and comprehensive scientific and human clinical data. FDA review may take years after a PMA application is filed. The FDA may never grant approval. The FDA can delay, limit or deny approval of a PMA application for many reasons, including:

- MelaFind® may not be safe or effective to the FDA's satisfaction;
- the data from our pre-clinical studies and clinical trials may be insufficient to support approval;
- the manufacturing process or facilities we use may not meet applicable requirements; and
- changes in FDA approval policies or adoption of new regulations may require additional data.

No precedent has been established for FDA approval of a device such as MelaFind® to assist in determining the appropriateness of biopsies of suspicious pigmented skin lesions. Before submitting a PMA application (the final module), we must successfully complete a pivotal clinical trial to demonstrate that MelaFind® is safe and effective. Product development, including clinical trials, is a long, expensive and uncertain process, and is subject to delays and failure at any stage. Furthermore, the data obtained from the trial may be inadequate to support approval of a PMA application. While we obtained a Protocol Agreement from the FDA, FDA approval of a Protocol Agreement does not mean that the FDA will consider the data gathered in the trial sufficient to support approval of a PMA application, even if the trial's intended endpoints are achieved. There may be unexpected findings, particularly those that may only become evident from the larger scale of the pivotal clinical trial, as compared with the smaller scale tests done to date. For example, we initiated a clinical trial and encountered several technical problems which required us to refine the MelaFind® system. The data obtained in the pivotal trial may not be sufficient to support the anticipated indication for use, and may not support a more limited indication for use. The occurrence of unexpected findings in connection with the pivotal trial or any subsequent clinical trial required by the FDA may prevent or delay obtaining PMA approval, and may adversely affect coverage or reimbursement determinations. The FDA may also determine that additional clinical trials are necessary, in which case the PMA approval may be delayed for several months or even years while the trials are conducted and the data acquired are submitted in an amendment to the PMA. If we are unable to complete the clinical trials necessary to successfully support the MelaFind® PMA application, our ability to commercialize MelaFind®, and our business, financial condition, and results of operations would be materially adversely affected, thereby threatening our ability to continue operations.

***If MelaFind® is approved by the FDA, it may be approved only for narrow indications.***

Even if approved, MelaFind® may not be approved for the indications that are necessary or desirable for successful commercialization. Our preference is to obtain a broad indication for use in diagnosing almost all pigmented melanomas (other than those on palms, soles of the feet, in or near the eye, and inaccessible areas such as the edge of the nose). The final MelaFind® lesion classifier should be able to identify the maximum number of types of melanoma possible. The indications for use must specify those lesion types for which the classifier has not been trained. Approximately five percent of melanoma lesions may be amelanotic, meaning they are not pigmented. These lesions cannot be differentiated by MelaFind®, which will be restricted to pigmented lesions. Approximately ten percent of pigmented melanoma lesions are nodular, a type of melanoma that is often missed by dermatologists in early stages. If nodular melanoma lesions are not sufficiently well-represented in the MelaFind® training database, the classifier may not differentiate nodular melanomas from non-melanomas with sufficient sensitivity and specificity. If we restrict the indications for use of MelaFind® to exclude certain melanoma lesion types, in addition to the other restrictions, then the size of the market for MelaFind® and the rate of acceptance of MelaFind® by physicians may be adversely affected.

If we wish to modify MelaFind® after receiving FDA approval, including changes in indications or other modifications that could affect safety and effectiveness, additional approvals could be required from the FDA. We may be required to submit extensive pre-clinical and clinical data, depending on the nature of the changes. Any request by the FDA for additional data, or any requirement by the FDA that we conduct additional clinical studies, could delay the commercialization of MelaFind® and require us to make substantial additional research, development and other expenditures. We may not obtain the necessary regulatory approvals to market MelaFind® in the US or anywhere else. Any delay in, or failure to receive or maintain, approval for MelaFind® could prevent us from generating revenue or achieving profitability, and our business, financial condition, and results of operations would be materially adversely affected.

***MelaFind® may not be commercially viable if we fail to obtain an adequate level of reimbursement by Medicare and other third party payors. The markets for MelaFind® may also be limited by the indications for which its use may be reimbursed.***

The availability of medical insurance coverage and reimbursement for newly approved medical devices is uncertain. In the US, physicians and other healthcare providers performing biopsies for suspicious skin lesions are generally reimbursed for all or part of the cost of the diagnosis and biopsy by Medicare, Medicaid, or other third-party payors. The commercial success of MelaFind® in both domestic and international markets will significantly depend on whether third-party coverage and reimbursement are available for services involving MelaFind®. Medicare, Medicaid, health maintenance organizations and other third-party payors are increasingly attempting to contain healthcare costs by limiting both the scope of coverage and the level of reimbursement of new medical devices, and as a result, they may not cover or provide adequate payment for the use of MelaFind®. In order to obtain satisfactory reimbursement arrangements, we may have to agree to a fee or sales price lower than the fee or sales price we might otherwise charge. Even if Medicare and other third-party payors decide to cover procedures involving our product, we cannot be certain that the reimbursement levels will be adequate. Accordingly, even if MelaFind® or future products we develop are approved for commercial sale, unless government and other third-party payors provide adequate coverage and reimbursement for our products, some physicians may be discouraged from using them, and our sales would suffer.

Medicare reimburses for medical devices in a variety of ways, depending on where and how the device is used. However, Medicare only provides reimbursement if CMS determines that the device should be covered and that the use of the device is consistent with the coverage criteria. A coverage determination can be made at the local level by the Medicare administrative contractor (formerly called carriers and fiscal intermediaries), a private contractor that processes and pays claims on behalf of CMS for the geographic area where the services were rendered, or at the national level by CMS through a national coverage determination. There are new statutory provisions intended to facilitate coverage determinations for new technologies, but it is unclear how these new provisions will be implemented. Coverage presupposes that the device has been cleared or approved by the FDA and further, that the coverage will be no broader than the approved intended uses of the device as approved or cleared by the FDA, but coverage can be narrower. A coverage determination may be so limited that relatively few patients will qualify for a covered use of the device. Should a very narrow coverage determination be made for MelaFind®, it may undermine the commercial viability of MelaFind®.

Obtaining a coverage determination, whether local or national, is a time-consuming, expensive and highly uncertain proposition, especially for a new technology, and inconsistent local determinations are possible. On average, according to an industry report, Medicare coverage determinations for medical devices lag 15 months to five years or more behind FDA approval for that device. The Medicare statutory framework is also subject to administrative rulings, interpretations and discretion that affect the amount and timing of reimbursement made under Medicare. Medicaid coverage determinations and reimbursement levels are determined on a state by state basis, because Medicaid, unlike Medicare, is administered by the states under a state plan filed with the Secretary of the US Department of Health and Human Services (HHS). Medicaid generally reimburses at lower levels than Medicare. Moreover, Medicaid programs and private insurers are frequently influenced by Medicare coverage determinations.

***Any adverse results in our clinical trials, or difficulties in conducting our clinical trials, could have a material adverse effect on our business.***

Clinical studies in the US have been ongoing for over five years, and we have a Protocol Agreement with the FDA, but we have not conducted the pivotal clinical trial required for PMA approval. We initiated a trial under the terms of the Protocol Agreement at the end of 2004. However, technical operational issues with the systems were experienced, requiring further refinement. We are currently refining the hardware systems and expect to have new systems available in order to start the pivotal clinical trial in early 2006. However, we cannot provide any assurances that we will have these systems available on a timely basis. In addition, the pivotal clinical trial and supporting clinical studies will require

the involvement of larger numbers of clinical sites than we have previously engaged at any single time, and the recruitment of large numbers of patients. If the clinical sites, which enroll patients on a best efforts basis, do not provide cases at rates anticipated for any reason (such as, for example, lower than forecasted clinical site productivity), we may face delays or may be unable to complete the development of MelaFind®.

***Risk of delay in product development.***

We could encounter delays in our pivotal trial or in obtaining PMA approval because of a number of factors. We will require the receipt of all information specified in our Protocol Agreement on the required number of melanomas before the pivotal clinical trial can be concluded. The MelaFind® classifier will then be utilized to evaluate the lesions acquired during the pivotal trial, and the results will be analyzed to determine if we have achieved the endpoints specified in the Protocol Agreement.

The final training of the classifier, required to be completed before the classifier is utilized as described above, is expected to take approximately two months. Accordingly, the classifier must be ready for final training two months before the end of the pivotal trial. For the classifier to be ready for final training, approximately 300 melanoma lesions are targeted to have been received. Therefore, in addition to acquiring the melanoma lesions required to complete the pivotal trial (approximately 100), we must have completed the acquisition of approximately 300 training melanoma lesions on schedule. Currently, approximately 225 melanoma lesions are in the training database. The current classifier has been trained on 113 of these melanoma lesions.

Our schedule for the acquisition of these lesions is based upon the projected numbers of imaging devices to be located at participating sites, the projected productivity of those sites in terms of melanomas and other lesions biopsied per month, and the projected efficiency of the study pathologists in classifying the lesion slides presented for histological analysis (the microscopic examination of excised or biopsied tissue specimens) and reporting their results. If we are unable to produce and maintain a sufficient number of imaging devices at participating sites, if the clinicians do not maintain sufficient productivity, or if the pathologists do not produce reports with sufficient efficiency, then our ability to maintain our schedule will be adversely affected, the start or conclusion of the pivotal trial may be delayed, and the submission of the completed PMA will be delayed.

To date, the lesion images in the training database have been acquired using first-generation hand-held devices, which also extract data from the lesions that are used by the classifiers. Pre-commercialization hand-held devices are being developed for use in the pivotal trial. If the lesion data obtained with pre-commercialization devices are not consistent with data from the first generation hand-held devices, the classifier will need to be trained solely on lesions imaged using only one or the other generation of hand-held devices. Were this need to arise, significant delay and expense could be incurred, which could jeopardize our ability to complete the development of MelaFind®.

***We have incurred losses for a number of years, and anticipate that we will incur continued losses for the foreseeable future.***

We began operations in December 1989. At that time we provided research services, mostly to US government agencies, on classified projects. We have financed our operations since 1999 primarily through private placements of our equity securities, and have devoted substantially all of our resources to research and development relating to MelaFind®. Our net loss for the six months ended June 30, 2005 was \$2.8 million, and as of June 30, 2005, we had an accumulated deficit of approximately \$16.7 million. We expect our research and development expenses to increase in connection with our clinical trials and other development activities related to MelaFind®. If we receive PMA approval for MelaFind® from the FDA, we expect to incur significant sales and marketing expenses, and manufacturing expenses. Additionally, if we complete our initial public offering, we expect that our general and administrative expenses will increase due to the additional operational and regulatory burdens applicable to public companies. As a result, we expect to continue to incur significant and increasing operating losses for the foreseeable future. These losses, among other things, have had and will continue to have an adverse effect on our stockholders' equity.

***We expect to operate in a highly competitive market, we may face competition from large, well-established medical device manufacturers with significant resources, and we may not be able to compete effectively.***

We do not know of any product possessing the diagnostic assistance capabilities of MelaFind®. We believe that electro-optical products designed to enhance the visualization and analysis of potential melanomas have been approved or are under development by: Welch Allyn, Inc.; Heine Optotechnik; 3Gen, LLC; Derma Medical Systems, Inc.; Medical High Technologies S.p.A.; ZN Vision Technologies AG; Polartechnics, Ltd.; Astron Clinica, Ltd.; LINOS Photonics, Inc.; and Biomips Engineering. The broader market for precision optical imaging devices used for medical diagnosis is intensely competitive, subject to rapid change, and significantly affected by new product introductions and other market activities of industry participants. If our products are approved for marketing, we will potentially be subject to competition from major optical imaging companies, such as: General Electric Co.; Siemens AG; Bayer AG; Eastman Kodak Company; Welch Allyn, Inc.; Olympus Corporation; Carl Zeiss AG Deutschland; and others, each of which manufactures and markets precision optical imaging products for the medical market, and could decide to develop or acquire a product to compete with MelaFind®. These companies enjoy numerous competitive advantages, including:

- significantly greater name recognition;
- established relations with healthcare professionals, customers and third-party payors;
- established distribution networks;
- additional lines of products, and the ability to offer rebates, higher discounts or incentives to gain a competitive advantage;
- greater experience in conducting research and development, manufacturing, clinical trials, obtaining regulatory approval for products, and marketing approved products; and
- greater financial and human resources for product development, sales and marketing, and patent litigation.

As a result, we may not be able to compete effectively against these companies or their products.

***Technological breakthroughs in the diagnosis or treatment of melanoma could render MelaFind® obsolete.***

The precision optical imaging field is subject to rapid technological change and product innovation. MelaFind® is based on our proprietary technology, but a number of companies and medical researchers are pursuing new technologies. Companies in the medical device industry with significantly greater financial, technical, research, marketing, sales and distribution and other resources have expertise and interest in the exploitation of computer-aided diagnosis, medical imaging, and other technologies MelaFind® utilizes. Some of these companies are working on potentially competing products or therapies, including confocal microscopy (a type of scanning microscopy for 3-dimensional specimens, which produces blur-free images at various depths), various forms of spectroscopy (a study of the way molecules absorb and emit light), other imaging modalities, and molecular and genetic screening tests. In addition, the National Institutes of Health and other supporters of cancer research are presumptively seeking ways to improve the diagnosis or treatment of melanoma by sponsoring corporate and academic research. There can be no assurance that one or more of these companies will not succeed in developing or marketing technologies and products or services that demonstrate better safety or effectiveness, superior clinical results, greater ease of use or lower cost than MelaFind®, or that such competitors will not succeed in obtaining regulatory approval for introducing or commercializing any such products or services prior to us. FDA approval of a commercially viable alternative to MelaFind® produced by a competitor could significantly reduce market acceptance of MelaFind®. Any of the above competitive developments could have a material adverse effect on our business, financial condition, and results of operations. There is no assurance that products, services, or technologies introduced prior to or subsequent to the commercialization of MelaFind® will not render MelaFind® less marketable or obsolete.



***We depend on clinical investigators and clinical sites to enroll patients in our clinical trials and other third parties to manage the trials and to perform related data collection and analysis, and, as a result, we may face costs and delays that are outside of our control.***

We rely on clinical investigators and clinical sites, some of which are private practices, and some of which are research university or government-affiliated, to enroll patients in our clinical trials. We rely on: pathologists and pathology laboratories; a contract research organization to assist in monitoring, collection of data, and ensuring FDA Good Clinical Practices (GCP) are observed at our sites; a consultant biostatistician; and other third parties to manage the trial and to perform related data collection and analysis. However, we may not be able to control the amount and timing of resources that clinical sites and other third parties may devote to our clinical trials. If these clinical investigators and clinical sites fail to enroll a sufficient number of patients in our clinical trials, or if the clinical sites fail to comply adequately with the clinical protocols, we will be unable to complete these trials, which could prevent us from obtaining regulatory approvals for MelaFind®. Our agreements with clinical investigators and clinical sites for clinical testing place substantial responsibilities on these parties and, if these parties fail to perform as expected, our trials could be delayed or terminated. If these clinical investigators, clinical sites or other third parties do not carry out their contractual duties or obligations or fail to meet expected deadlines, or if the quality or accuracy of the clinical data they obtain are compromised due to their failure to adhere to our clinical protocols or for other reasons, our clinical trials may be extended, delayed or terminated, and we may be unable to obtain regulatory approval for, or successfully commercialize, MelaFind®.

In addition to the foregoing, our clinical trial may be delayed or halted, or be inadequate to support approval of a PMA application, for numerous other reasons, including, but not limited to, the following:

- the FDA, an Institutional Review Board (IRB), or other regulatory authorities place our clinical trial on hold;
- patients do not enroll in clinical trials at the rate we expect;
- patient follow-up is not at the rate we expect;
- IRBs and third-party clinical investigators delay or reject our trial protocol;
- third-party organizations do not perform data collection and analysis in a timely or accurate manner;
- regulatory inspections of our clinical trials or manufacturing facilities, among other things, require us to undertake corrective action or suspend or terminate our clinical trials, or invalidate our clinical trials;
- changes in governmental regulations or administrative actions; and
- the interim or final results of the clinical trial are inconclusive or unfavorable as to safety or effectiveness.

***If MelaFind® is approved for reimbursement, we anticipate experiencing significant pressures on pricing.***

Even if Medicare covers a device for certain uses, that does not mean that the level of reimbursement will be sufficient for commercial success. We expect to experience pricing pressures in connection with the commercialization of MelaFind® and our future products due to efforts by private and government-funded payors to reduce or limit the growth of healthcare costs, the increasing influence of health maintenance organizations, and additional legislative proposals to reduce or limit increase in public funding for healthcare services. Private payors, including managed care payors, increasingly are demanding discounted fee structures and the assumption by healthcare providers of all or a portion of the financial risk. Efforts to impose greater discounts and more stringent cost controls upon healthcare providers by private and public payors are expected to continue. Payors frequently review their coverage policies for existing and new diagnostic tools and can, sometimes without advance notice, deny or change their coverage policies. Significant limits on the scope of services covered or on reimbursement rates and fees on those services

that are covered could have a material adverse effect on our ability to commercialize MelaFind® and therefore, on our liquidity and our business, financial condition, and results of operations.

In some foreign markets, which we may seek to enter in the future, pricing and profitability of medical devices are subject to government control. In the US, we expect that there will continue to be federal and state proposals for similar controls. Also, the trends toward managed healthcare in the US and proposed legislation intended to control the cost of publicly funded healthcare programs could significantly influence the purchase of healthcare services and products, and may force us to reduce prices for MelaFind® or result in the exclusion of MelaFind® from reimbursement programs.

***MelaFind® may never achieve market acceptance even if we obtain regulatory approvals.***

To date, only those patients who were treated by physicians involved in our clinical trials have been evaluated using MelaFind® and even if we obtain regulatory approval patients with suspicious lesions and physicians evaluating suspicious lesions may not endorse MelaFind®. Physicians tend to be slow to change their diagnostic and medical treatment practices because of perceived liability risks arising from the use of new products and the uncertainty of third party reimbursement. Physicians may not utilize MelaFind® until there is long-term clinical evidence to convince them to alter their existing methods of diagnosing or evaluating suspicious lesions and there are recommendations from prominent physicians that MelaFind® is effective. We cannot predict the speed at which physicians may adopt the use of MelaFind®. If MelaFind® receives the appropriate regulatory approvals but does not achieve an adequate level of acceptance by patients, physicians and healthcare payors, we may not generate significant product revenue and we may not become profitable. The degree of market acceptance of MelaFind® will depend on a number of factors, including:

- perceived effectiveness of MelaFind®;
- convenience of use;
- cost of the use of MelaFind®;
- availability and adequacy of third-party coverage or reimbursement;
- approved indications and product labeling;
- publicity concerning MelaFind® or competitive products;
- potential advantages over alternative diagnostic methodologies;
- introduction and acceptance of competing products or technologies; and
- extent and success of our sales, marketing and distribution efforts.

The identification and screening of melanomas is now dominated by visual clinical evaluation, with a minority of dermatologists using dermoscopy. Even if MelaFind® proves to be as effective as visual inspection by an expert dermatologist, and if all approvals are obtained, the success of MelaFind® will depend upon the acceptance by dermatologists and other physicians who perform skin examinations and treat skin disorders, including industry opinion leaders, that the diagnostic information provided by MelaFind® is medically useful and reliable. We will be subject to intense scrutiny before physicians will be comfortable incorporating MelaFind® in their diagnostic approaches. We believe that recommendations by respected physicians will be essential for the development and successful marketing of MelaFind®, and there can be no assurance that any such recommendations will be obtained. To date, the medical community outside the limited circle of certain dermatologists specializing in melanoma has had little exposure to us and MelaFind®. Because the medical community is often skeptical of new companies and new technologies, we may be unable to gain access to potential customers in order to demonstrate the operation and effectiveness of MelaFind®. Even if we gain access to potential customers, no assurance can be given that members of the dermatological, or later the general practice, medical community will perceive a need for or accept MelaFind®. In particular, given the potentially fatal consequences of failing to detect melanoma at the early, curable stages, practitioners may remain reluctant to rely upon MelaFind® even after we receive approval from the FDA for marketing the product.

Any of the foregoing factors, or other currently unforeseen factors, could limit or detract from market acceptance of MelaFind®. Insufficient market acceptance of MelaFind® would have a material adverse effect on our business, financial condition and results of operations.

***We may be unable to complete the development and commercialization of MelaFind® or other products without additional funding.***

We currently believe that our available cash, cash equivalents and marketable securities, together with our net proceeds from this offering, will be sufficient to fund our anticipated levels of operations through late 2007. However, our operations have consumed substantial amounts of cash for each of the last six years. We expect to continue to spend substantial amounts on research and development, including conducting a clinical trial for MelaFind®. Even before we receive approval to market MelaFind®, we expect to spend significant additional amounts to ready the product for commercial distribution following FDA approval, including development of a direct sales force and expansion of manufacturing capacity. We expect that our cash used by operations will increase significantly in each of the next several years, and should we encounter any material delays or impediments, we may need additional funds to complete the development and commercialization of MelaFind®. Any additional financing may be dilutive to stockholders, or may require us to grant a lender a security interest in our assets. The amount of funding we will need will depend on many factors, including:

- the schedule, costs, and results of our clinical trials;
- the success of our research and development efforts;
- the costs and timing of regulatory approval;
- reimbursement amounts for the use of MelaFind® that we are able to obtain from Medicare and third party payors, or the amount of direct payments we are able to obtain from patients and/or physicians utilizing MelaFind®;
- the cost of commercialization activities, including product marketing and building a domestic direct sales force;
- the emergence of competing or complementary technological developments;
- the costs of filing, prosecuting, defending and enforcing any patent claims and other rights, including litigation costs and the results of such litigation;
- the costs involved in defending any patent infringement actions brought against us by third parties; and
- our ability to establish and maintain any collaborative, licensing or other arrangements, and the terms and timing of any such arrangements.

Additional financing may not be available to us when we need it, or it may not be available on favorable terms. If we are unable to obtain adequate financing on a timely basis, we may be required to significantly curtail or cease one or more of our development and marketing programs. We could be required to seek funds through arrangements with collaborators or others that may require us to relinquish rights to some of our technologies, product candidates or products that we would otherwise pursue on our own. We also may have to reduce marketing, customer support and other resources devoted to our products. If we raise additional funds by issuing equity securities, our then-existing stockholders will experience ownership dilution, could experience declines in our share price and the terms of any new equity securities may have preferences over our common stock.

***If we are unable to establish sales, marketing and distribution capabilities or enter into and maintain arrangements with third parties to sell, market and distribute MelaFind®, our business may be harmed.***

We do not have a sales organization, and have no experience as a company in the marketing and distribution of devices such as MelaFind®. To achieve commercial success for MelaFind®, we must develop a sales and marketing force and enter into arrangements with others to market and sell our products. Following product approval, we currently plan to establish a small direct sales force to market

MelaFind® in the US, focused on introducing it at high volume dermatologists' offices and training their staff in its use, but we have not made any final determinations regarding the use of a particular marketing channel. Developing such a sales force is expensive and time consuming, and could delay or limit the success of any product launch. We may not be able to develop this capacity on a timely basis or at all. Qualified direct sales personnel with experience in the medical device market are in high demand, and there is no assurance that we will be able to hire or retain an effective direct sales team. Similarly, qualified, independent medical device representatives both within and outside the US are in high demand, and we may not be able to build an effective network for the distribution of our product through such representatives. We have no assurance that we will be able to enter into contracts with representatives on terms acceptable or reasonable to us. Similarly, there is no assurance that we will be able to build an alternate distribution framework, should we attempt to do so.

We will need to contract with third parties in order to sell and install our products in larger markets, including non-specialist dermatologists and primary care physicians. To the extent that we enter into arrangements with third parties to perform marketing and distribution services in the US, our product revenue could be lower and our costs higher than if we directly marketed MelaFind®. Furthermore, to the extent that we enter into co-promotion or other marketing and sales arrangements with other companies, any revenue received will depend on the skills and efforts of others, and we do not know whether these efforts will be successful. If we are unable to establish and maintain adequate sales, marketing and distribution capabilities, independently or with others, we will not be able to generate product revenue, and may not become profitable.

***We have limited manufacturing capabilities and manufacturing personnel, and if our manufacturing capabilities are insufficient to produce an adequate supply of MelaFind®, our growth could be limited and our business could be harmed.***

We have not yet completed the development and testing of MelaFind®, and as a result have no experience in manufacturing MelaFind® for commercial distribution. We currently have limited resources, facilities and experience to commercially manufacture MelaFind®. In order to produce MelaFind® in the quantities we anticipate to meet market demand, we will need to increase our manufacturing capacity by a significant factor over the current level, or procure manufacturing services from others. There are technical challenges to increasing manufacturing capacity, including equipment design and automation, material procurement, problems with production yields, and quality control and assurance. Developing commercial-scale manufacturing facilities that meet FDA requirements would require the investment of substantial additional funds and the hiring and retaining of additional management and technical personnel who have the necessary manufacturing experience.

We currently plan to outsource certain production aspects to contract manufacturers. Any difficulties in the ability of third-party manufacturers to supply devices of the quality, at the times, and in the quantities we need, could have a material adverse effect on our business, financial condition, and results of operations. Similarly, if we enter into contracts for third party manufacture of our devices, any revenue received will depend on the skills and efforts of others, and we do not know whether these efforts will be successful. Manufacturers often encounter difficulties in scaling up production of new products, including problems involving product yields, controlling and anticipating product costs, quality control and assurance, component supply, and shortages of qualified personnel. We cannot assure you that the third-party contract manufacturers with whom we are developing relationships will have or sustain the ability to produce the quantities of MelaFind® needed for development or commercial sales, or will be willing to do so at prices that allow MelaFind® to compete successfully in the market.

Assuming that MelaFind® receives regulatory approval, if we are unable to manufacture or obtain a sufficient supply of product, maintain control over expenses, or otherwise adapt to anticipated growth, or if we underestimate growth, we may not have the capability to satisfy market demand, and our business will suffer. Additionally, if MelaFind® receives regulatory approval and we then need to make manufacturing changes, we may need to obtain additional approval for these changes.

MelaFind® is complex and may contain undetected design defects and errors when first introduced, or errors that may be introduced when enhancements are released. Such defects and errors may occur despite our testing, and may not be discovered until after our devices have been shipped to and used by our customers. The existence of these defects and errors could result in costly repairs, returns of devices, diversion of development resources and damage to our reputation in the marketplace. Any of these conditions could have a material adverse impact on our business, financial condition and results of operations. In addition, if we contract with third-party manufacturers for the production of our products, these manufacturers may inadvertently produce devices that vary from devices we have produced in unpredictable ways that cause adverse consequences.

***Our manufacturing operations are dependent upon third-party suppliers, making us vulnerable to supply problems and price fluctuations, which could harm our business. We anticipate contracting for final device assembly and integration, but no contract for such services on a commercial basis has yet been procured.***

Our manufacturing efforts currently rely on FillFactory, a subsidiary of Cypress Semiconductor Corp., to manufacture and supply the complementary metal oxide semiconductor sensor in MelaFind®, on Pracownia Optyki Instrumentalnej (Optyka) for lens elements and on Fairchild Semiconductor Corp., Panasonic Corp., and others for light-emitting diodes, or LEDs, printed circuit boards, and other elements or components of our devices. We have written agreements with several of these vendors, under which the vendor is obligated to perform services or produce components for us. There can be no assurance that these third parties will meet their obligations under the agreements. Each of these suppliers is a sole-source supplier. Our contract manufacturers also rely on sole-source suppliers to manufacture some of the components used in our products. Our manufacturers and suppliers may encounter problems during manufacturing due to a variety of reasons, including failure to follow specific protocols and procedures, failure to comply with applicable regulations, equipment malfunction and environmental factors, any of which could delay or impede their ability to meet our demand. Our reliance on these outside manufacturers and suppliers also subjects us to other risks that could harm our business, including:

- suppliers may make errors in manufacturing components that could negatively affect the effectiveness or safety of our products, or cause delays in shipment of our products;
- we may not be able to obtain adequate supply in a timely manner or on commercially reasonable terms;
- we may have difficulty locating and qualifying alternative suppliers for our sole-source suppliers;
- switching components may require product redesign and submission to the FDA of a PMA supplement or possibly a separate PMA, either of which could significantly delay production;
- our suppliers manufacture products for a range of customers, and fluctuations in demand for the products these suppliers manufacture for others may affect their ability to deliver components to us in a timely manner; and
- our suppliers may encounter financial hardships unrelated to our demand for components, which could inhibit their ability to fulfill our orders and meet our requirements.

Any interruption or delay in the supply of components or materials, or our inability to obtain components or materials from alternate sources at acceptable prices in a timely manner, could impair our ability to meet the demand of our customers and cause them to cancel orders.

We have entered into a development agreement with ASKION GmbH (ASKION) to complete developmental engineering and testing of our hand-held imaging device, and have entered into a non-binding Letter of Intent with ASKION to assemble the components and produce initial quantities of our hand-held imaging devices for clinical trials. We intend to enter into a contract for commercial production of the hand-held imaging devices once specifications for MelaFind® have been finalized, but we may not be able to enter such an agreement on mutually acceptable terms. Failure to enter into such an agreement with ASKION would require us to expand our own manufacturing facilities or obtain such services elsewhere. Our planned reliance upon an outside provider for assembly and production services subjects us

to the risk of adverse consequences from delays and defects caused by the failure of such outside supplier to meet its contractual obligations. The failure by us or our supplier to produce a sufficient number of hand-held imaging devices that can operate according to our specifications could delay the pivotal clinical trial and/or the commercial sale of MelaFind®, and would adversely affect both our ability to successfully commercialize MelaFind® and our business, financial condition and results of operations.

***We will not be able to sell MelaFind® unless and until its design is verified and validated in accordance with current good manufacturing practices as set forth in the US medical device Quality System Regulation.***

We are in the process, but have not yet successfully completed, all the steps necessary to verify and validate the design of the MelaFind® system that are required to be performed prior to commercialization. If we are delayed or unable to complete verification and validation successfully, we will not be able to sell MelaFind®, and we will not be able to meet our plans for the commercialization of MelaFind® in 2007.

Assuming that regulatory approval of MelaFind® is granted, the approval may be subject to limitations on the indicated uses for which the product may be marketed, or may contain requirements for costly post-marketing testing and surveillance to monitor the safety or effectiveness of the device. Later discovery of previously unknown problems with MelaFind®, including manufacturing problems, or failure to comply with regulatory requirements such as the Quality System Regulation (a set of current good manufacturing practice requirements put forth by the FDA which govern the methods used in, and the facilities and controls used for, the design, manufacture, packaging, labeling, storage, installation and servicing of finished devices) (QSR), may result in restrictions on MelaFind® or its manufacturing processes, withdrawal of MelaFind® from the market, patient or physician notification, voluntary or mandatory recalls, fines, withdrawal of regulatory approvals, refusal to approve pending applications or supplements to approved applications, refusal to permit the import or export of our products, product seizures, injunctions or the imposition of civil or criminal penalties. Should any of these enforcement actions occur, our business, financial condition and results of operations could be materially and adversely affected.

***Assuming that MelaFind® is approved by regulatory authorities, if we or our suppliers fail to comply with ongoing regulatory requirements, or if we experience unanticipated problems with MelaFind®, it could be subject to restrictions or withdrawal from the market.***

Any product for which we obtain marketing approval, along with the manufacturing processes, post-approval clinical data and promotional activities for such product, will be subject to continuous review and periodic inspections by the FDA and other regulatory bodies. In particular, we and our suppliers are required to comply with the QSR and other regulations which cover the methods and documentation of the design, testing, production, control, quality assurance, labeling, packaging, storage, promotion, distribution, and shipping of MelaFind®, and with record keeping practices. We also will be subject to ongoing FDA requirements, including required submissions of safety and other post-market information and reports and registration and listing requirements. To the extent that we contract with third parties to manufacture some of our products, our manufacturers will be required to adhere to current Good Manufacturing Practices (cGMP) requirements enforced by the FDA as part of QSR, or similar regulations required by regulatory agencies in other countries. The manufacturing facilities of our contract manufacturers must be inspected or must have been inspected, and must be in full compliance with cGMP requirements before approval for marketing. The FDA enforces the QSR and other regulatory requirements through unannounced inspections. We have not yet been inspected by the FDA for MelaFind®, and will have to complete such an inspection successfully before we ship any commercial MelaFind® devices. However, we were previously inspected in connection with DIFOTI®, which we have discontinued for business reasons, and were cited for failures to comply fully with QSR mandated procedures. We have discussed the findings in a subsequent meeting with the FDA and are in the process of addressing the deficiencies. The FDA inspectors observed deficiencies that were documented on FDA Form 483 that was issued to us following the inspection. We have had a follow-up meeting with the FDA, and are working with the FDA and consultants to address the inspectional findings, particularly as they relate to current MelaFind® design development and ultimate MelaFind® commercial manufacturing. If we are not successful in convincing the FDA that we are capable of addressing its concerns, or if our efforts to

address the deficiencies should prove unsuccessful, we might be subject to additional FDA action of a type described below, which could negatively affect our ability to commercialize MelaFind®.

There can be no assurance that the future interpretations of legal requirements made by the FDA or other regulatory bodies with possible retroactive effect, or the adoption of new requirements or policies, will not adversely affect us. We may be slow to adapt, or may not be able to adapt to these changes or new requirements. Failure by us or one of our suppliers to comply with statutes and regulations administered by the FDA and other regulatory bodies, or failure to take adequate response to any observations, could result in, among other things, any of the following actions:

- warning letters;
- fines and civil penalties;
- unanticipated expenditures;
- delays in approving or refusal to approve MelaFind®;
- withdrawal of approval by the FDA or other regulatory bodies;
- product recall or seizure;
- interruption of production;
- operating restrictions;
- injunctions; and
- criminal prosecution.

If any of these actions were to occur, it would harm our reputation and cause our product sales and profitability to suffer.

***We are involved in a heavily regulated sector, and our ability to remain viable will depend on favorable government decisions at various points by various agencies.***

From time to time, legislation is introduced in the US Congress that could significantly change the statutory provisions governing the approval, manufacture and marketing of a medical device. Additionally, healthcare is heavily regulated by the federal government, and by state and local governments. The federal laws and regulations affecting healthcare change constantly, thereby increasing the uncertainty and risk associated with any healthcare related venture, including our business and MelaFind®. In addition, FDA regulations and guidance are often revised or reinterpreted by the agency in ways that may significantly affect our business and our products. It is impossible to predict whether legislative changes will be enacted or FDA regulations, guidance, or interpretations changed, and what the impact of such changes, if any, may be.

The federal government regulates healthcare through various agencies, including but not limited to the following: (i) the FDA, which administers the Food, Drug, and Cosmetic Act (FD&C Act), as well as other relevant laws; (ii) CMS, which administers the Medicare and Medicaid programs; (iii) the Office of Inspector General (OIG) which enforces various laws aimed at curtailing fraudulent or abusive practices, including by way of example, the Anti-Kickback Law, the Anti-Physician Referral Law, commonly referred to as Stark, the Anti-Inducement Law, the Civil Money Penalty Law, and the laws that authorize the OIG to exclude healthcare providers and others from participating in federal healthcare programs; and (iv) the Office of Civil Rights, which administers the privacy aspects of the Health Insurance Portability and Accountability Act of 1996 (HIPAA). All of the aforementioned are agencies within HHS. Healthcare is also provided or regulated, as the case may be, by the Department of Defense through its TriCare program, the Public Health Service within HHS under the Public Health Service Act, the Department of Justice through the Federal False Claims Act and various criminal statutes, and state governments under Medicaid and other state sponsored or funded programs and their internal laws regulating all healthcare activities.

In addition to regulation by the FDA as a medical device manufacturer, we are subject to general healthcare industry regulations. The healthcare industry is subject to extensive federal, state and local laws and regulations relating to:

- billing for services;
- quality of medical equipment and services;
- confidentiality, maintenance and security issues associated with medical records and individually identifiable health information;
- false claims; and
- labeling products.

These laws and regulations are extremely complex and, in some cases, still evolving. In many instances, the industry does not have the benefit of significant regulatory or judicial interpretation of these laws and regulations. If our operations are found to be in violation of any of the federal, state or local laws and regulations that govern our activities, we may be subject to the applicable penalty associated with the violation, including civil and criminal penalties, damages, fines or curtailment of our operations. The risk of being found in violation of these laws and regulations is increased by the fact that many of them have not been fully interpreted by the regulatory authorities or the courts, and their provisions are open to a variety of interpretations. Any action against us for violation of these laws or regulations, even if we successfully defend against it, could cause us to incur significant legal expenses and divert our management's time and attention from the operation of our business.

***We must comply with complex statutes prohibiting fraud and abuse, and both we and physicians utilizing MelaFind® could be subject to significant penalties for noncompliance.***

There are extensive federal and state laws and regulations prohibiting fraud and abuse in the healthcare industry that can result in significant criminal and civil penalties. These federal laws include: the anti-kickback statute which prohibits certain business practices and relationships, including the payment or receipt of remuneration for the referral of patients whose care will be paid by Medicare or other federal healthcare programs; the physician self-referral prohibition, commonly referred to as the Stark Law; the anti-inducement law, which prohibits providers from offering anything to a Medicare or Medicaid beneficiary to induce that beneficiary to use items or services covered by either program; the Civil False Claims Act, which prohibits any person from knowingly presenting or causing to be presented false or fraudulent claims for payment by the federal government, including the Medicare and Medicaid programs and; the Civil Monetary Penalties Law, which authorizes HHS to impose civil penalties administratively for fraudulent or abusive acts.

Sanctions for violating these federal laws include criminal and civil penalties that range from punitive sanctions, damage assessments, money penalties, imprisonment, denial of Medicare and Medicaid payments, or exclusion from the Medicare and Medicaid programs, or both. As federal and state budget pressures continue, federal and state administrative agencies may also continue to escalate investigation and enforcement efforts to root out waste and to control fraud and abuse in governmental healthcare programs. Private enforcement of healthcare fraud has also increased, due in large part to amendments to the Civil False Claims Act in 1986 that were designed to encourage private persons to sue on behalf of the government. A violation of any of these federal and state fraud and abuse laws and regulations could have a material adverse effect on our liquidity and financial condition. An investigation into the use of MelaFind® by physicians may dissuade physicians from either purchasing or using MelaFind®, and could have a material adverse effect on our ability to commercialize MelaFind®.

***The application of the privacy provisions of HIPAA is uncertain.***

HIPAA, among other things, protects the privacy and security of individually identifiable health information by limiting its use and disclosure. HIPAA directly regulates "covered entities" (insurers, clearinghouses, and most healthcare providers) and indirectly regulates "business associates" with respect to the privacy of patients' medical information. All entities that receive and process protected health information are required to adopt certain procedures to safeguard the security of that information. It is



uncertain whether we would be deemed to be a covered entity under HIPAA, and it is unlikely that based on our current business model, we would be a business associate. Nevertheless, we will likely be contractually required to physically safeguard the integrity and security of the patient information that we or our physician customers receive, store, create or transmit. If we fail to adhere to our contractual commitments, then our physician customers may be subject to civil monetary penalties, and this could adversely affect our ability to market MelaFind®. We also may be liable under state laws governing the privacy of health information.

***We may become subject to claims of infringement or misappropriation of the intellectual property rights of others, which could prohibit us from shipping affected products, require us to obtain licenses from third parties or to develop non-infringing alternatives, and subject us to substantial monetary damages and injunctive relief. Our patents may also be subject to challenge on validity grounds, and our patent applications may be rejected.***

Third parties could, in the future, assert infringement or misappropriation claims against us with respect to our current or future products. Whether a product infringes a patent involves complex legal and factual issues, the determination of which is often uncertain. Therefore, we cannot be certain that we have not infringed the intellectual property rights of such third parties. Our potential competitors may assert that some aspect of MelaFind® infringes their patents. Because patent applications may take years to issue, there also may be applications now pending of which we are unaware that may later result in issued patents that MelaFind® infringes. There also may be existing patents of which we are unaware that one or more components of our MelaFind® system may inadvertently infringe.

Any infringement or misappropriation claim could cause us to incur significant costs, could place significant strain on our financial resources, divert management's attention from our business and harm our reputation. If the relevant patents were upheld as valid and enforceable and we were found to infringe, we could be prohibited from selling our product that is found to infringe unless we could obtain licenses to use the technology covered by the patent or are able to design around the patent. We may be unable to obtain a license on terms acceptable to us, if at all, and we may not be able to redesign MelaFind® to avoid infringement. A court could also order us to pay compensatory damages for such infringement, plus prejudgment interest and could, in addition, treble the compensatory damages and award attorney fees. These damages could be substantial and could harm our reputation, business, financial condition and operating results. A court also could enter orders that temporarily, preliminarily or permanently enjoin us and our customers from making, using, selling, offering to sell or importing MelaFind®, and/or could enter an order mandating that we undertake certain remedial activities. Depending on the nature of the relief ordered by the court, we could become liable for additional damages to third parties.

We also may rely on our patents, patent applications and other intellectual property rights to give us a competitive advantage. Whether a patent is valid, or whether a patent application should be granted, is a complex matter of science and law, and therefore we cannot be certain that, if challenged, our patents, patent applications and/or other intellectual property rights would be upheld. If one or more of those patents, patent applications and other intellectual property rights are invalidated, rejected or found unenforceable, that could reduce or eliminate any competitive advantage we might otherwise have had.

***New product development in the medical device industry is both costly and labor intensive with very low success rates for successful commercialization; if we cannot successfully develop or obtain future products, our growth would be delayed.***

Our long-term success is dependent, in large part, on the design, development and commercialization of MelaFind® and other new products and services in the medical device industry. The product development process is time-consuming, unpredictable and costly. There can be no assurance that we will be able to develop or acquire new products, successfully complete clinical trials, obtain the necessary regulatory clearances or approvals required from the FDA on a timely basis, or at all, manufacture our potential products in compliance with regulatory requirements or in commercial volumes, or that MelaFind® or other potential products will achieve market acceptance. In addition, changes in regulatory policy for product approval during the period of product development, and regulatory agency review of

each submitted new application, may cause delays or rejections. It may be necessary for us to enter into licensing arrangements, in order to market effectively any new products or new indications for existing products. There can be no assurance that we will be successful in entering into such licensing arrangements on terms favorable to us or at all. Failure to develop, obtain necessary regulatory clearances or approvals for, or successfully market potential new products could have a material adverse effect on our business, financial condition and results of operations.

***We face the risk of product liability claims and may not be able to obtain or maintain adequate insurance.***

Our business exposes us to the risk of product liability claims that is inherent in the testing, manufacturing and marketing of medical devices, including those which may arise from the misuse or malfunction of, or design flaws in, our products. We may be subject to product liability claims if MelaFind® causes, or merely appears to have caused, an injury or if a patient alleges that MelaFind® failed to provide appropriate diagnostic information on a lesion where melanoma was subsequently found to be present. Claims may be made by patients, healthcare providers or others involved with MelaFind®. MelaFind® will require PMA approval prior to commercialization in the US. The clinical studies of MelaFind® are considered by the FDA as Non-Significant Risk (NSR). Consequently, the trials are conducted under the auspices of an abbreviated Investigational Device Exemption (IDE). We therefore do not maintain domestic clinical trial liability insurance. We have obtained clinical trial liability insurance in certain European countries where required by statute or clinical site policy. Although we have general liability insurance that we believe is appropriate, and anticipate obtaining adequate product liability insurance before commercialization of MelaFind®, this insurance is and will be subject to deductibles and coverage limitations. Our anticipated product liability insurance may not be available to us in amounts and on acceptable terms, if at all, and if available, the coverages may not be adequate to protect us against any future product liability claims. If we are unable to obtain insurance at an acceptable cost or on acceptable terms with adequate coverage, or otherwise protect against potential product liability claims, we will be exposed to significant liabilities, which may harm our business. A product liability claim, recall or other claim with respect to uninsured liabilities or for amounts in excess of insured liabilities could result in significant costs and significant harm to our business.

We may be subject to claims against us even if the apparent injury is due to the actions of others. For example, we rely on the expertise of physicians, nurses and other associated medical personnel to operate MelaFind®. If these medical personnel are not properly trained or are negligent, we may be subjected to liability. These liabilities could prevent or interfere with our product commercialization efforts. Defending a suit, regardless of merit, could be costly, could divert management attention and might result in adverse publicity, which could result in the withdrawal of, or inability to recruit, clinical trial volunteers, or result in reduced acceptance of MelaFind® in the market.

Insurance and surety companies have reassessed many aspects of their business and, as a result, may take actions that could negatively affect our business. These actions could include increasing insurance premiums, requiring higher self-insured retentions and deductibles, reducing limits, restricting coverages, imposing exclusions, and refusing to underwrite certain risks and classes of business. Any of these actions may adversely affect our ability to obtain appropriate insurance coverage at reasonable costs, which could have a material adverse effect on our business, financial condition and results of operations.

***We may be adversely affected by a data center failure.***

The success of MelaFind® is dependent upon our ability to protect our data center against damage from fire, power loss, telecommunications failure, natural disaster, sabotage or a similar catastrophic event. Substantially all of our computer equipment and data operations are located in a single facility. Our prospective failure to maintain off-site copies of information contained in our MelaFind® database, or our inability to use alternative sites in the event we experience a natural disaster, hardware or software malfunction or other interruption of our data center, or any interruption in the ability of physicians to obtain access to our MelaFind® server and its database could adversely impact our business, financial condition and results of operations.

***We may be adversely affected by breaches of online security.***

Our MelaFind® database does not contain any information that allows us to identify specific patients. However, we must identify certain data as belonging to or as derived from specific patients for billing purposes. To the extent that our activities involve the storage and transmission of confidential information, security breaches could damage our reputation and expose us to a risk of loss, or to litigation and possible liability. Our business may be materially adversely affected if our security measures do not prevent security breaches. In addition, such information may be subject to HIPAA privacy and security regulations, the potential violation of which may trigger concerns by healthcare providers, which may adversely impact our business, financial condition and results of operations.

***We are dependent upon telecommunications and the internet.***

The connection between the MelaFind® hand-held imaging device and the central server in our offices will be dependent on the internet. Our success will depend in large part on the continued availability of electronic means for storing and transmitting encoded compressed diagnostic information, and storing and transmitting the results of the comparison of such information with our electronically-maintained database through the internet. If the domestic and international telecommunications infrastructure required for these transmissions fails, our business could be materially adversely affected.

We plan to use the internet as a medium to provide diagnostic assistance services to physicians. We also plan to use the internet to inform the public about the availability of our products and to market to and communicate with physicians who are potential or actual customers. Our success will therefore depend in part on the continued growth and use of the internet. If our ability to use the internet fails, it may materially adversely affect our business.

***We will be obligated to comply with Federal Communications Commission regulations for radio transmissions used by our products.***

Versions of MelaFind® may rely on radio transmissions from the hand-held imaging device to a base station that is connected to the internet. Applicable requirements will restrict us to a particular band of frequencies allocated to low power radio service for transmitting data in support of specific diagnostic or therapeutic functions. Failure to comply with all applicable restrictions on the use of such frequencies, or unforeseeable difficulties with the use of such frequencies, could impede our ability to commercialize MelaFind®.

***All of our operations are conducted at a single location. Any disruption at our facility could increase our expenses.***

All of our operations are conducted at two adjacent buildings in Irvington, New York. We take precautions to safeguard our facility, including insurance, health and safety protocols, contracted off-site engineering services, provision for off-site manufacturing, and storage of computer data. However, a natural disaster, such as a fire, flood or earthquake, could cause substantial delays in our operations, damage or destroy our manufacturing equipment or inventory, and cause us to incur additional expenses. The insurance we maintain against fires, floods, earthquakes and other natural disasters may not be adequate to cover our losses in any particular case.

***We may be liable for contamination or other harm caused by materials that we handle, and changes in environmental regulations could cause us to incur additional expense.***

Our manufacturing, research and development and clinical processes do not generally involve the handling of potentially harmful biological materials or hazardous materials, but they may occasionally do so. We are subject to federal, state and local laws and regulations governing the use, handling, storage and disposal of hazardous and biological materials. If violations of environmental, health and safety laws occur, we could be held liable for damages, penalties and costs of remedial actions. These expenses or this liability could have a significant negative impact on our business, financial condition and results of operations. We may violate environmental, health and safety laws in the future as a result of human error, equipment failure or other causes. Environmental laws could become more stringent over time, imposing

greater compliance costs and increasing risks and penalties associated with violations. We may be subject to potentially conflicting and changing regulatory agendas of political, business and environmental groups. Changes to or restrictions on permitting requirements or processes, hazardous or biological material storage or handling might require an unplanned capital investment or relocation. Failure to comply with new or existing laws or regulations could harm our business, financial condition and results of operations.

***Failure to obtain and maintain regulatory approval in foreign jurisdictions will prevent us from marketing abroad.***

Following commercialization of MelaFind® in the US, we may market MelaFind® internationally. Outside the US, we can market a product only if we receive a marketing authorization and, in some cases, pricing approval, from the appropriate regulatory authorities. The approval procedure varies among countries and can involve additional testing, and the time required to obtain approval may differ from that required to obtain FDA approval. The foreign regulatory approval process may include all of the risks associated with obtaining FDA approval, in addition to other risks. Foreign regulatory bodies have established varying regulations governing product standards, packaging requirements, labeling requirements, import restrictions, tariff regulations, duties and tax requirements. We may not obtain foreign regulatory approvals on a timely basis, if at all. Foreign regulatory agencies, as well as the FDA, periodically inspect manufacturing facilities both in the US and abroad. Approval by the FDA does not ensure approval by regulatory authorities in other countries, and approval by one foreign regulatory authority does not ensure approval by regulatory authorities in other foreign countries or by the FDA. We have not taken any significant actions to obtain foreign regulatory approvals. We may not be able to file for regulatory approvals and may not receive necessary approvals to commercialize MelaFind® in any market on a timely basis, or at all. Our inability or failure to comply with varying foreign regulation, or the imposition of new regulations, could restrict our sale of products internationally.

***Our success will depend on our ability to attract and retain our personnel.***

We are highly dependent on our senior management, especially Joseph V. Gulfo, M.D., our President and Chief Executive Officer, and Dina Gutkowitz-Krusin, Ph.D., our Director of Clinical Studies. Our success will depend on our ability to retain our current management and to attract and retain qualified personnel in the future, including scientists, clinicians, engineers and other highly skilled personnel. Competition for senior management personnel, as well as scientists, clinicians, engineers, and experienced sales and marketing individuals, is intense, and we may not be able to retain our personnel. The loss of the services of members of our senior management, scientists, clinicians or engineers could prevent the implementation and completion of our objectives, including the development and introduction of MelaFind®. The loss of a member of our senior management or our professional staff would require the remaining executive officers to divert immediate and substantial attention to seeking a replacement. Each of our officers may terminate their employment at any time without notice and without cause or good reason.

We expect to expand our operations and grow our research and development, product development and administrative operations. This expansion is expected to place a significant strain on our management, and will require hiring a significant number of qualified personnel. Accordingly, recruiting and retaining such personnel in the future will be critical to our success. There is competition from other companies and research and academic institutions for qualified personnel in the areas of our activities. If we fail to identify, attract, retain and motivate these highly skilled personnel, we may be unable to continue our development and commercialization activities.

***Our financial results for future periods may be adversely affected by changes required by financial and accounting regulatory agencies.***

Our reported financial results may be adversely affected by changes in accounting principles generally accepted in the US. Generally accepted accounting principles in the US are subject to interpretation by the Financial Accounting Standards Board (FASB), the American Institute of Certified Public Accountants, the Securities and Exchange Commission (SEC), and various bodies formed to promulgate

and interpret appropriate accounting principles. A change in these principles or interpretations could have a significant effect on our reported financial results, and could affect the reporting of transactions completed before the announcement of a change.

For example, we currently are not required to record stock-based compensation charges if the employee's stock option exercise price is equal to or exceeds the fair value of our common stock at the date of grant. However, several companies have recently elected to change their accounting policies, and have begun to record the fair value of stock options as an expense. New FASB Statement of Financial Accounting Standards No. 123 (revised 2004), Share-Based Payment (FASB Statement No. 123R), requires companies to recognize in the income statement the grant-date fair value of stock options and other equity-based compensation issued to employees. Under FASB Statement No. 123R, SEC registrants would have been required to implement this standard for interim or annual periods beginning after June 15, 2005, or after December 15, 2005 for small business issuers. On April 14, 2005, the SEC adopted a new rule amending the compliance dates for FASB Statement No. 123R. The SEC's new rule permits companies to implement FASB Statement No. 123R at the beginning of their next fiscal year, instead of the next reporting period that begins after June 15, 2005, or December 15, 2005 for small business issuers. Awards to most non-employee directors will be accounted for as employee awards. All public companies must use either the modified prospective or the modified retrospective transition method. Under the modified prospective method, awards that are granted, modified, or settled after the date of adoption should be measured and accounted for in accordance with FASB Statement No. 123R. Under the modified retrospective method, the previously-reported amounts are restated to either the beginning of the year of adoption or for all periods presented. If we elect to adopt the retroactive provisions and to restate all prior periods presented our operating expenses and reported losses will increase. Although we believe that our accounting practices are consistent with current accounting pronouncements, changes to or interpretations of accounting methods or policies in the future may require us to reclassify, restate or otherwise change or revise our financial statements.

***Our financial results for future periods will be affected by the attainment of milestones.***

We have granted to certain employees stock options that vest with the attainment of various performance milestones. Upon the attainment of these milestones we will be required to recognize a stock based compensation expense in an amount based on the then current fair market value of our common stock underlying the options which vest when the milestone is attained. Assuming that all shares offered are sold in this public offering at a price of \$9.00 per share, the mid-point of our filing range, that upon the attainment of each of the relevant milestones such offering price remains the fair market value per share of our common stock, and that the number of shares of our common stock outstanding after this offering remains 9,513,164 then we will record a compensation expense: (1) upon completion of this offering of \$1,051,570 with respect to 125,000 shares underlying options with an exercise price of \$0.46 per share; (2) upon filing our MelaFind® PMA with the FDA of \$427,000 with respect to 50,000 shares underlying options with an exercise price of \$0.46 per share; and (3) upon our receipt of PMA approval for MelaFind® of \$428,000 with respect to 50,000 shares underlying options with a weighted average exercise price of \$0.44 per share and of \$2,952,269 with respect to 345,699 shares underlying options with an exercise price of \$0.46 per share.

***If we fail to maintain the adequacy of our internal controls, our ability to provide accurate financial statements could be impaired and any failure to maintain our internal controls and provide accurate financial statements could cause our stock price to decrease substantially.***

We will face increased legal, accounting, administrative and other costs and expenses as a public company that we did not incur as a private company. The Sarbanes-Oxley Act of 2002 (SOX), as well as new rules subsequently implemented by the SEC, the Public Company Accounting Oversight Board and the NASDAQ National Market, require changes in the corporate governance practices of public companies. We expect these new rules and regulations to increase our legal and financial compliance costs, to divert management attention from operations and strategic opportunities, and to make legal, accounting and administrative activities more time-consuming and costly. We also expect to incur substantially higher

costs to maintain directors' and officers' insurance. We are in the process of instituting changes to our internal procedures to satisfy the requirements of the SOX. We are evaluating our internal controls systems in order to allow us to report on, and our independent registered public accounting firm to attest to, our internal controls, as required by Section 404 of the SOX. While we anticipate being able to fully implement the requirements relating to internal controls and all other aspects of Section 404 of the SOX in a timely fashion, we cannot be certain as to the timing of completion of our evaluation, testing and remediation actions or the impact of the same on our operations, since there is no precedent available by which to measure compliance adequacy. As a small company with limited capital and human resources, we will need to divert management's time and attention away from our business in order to ensure compliance with these regulatory requirements. As a public company, we will require greater financial resources than we have had as a private company. Implementing these changes may require new information technologies systems, the auditing of our internal controls, and compliance training for our directors, officers and personnel. Such efforts would require a potentially significant expense. If we fail to maintain the adequacy of our internal controls as such standards are modified, supplemented or amended from time to time, we may not be able to provide accurate financial statements and comply with the SOX. Any failure to maintain the adequacy of our internal controls and provide accurate financial statements could cause the trading price of our common stock to decrease substantially.

### **Risks Relating to this Offering**

#### ***An active trading market for our common stock may not develop.***

Prior to this offering, there has been no public market for our common stock. Although we are seeking approval for listing of our common stock on the NASDAQ National Market, an active trading market for our shares may never develop or be sustained following this offering. Further, we cannot be certain that the market price of our common stock will not decline below the initial public offering price or below the amount required by Nasdaq to maintain a listing on its National Market. Should we fail to meet the minimum standards established by Nasdaq for its National Market, we could be de-listed, meaning shareholders might be subject to limited liquidity. The initial public offering price for our common stock will be determined through negotiations with the underwriters. This initial public offering price may vary from the market price of our common stock after the offering and investors may therefore be unable to sell their common stock at or above the initial public offering price.

#### ***Our stock price will be volatile, meaning purchasers of our common stock could incur substantial losses.***

Our stock price is likely to be volatile. The stock market in general and the market for medical technology companies in particular have experienced extreme volatility that has often been unrelated to the operating performance of particular companies. As a result of this volatility, investors may not be able to sell their common stock at or above the initial public offering price. The following factors, in addition to other risk factors described in this section and general market and economic conditions, may have a significant impact on the market price of our common stock:

- results of our research and development efforts and our clinical trials;
- the timing of regulatory approval for our products;
- failure of any of our products, if approved, to achieve commercial success;
- the announcement of new products or product enhancements by us or our competitors;
- regulatory developments in the US and foreign countries;
- ability to manufacture our products to commercial standards;
- developments concerning our clinical collaborators, suppliers or marketing partners;
- changes in financial estimates or recommendations by securities analysts;
- public concern over our products;
- developments or disputes concerning patents or other intellectual property rights;

- product liability claims and litigation against us or our competitors;
- the departure of key personnel;
- the strength of our balance sheet;
- variations in our financial results or those of companies that are perceived to be similar to us;
- changes in the structure of and third-party reimbursement in the US and other countries;
- changes in accounting principles or practices;
- general economic, industry and market conditions; and
- future sales of our common stock.

A decline in the market price of our common stock could cause you to lose some or all of your investment and may adversely impact our ability to attract and retain employees and raise capital. In addition, stockholders may initiate securities class action lawsuits if the market price of our stock drops significantly. Whether or not meritorious, litigation brought against us could result in substantial costs and could divert the time and attention of our management. Our insurance to cover claims of this sort may not be adequate.

***We have broad discretion in the use of the net proceeds from this offering and may not use them effectively.***

We cannot specify with certainty the particular uses of the net proceeds we will receive from this offering. Our management will have broad discretion in the application of the net proceeds, including for any of the purposes described in “Use of Proceeds.” Accordingly, you will have to rely upon the judgment of our management with respect to the use of the proceeds, with only limited information concerning management’s specific intentions. Our management may spend a portion or all of the net proceeds from this offering in ways that our stockholders may not desire or that may not yield a favorable return. The failure by our management to apply these funds effectively could harm our business and financial condition. Pending their use, we may invest the net proceeds from this offering in a manner that does not produce income or that loses value.

***Concentration of ownership among our directors, executive officers, and principal stockholders may prevent new investors from influencing significant corporate decisions.***

Upon closing of this offering, based upon beneficial ownership as of June 30, 2005, our directors, executive officers, holders of more than 5% of our common stock, and their affiliates will, in the aggregate, beneficially own approximately 31% of our outstanding common stock. As a result, these stockholders, subject to any fiduciary duties owed to our other stockholders under Delaware law, will be able to exercise a controlling influence over matters requiring stockholder approval, including the election of directors and approval of significant corporate transactions, and will have significant control over our management and policies. Some of these persons or entities may have interests that are different from yours. For example, these stockholders may support proposals and actions with which you may disagree or which are not in your interests. The concentration of ownership could delay or prevent a change in control of our company or otherwise discourage a potential acquirer from attempting to obtain control of our company, which in turn could reduce the price of our common stock. In addition, these stockholders, some of whom have representatives sitting on our board of directors, could use their voting influence to maintain our existing management and directors in office, delay or prevent changes of control of our company, or support or reject other management and board proposals that are subject to stockholder approval, such as amendments to our employee stock plans and approvals of significant financing transactions.

***If there are substantial sales of our common stock, our stock price could decline.***

If our existing stockholders sell a large number of shares of our common stock or the public market perceives that these sales may occur, the market price of our common stock could decline. Based on shares outstanding on June 30, 2005, upon the closing of this offering, assuming no outstanding options are exercised prior to the closing of this offering, we will have approximately 9,513,164 shares of common

stock outstanding. All of the shares offered under this prospectus will be freely tradable without restriction or further registration under the federal securities laws, unless purchased by our affiliates. Taking into consideration the effect of lock-up agreements that have been entered into by certain of our stockholders, we estimate that the remaining 6,513,164 shares of our common stock outstanding upon the closing of this initial public offering will be available for sale pursuant to Rule 144 and Rule 144(k), as follows:

- beginning on the effective date of this prospectus, in addition to the shares sold in the offering, approximately 1,229,577 of our restricted shares will be eligible for sale under Rule 144, of which approximately 408,402 shares will be eligible for sale subject to the volume, manner of sale and other limitations under Rule 144 and approximately 821,175 shares will be eligible for sale as unrestricted shares under Rule 144(k);
- beginning 270 days after the effective date of this prospectus, approximately 6,347,015 of our restricted shares will be eligible for sale under Rule 144 (which includes the 1,229,577 restricted shares referred to above), of which approximately 3,226,819 shares will be eligible for sale subject to the volume, manner of sale and other limitations under Rule 144 and approximately 3,120,196 shares will be eligible for sale as unrestricted shares under Rule 144(k); and
- beginning October 27, 2006, approximately an additional 166,149 of our restricted shares will be eligible for sale subject to the volume, manner of sale and other limitations under Rule 144.

Existing stockholders holding an aggregate of 5,090,001 shares of common stock (including shares of our common stock purchasable pursuant to warrants to purchase our common stock) based on shares outstanding as of June 30, 2005 have rights with respect to the registration of these shares of common stock with the SEC. See “Description of Capital Stock — Registration Rights.” If we register these shares of common stock, they can immediately sell those shares in the public market.

Within nine months following this offering, we intend to register up to 1,899,875 shares of common stock that are authorized for issuance under our stock option plans. As of June 30, 2005, 899,875 shares were subject to outstanding options, of which 446,675 shares were vested. Once we register these shares, they can be freely sold in the public market upon issuance, subject to the lock-up agreements referred to above and restrictions on our affiliates.

***You will incur immediate and substantial dilution as a result of this offering.***

The initial public offering price is substantially higher than the book value per share of our common stock. As a result, purchasers in this offering will experience immediate and substantial dilution of \$6.14 per share in the tangible book value of our common stock from the initial public offering price, based on the number of shares outstanding as of June 30, 2005. This is due in large part to earlier investors in the company having paid substantially less than the initial public offering price when they purchased their shares. Investors who purchase shares of common stock in this offering will contribute approximately 57% of the total amount we have raised to fund our operations but will own only approximately 32% of our common stock, based on the number of shares outstanding as of June 30, 2005. In addition, the exercise of currently outstanding options and warrants to purchase common stock and future equity issuances, including future public or private securities offerings and any additional shares issued in connection with acquisitions, will result in further dilution.

***Our charter documents and Delaware law may inhibit a takeover that stockholders consider favorable and could also limit the market price of our stock.***

Upon the closing of this offering, provisions of our restated certificate of incorporation and bylaws and applicable provisions of Delaware law may make it more difficult for or prevent a third party from acquiring control of us without the approval of our board of directors. These provisions:

- set limitations on the removal of directors;
- limit who may call a special meeting of stockholders;
- establish advance notice requirements for nominations for election to our board of directors or for proposing matters that can be acted upon at stockholder meetings;



- do not permit cumulative voting in the election of our directors, which would otherwise permit less than a majority of stockholders to elect directors;
- prohibit stockholder action by written consent, thereby requiring all stockholder actions to be taken at a meeting of our stockholders; and
- provide our board of directors the ability to designate the terms of and issue a new series of preferred stock without stockholder approval.

In addition, Section 203 of the Delaware General Corporation Law generally limits our ability to engage in any business combination with certain persons who own 15% or more of our outstanding voting stock or any of our associates or affiliates who at any time in the past three years have owned 15% or more of our outstanding voting stock. These provisions may have the effect of entrenching our management team and may deprive you of the opportunity to sell your shares to potential acquirors at a premium over prevailing prices. This potential inability to obtain a control premium could reduce the price of our common stock.

## **SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS**

This prospectus contains forward-looking statements that involve substantial risks and uncertainties. All statements, other than statements of historical facts, included in this prospectus regarding our strategy, future operations, future financial position, future revenues, projected costs, prospects, plans and objectives of management are forward-looking statements. The words “anticipates,” “believes,” “estimates,” “expects,” “intends,” “may,” “plans,” “projects,” “will,” “would” and similar expressions are intended to identify forward-looking statements, although not all forward-looking statements contain these identifying words. Although we do not make forward-looking statements unless we believe we have a reasonable basis for doing so, we cannot guarantee their accuracy. We may not actually achieve the plans, intentions or expectations disclosed in our forward-looking statements and you should not place undue reliance on our forward-looking statements. Actual results or events could differ materially from the plans, intentions and expectations stated in the forward-looking statements we make. We have included important factors in the cautionary statements included in this prospectus, particularly in the “Risk Factors” section, that we believe could cause actual results or events to differ materially from the forward-looking statements that we make. Additional risks, uncertainties and factors, other than those discussed under “Risk Factors,” could also cause our actual results to differ materially from those projected in any forward-looking statements we make. We operate in a very competitive and rapidly changing environment in which new risks emerge from time to time and it is not possible for us to predict all risk factors, nor can we address the impact of all factors on our business or the extent to which any factor, or combination of factors, may cause actual results to differ materially from those contained in any forward-looking statements. Our forward-looking statements do not reflect the potential impact of any future acquisitions, mergers, dispositions, joint ventures or investments we may make. We do not assume any obligation to update or revise any forward-looking statements, or to so update the reasons actual results could differ materially from those anticipated in these forward-looking statements, even if new information becomes available in the future.

## USE OF PROCEEDS

We estimate that we will receive net proceeds of approximately \$23.5 million from our sale of 3,000,000 shares of common stock at an assumed initial public offering price of \$9.00 per share, the mid-point of our filing range, after deducting underwriting discounts and commissions and estimated expenses of approximately \$3.5 million, which includes our underwriter's non-accountable expense allowance, legal, accounting, printing costs and expenses, and various fees associated with the registration and listing of our securities payable by us. If the underwriters exercise their over-allotment option in full, we will receive an additional \$3,766,500 after deducting \$283,500 for underwriting discounts and commissions.

We intend to use these net proceeds approximately as follows:

- 62% (\$14.6 million) to fund our research and development activities, including our clinical studies;
- 17% (\$4.0 million) to develop our sales and marketing capabilities; and
- 21% (\$4.9 million) for general corporate purposes, including working capital, and capital expenditures made in the ordinary course of business.

The amounts that we actually expend for working capital purposes will vary significantly depending on a number of factors. As a result, we will retain broad discretion in the allocation of the net proceeds of this offering. While we have no present understandings, commitments or agreements to enter into any potential acquisitions, we may also use a portion of the net proceeds for the acquisition of, or investment in, technologies or products that complement our business. Pending the uses described above, we intend to invest the net proceeds of this offering in short-term, investment-grade, interest-bearing securities. We cannot predict whether the proceeds which we invest will yield a favorable return.

## DIVIDEND POLICY

We have never declared or paid cash dividends on our common stock. We currently intend to retain our cash for the development of our business. We do not intend to pay cash dividends to our stockholders in the foreseeable future.

Any future determination relating to our dividend policy will be made at the discretion of our board of directors and will depend on then existing conditions, including our earnings, financial condition, results of operations, level of indebtedness, contractual restrictions, capital requirements, business prospects and other factors our board of directors may deem relevant. Our board of directors' ability to declare a dividend is also subject to limits imposed by Delaware law.

## CAPITALIZATION

You should read this capitalization table together with the sections of this prospectus entitled “Management’s Discussions and Analysis of Financial Condition and Results of Operations” and with the financial statements and related notes to those statements included elsewhere in this prospectus.

The following table sets forth our capitalization as of June 30, 2005:

- on an actual basis; and
- on a pro forma as adjusted basis to reflect the conversion of all our outstanding shares of convertible preferred stock into shares of common stock prior to completion of this offering, the assumed conversion of 2,610,643 warrants to purchase the company’s common stock to be exchanged for a total of 1,305,321 shares of the company’s common stock based on an exchange ratio of one share of our common stock for every two shares of our common stock purchasable under the warrants to occur prior to the closing of this offering and the receipt of the estimated net proceeds from the sale of 3,000,000 shares of our common stock in this offering at the assumed initial public offering price of \$9.00 per share, the mid-point of our filing range, and after deducting the underwriting discounts and commissions and estimated offering expenses payable by us.

|  | As of June 30, 2005                                |  |
|--|--|--|
|  | Actual   | Pro Forma(1)<br>As Adjusted<br>(unaudited) |
|  | (In thousands, except share<br>and per share data) |  |
| <b>Redeemable Convertible Preferred Stock:</b>   |  |  |
| Redeemable Preferred Stock Series B convertible; 992,986 shares designated (liquidation preference \$2.26 per share); issued and outstanding 992,986 shares at December 31, 2003 and 2004 and June 30, 2005 and 0 shares at June 30, 2005, pro forma as adjusted                                   | \$ 2,244   | —  |
| Redeemable Preferred Stock Series C convertible 5,744,340 shares designated (liquidation preference \$2.26 per share); issued and outstanding 907,077 shares at December 31, 2003 and 5,414,779 shares at December 31, 2004 and June 30, 2005 and 0 shares at June 30, 2005, pro forma as adjusted | 8,358  | —  |
| <b>Stockholders’ (Deficiency) Equity:</b>  |  |  |
| Preferred stock — \$.10 par value; authorized 16,936,704 shares:   |  |  |
| Series A Convertible Preferred Stock, 199,380 shares designated (liquidation preference \$5.00 per share); issued and outstanding 198,000 shares at December 31, 2003 and 2004 and June 30, 2005 and 0 shares at June 30, 2005, pro forma as adjusted  | 972  | —  |
| Common stock — \$.001 par value; authorized 30,000,000 shares; issued and outstanding 1,684,760 shares at December 31, 2003 and 1,809,758 shares at December 31, 2004 and June 30, 2005 and 9,513,164 shares at June 30, 2005, pro forma as adjusted   | 2  | 10   |
| Additional paid-in capital   | 9,035  | 44,081                                     |
| Deferred compensation  | (143)  | (143)                                      |
| Accumulated deficit  | (16,716)   | (16,716)                                   |
| <b>Stockholders’ (Deficiency) Equity</b>   | <b>(6,850)</b>                                     | <b>27,232</b>                              |
| <b>Total Capitalization</b>  | <b>\$ 3,752</b>                                    | <b>27,232</b>                              |

None of the columns shown above reflect the following:

- 899,875 shares of common stock issuable as of the date of this prospectus upon the exercise of outstanding stock options under our 2003 Stock Incentive Plan and our 1996 Stock Option Plan, respectively, at a weighted average exercise price of approximately \$0.64 per share”;

- up to 1,000,000 shares of common stock reserved for future grants under our 2005 Stock Incentive Plan;
- 75,000 shares of common stock issuable upon exercise of outstanding warrants to purchase our common stock at an exercise price of \$7.00 per share;
- 73,280 shares of common stock issuable upon exercise of outstanding warrants to purchase our Series C preferred stock (assuming conversion of our Series C preferred stock) at an exercise price of \$4.52 per share; and
- 225,000 shares of common stock issuable upon exercise of warrants to be issued to the underwriters upon completion of this offering at an exercise price equal to 125% of the public offering price per share.

- (1) Excludes the impact of 125,000 options that vest upon consummation of the offering, which will have no effect on total stockholders' equity but will require an expense of \$1,051,570 to be recorded if such options vested at the assumed initial public offering price of \$9.00 per share, which is the mid-point of our filing range.

#### DILUTION

If you invest in our common stock, your interest will be diluted to the extent of the difference between the public offering price per share of our common stock and the net tangible book value per share of our common stock immediately after this offering. Net tangible book value per share represents the amount of our common stockholders' equity, less intangible assets, divided by the number of shares of our common stock outstanding. As of June 30, 2005, we had a net tangible book value of approximately \$(6,849,911) or \$(3.78) per share of common stock. Pro forma net tangible book value as of June 30, 2005 is \$3,751,758 or \$0.58 per common share. Assuming the sale by us of 3,000,000 shares of common stock offered in this offering at an assumed initial public offering price of \$9.00 per share, the mid-point of our filing range, and after deducting the underwriting discounts and commissions and estimated offering expenses, our adjusted pro forma net tangible book value as of June 30, 2005, would have been \$27,231,758, or \$2.86 per share of common stock. This represents an immediate increase in pro forma net tangible book value of \$2.28 per share of common stock to our existing stockholders and an immediate dilution of \$6.14 per share to the new investors purchasing shares in this offering. The following table illustrates this per share dilution:

|  |    |        |
|--|----|--------|
| Assumed initial public offering price per share  | \$ | 9.00   |
| Net tangible book value per share as of June 30, 2005                                      | \$ | (3.78) |
| Pro forma net tangible book value per share as of June 30, 2005                            | \$ | 0.58   |
| Increase in pro forma net tangible book value per share attributable to existing investors | \$ | 2.28   |
| Pro forma net tangible book value per share after the offering                             | \$ | 2.86   |
| Dilution per share to new investors  | \$ | 6.14   |

The following table sets forth on a pro forma as adjusted basis, as of June 30, 2005, the number of shares of common stock purchased from us (assuming conversion of all preferred stock into common stock), the total consideration paid and the average price per share paid by existing holders of common stock (assuming conversion of all preferred stock into common stock) and by the new investors in this

initial public offering, before deducting the underwriting discounts and commissions and estimated offering expenses payable by us.

|                    | Shares Purchased |         | Total Consideration |         | Average                    |
|--------------------|------------------|---------|---------------------|---------|----------------------------|
|                    | Number           | Percent | Amount              | Percent | Consideration<br>Per Share |
| Existing Investors | 6,513,164        | 68.5%   | \$ 20,033,573       | 42.6%   | \$ 3.08                    |
| New Investors      | 3,000,000        | 31.5%   | 27,000,000          | 57.4%   | 9.00                       |
| Total              | 9,513,164        | 100.0%  | \$ 47,033,573       | 100.0%  |                            |

Assuming all our outstanding options and the outstanding warrants are fully exercised, the shares purchased by the new investors would constitute 28.4% of all shares purchased from us, and the total consideration paid by new investors would constitute 55.7% of the total consideration paid for all shares purchased from us. In addition, the average price per share paid by new investors would be \$9.00, and the average price per share paid by existing stockholders would be \$3.08.

If the underwriters exercise their over-allotment in full, the following will occur:

- The pro forma as adjusted percentage of shares of our common stock held by existing stockholders will decrease to approximately 65.4% of the total number of pro forma as adjusted shares of our common stock outstanding after this offering; and
- The pro forma as adjusted number of shares of our common stock held by new public investors will increase to 3,450,000, or approximately 34.6% of the total pro forma as adjusted number of shares of our common stock outstanding after this offering.

In addition, upon completion of this offering, the underwriters will receive warrants to purchase up to an aggregate of 225,000 shares of our common stock at an exercise price equal to 125% of the public offering price per share. The warrants will be exercisable commencing on the first anniversary of the date of this prospectus and ending on the fifth anniversary of the date of this prospectus.

In the preceding tables, the shares of our common stock exclude, as of June 30, 2005:

- 899,875 shares of common stock issuable as of the date of this prospectus upon the exercise of outstanding stock options under our 2003 Stock Incentive Plan and our 1996 Stock Option Plan, respectively, at a weighted average exercise price of approximately \$0.64 per share;
- up to 1,000,000 shares of common stock reserved for future grants under our 2005 Stock Incentive Plan;
- 75,000 shares of common stock issuable upon exercise of outstanding warrants to purchase common stock at an exercise price of \$7.00 per share;
- 73,280 shares of common stock issuable upon exercise of outstanding warrants to purchase our Series C preferred stock (assuming conversion of our Series C preferred stock) at an exercise price of \$4.52 per share; and
- 225,000 shares of common stock issuable upon exercise of warrants to be issued to the underwriters upon completion of this offering at an exercise price equal to 125% of the public offering price per share.

## SELECTED FINANCIAL DATA

The following summary financial data for the fiscal years ended December 31, 2000, 2001, 2002, 2003 and 2004 have been derived from our historical audited financial statements. The summary financial data for the six months periods ended June 30, 2004 and 2005 have been derived from our unaudited financial statements. The unaudited summary financial data include, in our opinion, all adjustments, consisting only of normal, recurring adjustments, necessary to present fairly the financial position and results of operations for the periods presented. Our historical results for and prior or interim period are not necessarily indicative of results to be expected for a full fiscal year or for any future period. The selected financial data shown below accounts for the revenues and related expenses for our DIFOTI® product, a non-invasive imaging device for the detection of dental cavities, as a discontinued operation. We decided to discontinue all operations associated with our DIFOTI® product, effective as of April 5, 2005, in order to focus our resources and attention on the development and commercialization of MelaFind®. See the footnote to the Financial Statements relating to discontinued operations and assets held for sale included elsewhere in this prospectus. You should read the following selected financial information together with the financial statements and the related notes appearing at the end of this prospectus and the “Management’s Discussion and Analysis of Financial Condition and Results of Operations” section of this prospectus.

|   | Year Ended December 31, |            |            |            |            | Six Months Ended<br>June 30, |                     |
|---|-------------------------|------------|------------|------------|------------|------------------------------|---------------------|
|   | 2000                    | 2001       | 2002       | 2003       | 2004       | 2004<br>(unaudited)          | 2005<br>(unaudited) |
| (In thousands, except share and per share data)   |                         |            |            |            |            |                              |                     |
| <b>Statements of Operations Data:</b>   |                         |            |            |            |            |                              |                     |
| Revenue from grants   | \$ 210                  | \$ 290     | \$ 547     | \$ —       | \$ —       | \$ —                         | \$ —                |
| Cost of grant revenue   | 248                     | 193        | 564        | —          | —          | —                            | —                   |
| General and administrative expenses   | 1,061                   | 2,563      | 511        | 1,034      | 1,234      | 639                          | 996                 |
| Research and development  | 726                     | 144        | 404        | 828        | 1,892      | 693                          | 1,546               |
| Operating loss from continuing operations   | (1,825)                 | (2,610)    | (932)      | (1,862)    | (3,126)    | (1,332)                      | (2,542)             |
| Interest (income)/expense   | (79)                    | (85)       | 8          | 76         | 67         | 82                           | (63)                |
| Loss from continuing operations   | (1,746)                 | (2,525)    | (940)      | (1,938)    | (3,193)    | (1,414)                      | (2,479)             |
| Loss from discontinued operations   | (534)                   | (343)      | (201)      | (12)       | (426)      | (102)                        | (330)               |
| Net loss  | (2,280)                 | (2,868)    | (1,141)    | (1,950)    | (3,619)    | (1,516)                      | (2,809)             |
| Preferred stock deemed dividends  | 85                      | 213        | 214        | 322        | 676        | 243                          | 719                 |
| Preferred stock accretion   | 143                     | 180        | 180        | 25         | 258        | 25                           | 647                 |
| Stock distribution of preferred Series B shares   | —                       | —          | —          | 102        | —          | —                            | —                   |
| Net loss attributable to common stockholders  | \$ (2,508)              | \$ (3,261) | \$ (1,535) | \$ (2,399) | \$ (4,553) | \$ (1,784)                   | \$ (4,175)          |
| <b>Net loss per share, basic and diluted:</b>   |                         |            |            |            |            |                              |                     |
| Continuing operations   | \$ (1.29)               | \$ (1.90)  | \$ (0.87)  | \$ (1.48)  | \$ (2.34)  | \$ (0.98)                    | \$ (2.13)           |
| Discontinued operations   | (0.35)                  | (0.23)     | (0.13)     | (0.01)     | (0.24)     | (0.06)                       | (0.18)              |
| Basic and diluted net loss per common share   | \$ \$(1.64)             | \$ (2.13)  | \$ (1.00)  | \$ (1.49)  | \$ (2.58)  | \$ (1.04)                    | \$ (2.31)           |
| Basic and diluted weighted average number of shares outstanding                                 | 1,529,471               | 1,534,760  | 1,534,760  | 1,614,897  | 1,766,608  | 1,722,743                    | 1,809,758           |
| Pro forma basic and diluted loss from continuing operations per common share (unaudited)(1)     |                         |            |            |            | \$ (0.80)  |                              | \$ (0.38)           |
| Pro forma basic and diluted weighted average number of common shares outstanding (unaudited)(1) |                         |            |            |            | 3,967,024  |                              | 6,513,164           |

- (1) Pro forma basic and diluted loss from continuing operations per common share reflects the effect of the assumed conversion of the company's preferred stock, as if this offering had occurred at the date of original issuance, into 3,398,105 shares of our common stock for the year ended December 31, 2004 and six months ended June 30, 2005 which will occur upon closing of this offering. Additionally, it is assumed that 2,610,643 warrants to purchase the Company's common stock will be exchanged for a total of 1,305,321 shares of the company's common stock based on an exchange ratio of one share of our common stock for every two shares of our common stock purchaseable under the warrants and will occur prior to the closing of this offering. The loss from continuing operations used in the computation of unaudited pro forma basic and diluted loss from continuing operations per share has been adjusted to reverse the accretion on our preferred stock and also excludes the preferred stock dividends for the respective period.

The following table presents summary balance sheet data, derived from our historical audited financial statements. The table also presents summary balance sheet, derived from our historical unaudited financial statements, as of June 30, 2004 and June 30, 2005:

|   | As of December 31,                              |         |         |          |          | As of June 30, |          |
|---|---|---------|---------|----------|----------|----------------|----------|
|   | 2000  | 2001    | 2002    | 2003     | 2004     | 2004           | 2005     |
|   | (In thousands, except share and per share data) |         |         |          |          | (unaudited)    |          |
| <b>Balance Sheet Data:</b>              |   |         |         |          |          |                |          |
| Total current assets                    | \$ 3,513  | \$ 867  | \$ 111  | \$ 217   | \$ 6,813 | \$ 877         | \$ 4,726 |
| Total assets                            | 3,814   | 1,131   | 344     | 432      | 7,096    | 1,086          | 4,997    |
| Total liabilities                       | 211   | 247     | 529     | 650      | 691      | 1,571          | 1,246    |
| Redeemable convertible preferred stock  | 2,058   | 2,155   | 2,244   | 4,067    | 9,955    | 5,167          | 10,602   |
| Accumulated deficit                     | (4,148)   | (7,197) | (8,518) | (10,288) | (13,907) | (11,804)       | (16,716) |
| Total stockholders' (deficiency)/equity | (498)   | (3,408) | (4,657) | (4,285)  | (3,550)  | (5,652)        | (6,850)  |



## MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

*You should read the following discussion and analysis of our financial condition and results of operations together with our financial statements and the related notes appearing at the end of this prospectus. Some of the information contained in this discussion and analysis or set forth elsewhere in this prospectus, including information with respect to our plans and strategy for our business and related financing, includes forward-looking statements that involve risks and uncertainties. You should review the "Risk Factors" section of this prospectus for a discussion of important factors that could cause actual results to differ materially from the results described in or implied by the forward-looking statements contained in the following discussion and analysis.*

### Overview

We are a medical device company focused on the design and development of a non-invasive, point-of-care instrument to assist in the early diagnosis of melanoma. Our flagship product, MelaFind® features a hand-held imaging device that emits multiple wavelengths of light to capture images of suspicious pigmented skin lesions and extract data. We currently do not have any commercialized products or any significant source of revenue; however, the financial results for all periods discussed below account for the revenues and the related expenses associated with our DIFOTI® product, a non-invasive imaging device for the detection of dental cavities, as a discontinued operation. We decided to discontinue all operations associated with our DIFOTI® product effective as of April 5, 2005, in order to focus our resources and attention on the development and commercialization of MelaFind®. We are currently seeking an acquirer for the DIFOTI® assets, and we do not expect to have any significant continuing responsibility for the DIFOTI® business after its disposition. Unless otherwise indicated, the following discussion relates to our continuing operations.

Our revenue for the foreseeable future will depend on the commercialization of MelaFind® and may vary substantially from year to year and quarter to quarter. Our operating expenses may also vary substantially from year to year and quarter to quarter based on the timing of the clinical trial and patient enrollment. We believe that period-to-period comparisons of our results of operations are not meaningful and should not be relied on as indicative of our future performance.

We commenced operations in December 1989 as a New York corporation and re-incorporated as a Delaware corporation in September 1997. Since our inception, we have generated significant losses. As of June 30, 2005, we had an accumulated deficit of \$16.7 million. We expect to continue to spend significant amounts on the development of MelaFind®. We expect to incur significant commercialization costs when we begin to introduce MelaFind® into the US market. Accordingly, we will need to generate significant revenues to achieve and then maintain profitability.

Most of our expenditures to date have been for research and development activities and general and administrative expenses. Research and development expenses represent costs incurred for product development, clinical trials and activities relating to regulatory filings and manufacturing development efforts. We expense all of our research and development costs as they are incurred.

Our research and development expenses incurred through June 30, 2005 were expenses related primarily to the development of MelaFind®. We expect to incur additional research and development expenses relating to MelaFind® prior to its commercial launch in the US and selected markets outside the US. These additional expenses are subject to the risks and uncertainties associated with clinical trials and the FDA regulatory review and approval process. As a result, these additional expenses could exceed our estimated amounts, possibly materially.

General and administrative expenses consist primarily of salaries and related expenses, general corporate activities and costs associated with our efforts to obtain PMA approval for MelaFind® and building a commercial infrastructure to market and sell MelaFind®. We anticipate that general and administrative expenses will increase as a result of the expected expansion of our operations, facilities and other activities associated with the planned expansion of our business, together with the additional costs associated with

operating as a public company. We expect selling, general and administrative expenses to increase as we build our sales force and marketing capabilities to support placing MelaFind® in selected markets.

At December 31, 2004 and June 30, 2005, we had available a net operating loss carry forward for federal income tax reporting purposes of approximately \$12.2 million and \$15.0 million, respectively. The net operating loss carry forward may be available to offset future taxable income expiring at various dates through the year 2025. The Company's ability to utilize its net operating losses may be significantly limited due to changes in the company's ownership as defined by federal income tax regulations.

### **Critical Accounting Policies and Significant Judgments and Estimates**

Our management's discussion and analysis of our financial condition and results of operations are based on our financial statements, which have been prepared in accordance with accounting principles generally accepted in the US. The preparation of these financial statements requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements as well as the reported revenues and expenses during the reporting periods. On an ongoing basis, we evaluate our judgments related to accounting estimates. We base our estimates on historical experience and on various other factors that we believe are reasonable under the circumstances, the results of which form the basis for making judgments about the carrying value of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

While our significant accounting policies are more fully described in Note 1 to our financial statements appearing at the end of this prospectus, we believe that the following accounting policies and significant judgments and estimates relating to revenue recognition, stock-based compensation charges, and accrued expenses are most critical to aid you in fully understanding and evaluating our reported financial results.

### **Revenue Recognition**

We decided to discontinue all operations associated with our DIFOTI® product effective as of April 5, 2005, and account for the DIFOTI® revenue and expenses as a discontinued operation. Revenue from the DIFOTI® product sales had been recognized at the time of delivery and acceptance, after consideration of all the terms and conditions of the customer contract. The DIFOTI® products which were being sold prior to December 31, 2004 included a 30-day return policy. Revenue on these products was recognized after the shipment was made and the 30-day return period had elapsed. DIFOTI® products sold subsequent to December 31, 2004 were sold without a right of return and revenue was therefore recognized after the shipment was made. Deferred revenues at each respective balance sheet date consisted of revenues that were billed or paid in advance of the shipment of the product.

We currently do not have any commercialized products or any significant source of revenue.

### **Stock-Based Compensation**

We account for non-employee stock-based awards in which goods or services are the consideration received for the equity instruments issued based on the fair value of the equity instruments issued in accordance with the 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."

We account for stock-based compensation to employees under the intrinsic-value-based method of accounting prescribed by Accounting Principles Board (APB) Opinion No. 25, "Accounting for Stock Issued to Employees," and disclose the effect of the differences which would result had we applied the fair-value-based method of accounting, on a pro forma basis, as required by FASB Statement No. 123, "Accounting for Stock-Based Compensation, as amended by Statement of Financial Accounting Standards (SFAS) No. 148, Accounting for Stock-Based Compensation, Transition and Disclosure." In December 2004, FASB issued FASB Statement No. 123R, which addresses the accounting for share-based awards to employees and requires companies to recognize the fair value of stock options and other stock-based

compensation to employees in their statement of operations. Because we currently account for our stock-based compensation plans in accordance with APB Opinion No. 25, the adoption of FASB Statement No. 123R will have a material effect on our financial statements in future accounting periods.

Our common stock has not been publicly traded and the determination of the fair value of our common stock involves considerable judgment. In making this determination, we evaluated, among other things, our common stock transactions, the pricing of private equity sales, the rights and preferences of the security being valued, current market conditions, and company specific operational milestones.

During the twelve months ended June 30, 2005, we used two different fair values for our common stock in determining recorded compensation expense for stock options and warrants granted to employees, non-employee directors, and consultants. For the period July 2004 through September 2004, the fair value of our common stock as determined by management took into consideration market, income, and asset based approaches to valuation as set forth in the AICPA Audit and Accounting Practice Aid for "Valuation of Privately Held Company Equity Securities Issued as Compensation." We relied most heavily on the income approach utilizing a discounted cash flow method and also utilized the value derived from the market approach. The weighted value range of our common stock for this period was determined to be \$0.78 to \$1.38 per share and we concluded the fair value was \$1.10 per share.

During the fourth quarter of 2004, the fair value of our common stock as determined by management increased from \$1.10 per share to \$4.00. This change in valuation from the third quarter 2004 to the fourth quarter 2004 reflected the operational progress as noted below.

During October 2004, we completed the second private placement of Series C preferred stock units for gross proceeds of \$8.1 million at a price of \$2.26 per unit (the post reverse split common stock equivalent value was \$4.52 per unit). Each unit consisted of one share of Series C preferred stock and one warrant to purchase one share of common stock at an exercise price of \$13.00 per share. Since no additional consideration was received for the warrant, the consideration for the preferred stock was less than \$2.26 per share. Approximately 35% of the Series C preferred stock units were acquired by new unaffiliated investors. The common stock warrants attached to this issuance were valued at approximately \$1.48 per warrant using the Black-Scholes model with a fair value of \$4.00 per share of our common stock.

During October 2004, we received a binding Protocol Agreement from the FDA defining the endpoints of the pivotal clinical trial for MelaFind® approval. We believe that the presence of a Protocol Agreement significantly enhances our ability to expedite the FDA approval process. To support our future growth and the commercialization of MelaFind®, our board of directors approved in December 2004, the appointment of key executives. In addition, our board of directors approved the issuance of 75,000 warrants to Allen & Co. to purchase common stock with an exercise price of \$7.00 per share in exchange for financing advice, acknowledging the need for additional capital to support MelaFind® development. The fair value of the Allen & Co. warrant was determined to be \$1.60 per warrant using the Black-Scholes method with the following assumptions: common stock value per share \$4.00, warrant life of 5 years, a risk-free interest rate of 3.67%, and an expected volatility of 60%. For these reasons, we believe the fair value of our common stock during this period was \$4.00 per common share, and accordingly the valuation of options and warrants issued during December 2004 was based upon the \$4.00 per share common stock value.

During the first quarter of 2005, we encountered operational issues and management believes these difficulties negatively impacted the fair value of our common stock for this period. Specifically, a study that was initiated in late 2004 under the Protocol Agreement was stopped due to technical difficulties with some of the MelaFind® clinical trial instruments. In addition, we were inspected by the FDA in connection with its DIFOTI® product in March 2005, and we were cited in a FDA Form 483 for failures to comply fully with the FDA's QSR. Since no equity transactions were consummated during this period, we did not determine a new estimated fair value of our common stock during this calendar quarter.

During the second quarter of 2005, progress was made in addressing the issues that we encountered during the first quarter of 2005. With respect to the MelaFind® clinical instruments, we engaged a consultant to direct the MelaFind® product development efforts and oversee the manufacturing process. In

addition, we entered into an agreement with ASKION, a precision optics specialty manufacturer, to develop methods for optimizing the design of the MelaFind® hardware. We provided a report to the FDA outlining our plan to address the technical difficulties with the MelaFind® instruments through a design modification and optimization process with ASKION. On June 30, 2005, we received written confirmation from the FDA that our plan is acceptable. These pre-commercialization instruments will be assembled by ASKION and are expected to be available for the pivotal trial we estimate will commence in early 2006.

We decided to discontinue all operations associated with our DIFOTI® product effective as of April 5, 2005, in order to focus our resources and attention on the development and commercialization of MelaFind®. We are currently seeking an acquirer for the DIFOTI® assets, and we do not expect to have any significant continuing responsibility for the DIFOTI® business after its disposition. In addition, the inspectional findings identified in the FDA Form 483 were discussed in a subsequent meeting with the FDA on April 28, 2005 and did not result in a product recall. We are in the process of addressing the deficiencies noted.

Based on our operational progress during the second quarter of 2005, we determined, in consultation with our underwriters, the fair value of our common stock for our proposed initial public offering to be in the range of \$10.00 to \$12.00 per share.

In May 2005, we amended stock option agreements for 125,000 shares of our common stock in the aggregate, of three key employees to immediately vest upon the completion of this offering. We will record a charge to operations in the amount of \$1.1 million.

We have granted to certain employees stock options that vest with the attainment of various performance milestones. Upon the attainment of these milestones, we will be required to recognize a stock based compensation expense in an amount based on the then current market value of our common stock underlying the options which vest when the milestone is attained. Assuming that all shares offered are sold in this public offering at a price of \$9.00 per share, the mid-point of our filing range, and that upon the attainment of each of the relevant milestones such offering price remains the fair market value per share of our common stock, that the number of shares of our common stock outstanding after this offering remains 9,513,164, then we will record a compensation expense upon filing our MelaFind® PMA with the FDA of \$0.4 million with respect to 50,000 shares of underlying options, and upon our receipt of PMA approval for MelaFind® of \$0.4 million with respect to 50,000 shares of underlying options. The employment agreement with Dr. Gulfo includes three separate grants of common stock options. The first two stock option grants for a total of 81,753 shares of our common stock have fully vested. The number of shares of our common stock subject to the third stock option can only be calculated at the time of PMA approval of MelaFind®. The number of shares under this option is equal to that number of shares of our common stock equal to four percent of our fully diluted capital stock at the time of PMA approval of MelaFind® minus the 81,753 options granted to Dr. Gulfo under the employment agreement. Assuming that 9,513,164 shares are outstanding as of the completion of this offering and remain the total number of shares outstanding on the date we receive PMA approval, the number of shares subject to this option would be 345,699. This third stock option grant vests 50% at the time of PMA approval of MelaFind®, and the remaining 50% vest in four equal installments over the one year period following such PMA approval of MelaFind®. We will recognize compensation expense in the amount of \$3.0 million over the vesting periods.

#### **Accrued Expenses**

As part of the process of preparing financial statements, we are required to estimate accrued expenses. This process involves identifying services that have been performed on our behalf and estimating the level of service performed and the associated cost incurred for such service where we have not been invoiced or otherwise notified of the actual cost. This is done as of each balance sheet date in our financial statements. Examples of estimated accrued expenses include:

- professional service fees;
- contract clinical service fees;

- fees paid to contract manufacturers in conjunction with the production of clinical components or materials; and
- fees paid to third party data collection organizations and investigators in conjunction with the clinical trials.

In connection with such service fees, our estimates are most affected by our projections of the timing of services provided relative to the actual level of services incurred by such service providers. The majority of our service providers invoice us monthly in arrears for services performed. In the event that we do not identify certain costs that have begun to be incurred or we under or over estimate the level of services performed or the costs of such services, our actual expenses could differ from such estimates. The date on which certain services commence, the level of services performed on or before a given date, and the cost of such services are often subjective determinations. We make these judgments based upon the facts and circumstances known to us in accordance with accounting principles generally accepted in the US.

## Results of Operations (in thousands)

### *Six Months Ended June 30, 2005 Compared to Six Months Ended June 30, 2004 (Unaudited)*

**Research and Development Expense.** Research and development expense increased by \$853 to \$1,546 for the six months ended June 30, 2005 from \$693 for the six months ended June 30, 2004. Of this increase, \$410 was attributable to higher personnel and personnel related costs as we increased headcount to support our research and development programs and \$418 relates to increased consulting and outside research fees for the development of our MelaFind® product.

**General and Administrative Expense.** General and administrative expense increased by \$357 to \$996 for the six months ended June 30, 2005 from \$639 for the six months ended June 30, 2004. The increase is primarily due to higher personnel and personnel related costs of \$140 associated with the addition of key management positions, \$44 related to rent and moving expenses on the additional office space, share-based compensation expense of \$86, and general office related expenses of \$79.

**Interest (Income)/Expense.** Interest (income)/ expense for the six months ended June 30, 2005 was (\$63) compared to \$82 for the corresponding period in 2004. The increase in income for the six months ended June 30, 2005 was due to the higher average cash, cash equivalents and marketable securities balance compared to the prior year period. The interest expense for the six months ended June 30, 2004 principally relates to an imputed interest charge of \$80 in connection with financings from related parties.

### *Year Ended December 31, 2004 Compared to Year Ended December 31, 2003*

**Research and Development Expense.** Research and development expenses increased by \$1,064, from \$828 for the year ended December 31, 2003 to \$1,892 for the year ended December 31, 2004. This increase relates to increased headcount to support our research and development programs in the amount of \$715, and \$332 represents increased consulting and outside research fees related to the development of MelaFind®. For the year ended December 31, 2004 research and development costs were approximately 60% of total operating expenses. Clinical and regulatory expense, a component of research and development expense totaled approximately \$797 for the year ended December 31, 2004. We expect our research and development expenses to increase in connection with our clinical trials and other development activities as we advance our MelaFind® pivotal study and complete the PMA regulatory approval process.

**General and Administrative Expense.** General and administrative expenses increased by \$200, to \$1,234 for the year ended December 31, 2004 from \$1,034 for the year ended December 31, 2003. The increase was principally attributable to \$150 in stock-based compensation to non-employee board members, an increase in personnel costs of \$63, MelaFind® reimbursement and pre-marketing costs of \$69, offset in part by lower consulting fees of \$82. For the year ended December 31, 2004, general and administrative expenses were approximately 40% of total operating expenses. We expect that our general and administrative expenses will increase to support the additional costs associated with being a public company. In the future, we will also incur selling and marketing expenses to support the commercialization of MelaFind®.

**Interest (Income)/ Expense.** Interest (income)/ expense for the year ended December 31, 2004 was \$67 compared to \$76 for the corresponding period in 2003. The decrease was due principally to higher interest income in 2004 associated with a higher average cash, cash equivalents and marketable securities balance compared to the prior year.

**Year Ended December 31, 2003 Compared to Year Ended December 31, 2002**

**Revenue.** Grant revenue generated in 2002 in the amount of \$547 represents federal grants received in conjunction with an undertaking to perform certain research.

**Cost of Grant Revenue.** The cost of grant revenue for the year ended December 31, 2002 represents the expenses attributable to the grant revenue and consists primarily of payroll and related costs amounting to \$564.

**Research and Development Expense.** Research and development expenses increased \$424 to \$828 for the year ended December 31, 2003 from \$404 for the year ended December 31, 2002. This increase was principally attributable to personnel and personnel related costs that specifically supported the grant program in 2002, and were classified as cost of grant revenue in 2002 and \$93 related to an increase in other consulting and outside research fees supporting the development of our MelaFind® product. For the year ended December 31, 2003 research and development costs were approximately 45% of total operating expenses. Clinical and regulatory expense, a component of research and development expense totaled approximately \$50 for the year ended December 31, 2003.

**General and Administrative Expense.** General and administrative expenses increased by \$523 to \$1034 for the year ended December 31, 2003 from \$511 for the year ended December 31, 2002. The increase was principally attributable to personnel and personnel related costs of \$488 and an increase in consulting fees of \$35. For the year ended December 31, 2003 general and administrative expenses were approximately 55% of total operating expenses.

**Interest (Income)/ Expense.** Interest (income)/ expense for the year ended December 31, 2003 was \$76 compared to \$8 for the corresponding period in 2002. The increase was due to a charge of \$45 associated with the value of the beneficial conversion feature for a promissory note during 2003.

**Liquidity and Capital Resources (in thousands)**

From inception, we have financed our operations primarily through the use of working capital from private placements of equity securities and by applying for and obtaining a series of National Institute of Health Small Business Innovative Research grants and similar grants. To date, we have not borrowed (other than by issuing convertible notes, all of which have been converted into equity) or financed our operations through significant equipment leases, financing loans or other debt instruments. As of June 30, 2005, we had \$3,794 in cash, cash equivalents and marketable securities as compared to \$6,703 at December 31, 2004. Our cash, cash equivalents and marketable securities are liquid investments with a maturity within one year and consist of investments in money market funds with a commercial bank and short-term US Treasury obligations and federal agency notes.

**Cash Flows from Operating Activities.** Net cash used in operations was \$2,890 for the six months ended June 30, 2005. For the years ended December 31, 2002, 2003 and 2004 the net cash used in operations was \$684, \$1,699, and \$3,065 respectively. For all periods, cash used in operations was attributable primarily to net losses after adjustment for non-cash charges related to depreciation and other changes in operating assets and liabilities.

**Cash from Investing Activities.** Net cash provided by our investing activities was \$2,923 for the six months ended June 30, 2005 principally relating to the redemption of investments. For the years ended December 31, 2002, 2003 and 2004 the net cash provided by (used in) investing activities was \$518, \$(8) and \$(6,677) respectively. The increase in cash used in investing activities in the years ended December 31, 2003 and 2004 was principally related to the net purchase of investments and equipment from the proceeds of our private placement financings. Cash used in investing activities for the year ended December 31, 2002 reflected the redemption of investments.

**Cash Flows from Financing Activities.** Net cash provided by financing activities was \$35 for the six months ended June 30, 2005. For the years ended December 31, 2002, 2003 and 2004 the net cash flows provided by financing activities was zero, \$1,816 and \$9,733 respectively. For these periods, financing cash flows reflected the proceeds from the issuance of common stock, and preferred stock.

### **Operating Capital and Capital Expenditure Requirements**

To date, we have not commercialized our principal product, MelaFind®. We anticipate that we will continue to incur net losses for the foreseeable future as we continue to develop the MelaFind® system, expand our clinical development team and corporate infrastructure, and prepare for the potential commercial launch of MelaFind®. We do not expect to generate significant product revenue until we successfully obtain PMA approval for and begin selling MelaFind®. We believe that the net proceeds from this offering, together with our current cash, cash equivalents and marketable securities and interest we earn on these balances, will be sufficient to meet our anticipated cash needs for working capital and capital expenditures through late 2007. If existing cash and cash generated from this offering are insufficient to satisfy our liquidity requirements, or if we develop additional products, we may seek to sell additional equity or debt securities or obtain a credit facility. If additional funds are raised through the issuance of debt securities, these securities could have rights senior to those associated with our common stock, and could contain covenants that would restrict our operations. Any additional financing may not be available in amounts or on terms acceptable to us, or at all. If we are unable to obtain this additional financing, we may be required to reduce the scope of, delay or eliminate some or all of planned product research development and commercialization activities, which could harm our business.

Because of the numerous risks and uncertainties associated with the development of medical devices such as MelaFind®, we are unable to estimate the exact amounts of capital outlays and operating expenditures associated with our current and anticipated clinical trials. Our future funding requirements will depend on many factors, including, but not limited to:

- the schedule, costs, and results of our clinical trials;
- the success of our research and development efforts;
- the costs and timing of regulatory approval;
- reimbursement amounts for the use of MelaFind® that we are able to obtain from Medicare and third party payors, or the amount of direct payments we are able to obtain from patients and/or physicians utilizing MelaFind®;
- the cost of commercialization activities, including product marketing and building a domestic direct sales force;
- the emergence of competing or complementary technological developments;
- the costs of filing, prosecuting, defending and enforcing any patent claims and other rights, including litigation costs and the results of such litigation;
- the costs involved in defending any patent infringement actions brought against us by third parties; and
- our ability to establish and maintain any collaborative, licensing or other arrangements, and the terms and timing of any such arrangements.

## Contractual Obligations

The following table summarizes our outstanding contractual obligations as of December 31, 2004 and the effect those obligations are expected to have on our liquidity and cash flows in future periods:

| Contractual Obligations | Payments Due by Period<br>(dollars in thousands) |                     |           |           |                      |
|-------------------------|--|---------------------|-----------|-----------|----------------------|
|                         | Total  | Less than<br>1 Year | 1-3 Years | 4-5 Years | More than<br>5 Years |
| Operating Leases        | \$ 1,114   | \$ 205              | \$ 634    | \$ 275    | —                    |
| Total                   | \$ 1,114   | \$ 205              | \$ 634    | \$ 275    | —                    |

Our long-term obligations are two non-cancelable operating leases for space expiring June 2009 and November 2010. The lease on 3,700 square feet of office, laboratory and assembly space expires in June 2009 and the lease on 2,800 square feet of office space expires November 2010.

## Related Party Transactions

For a description of our related party transactions, see the “Related Party Transactions” section of this prospectus and the related notes to our financial statements appearing at the end of this prospectus.

## Off-Balance Sheet Arrangements

We do not currently have, nor have we ever had, any relationships with unconsolidated entities or financial partnerships, such as entities often referred to as structured finance or special purpose entities, which would have been established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes. In addition, we do not engage in trading activities involving non-exchange traded contracts. As such, we are not materially exposed to any financing, liquidity, market or credit risk that could arise if we had engaged in these relationships.

## Quantitative and Qualitative Disclosures about Market Risk

Our exposure to market risk is confined to our cash equivalents and short-term investments. We invest in high-quality financial instruments; primarily money market funds, federal agency notes, and US Treasury obligations, with the effective duration of the portfolio within one year which we believe are subject to limited credit risk. We currently do not hedge interest rate exposure. Due to the short-term nature of our investments, we do not believe that we have any material exposure to interest rate risk arising from our investments.

## Recent Accounting Pronouncements

In May 2003, FASB issued Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity (SFAS No. 150). This statement establishes how a company classifies and measures certain financial instruments with characteristics of both liabilities and equity, including redeemable convertible preferred stock. This statement is effective for financial instruments entered into or modified after May 31, 2003, and is otherwise effective at the beginning of the interim period commencing July 1, 2003, except for mandatorily redeemable financial instruments of nonpublic companies. FASB has indefinitely deferred implementation of some provisions of SFAS No. 150. The adoption of SFAS No. 150 did not have a material effect on our financial position or results of operations.



## OUR BUSINESS

### Overview

We are a medical device company focused on the design and development of a non-invasive, point-of-care instrument to assist in the early diagnosis of melanoma. Our flagship product, MelaFind® features a hand-held imaging device that emits multiple wavelengths of light to capture images of suspicious pigmented skin lesions and extract data. The data are then analyzed against our proprietary database of melanomas and benign lesions using our sophisticated algorithms in order to provide information to the physician and produce a recommendation of whether the lesion should be biopsied.

The components of the MelaFind® system include:

- a *hand-held imaging device*, which employs high precision optics and multi-spectral illumination (multiple colors of light including near infra-red);
- our *proprietary database* of pigmented skin lesions, which we believe to be the largest in the US;
- our *lesion classifiers*, which are sophisticated mathematical algorithms that extract lesion feature information and classify lesions; and
- a *central server* in our offices that is intended to perform quality control functions and provide reports to the physician and in commercial use, will be connected to physicians' offices via the internet.

We have entered into a binding Protocol Agreement with the FDA which is an agreement for the conduct of the pivotal trial in order to establish the safety and effectiveness of MelaFind®. We believe the presence of the Protocol Agreement significantly enhances our ability to expedite the FDA approval process. We stopped a study that was initiated in late 2004 under the Protocol Agreement due to technical difficulties with some of the MelaFind® clinical trial instruments. The FDA has provided confirmation that our plan to correct the technical issues and start a new pivotal trial to satisfy the Protocol Agreement is acceptable. Management estimates that the pivotal trial will commence in early 2006 at over 20 US clinical study sites, and anticipates PMA approval to commercialize MelaFind® in 2007.

To date, we have not generated any revenues from MelaFind®. All of our historical revenues have come from activities and products that have since been discontinued, including our DIFOTI® product, a non-invasive imaging device for the detection of dental cavities. We decided to discontinue all operations associated with our DIFOTI® product, effective as of April 5, 2005, in order to focus our resources on the development and commercialization of MelaFind®.

Cancers of the skin have a higher incidence than all other cancers combined, and the rates are rising dramatically. In 2005, over 120,000 new cases of melanoma are projected. Melanoma is responsible for approximately 80% of skin cancer fatalities and is the deadliest of all skin cancers as there is currently no cure for advanced stage melanoma. However, early detection of skin cancers like melanoma can lead to virtually a 100% cure rate. Advanced stage melanoma is costly to treat and is responsible for approximately 90% of the total spending on melanoma treatment in the US, costing up to \$170,000 per patient. If diagnosed early, however, melanoma is almost always cured by simple resection at a cost of approximately \$1,800 per patient.

Because early detection is critical to survival, the American Cancer Society recommends that individuals age 40 years and older have complete skin examinations on an annual basis. According to the 2000 US Census data, over 100 million Americans in the US are over age 40. Furthermore, there are more than 20 million individuals in the US who have dysplastic nevi, a type of pigmented skin lesion that when present is associated with an increased risk of melanoma. These individuals warrant more frequent observation.

Melanomas are mainly diagnosed by dermatologists and/or primary care physicians using visual clinical evaluation. Physicians assess pigmented skin lesions using the "ABCDE" criteria, Asymmetry, Border irregularity, Color variation, Diameter greater than 6 mm, and Evolving — change in ABCD over time. This assessment is subjective and results in missed melanomas, as well as a ratio of benign lesions

biopsied to melanomas confirmed that is highly variable and as high as 40 to 1 for dermatologists and as high as 50 to 1 for primary care physicians.

To date, MelaFind® has been studied on over 5,000 skin lesions from over 3,500 patients at over 20 clinics. Our clinical studies have demonstrated that MelaFind® missed fewer melanomas and produced fewer false positives than experienced by study dermatologists, who are skin cancer specialists. The performance of a diagnostic is measured in terms of “*sensitivity*” (the ability to detect disease when disease is present) and “*specificity*” (the ability to exclude disease when disease is not present). In the largest blinded trial that we have performed to date on 352 suspicious pigmented skin lesions, using our most advanced system, MelaFind® did not miss a melanoma (measured sensitivity of 100%) and achieved 48.4% specificity compared to the study dermatologists’ sensitivity of 96.4% and specificity of 28.4%.

We believe that with the assistance provided by MelaFind®, physicians could diagnose more melanomas at the earliest, curable stage, which would reduce both treatment costs and the number of unnecessary biopsies, and improve quality of life.

Our objective is for MelaFind® to become an integral part of the standard of care in melanoma detection.

### **The Market Opportunity**

Cancer of the skin (nonmelanoma and melanoma skin cancers combined) is the most common of all cancers, projected to be over 1.3 million cases in 2005 and estimated to account for more than 50% of all cancers. In 2005, over 120,000 new cases of melanoma are projected. There are three significant forms of skin cancer: basal cell, accounting for approximately 75% of skin cancer; squamous cell, totaling approximately 20%; and melanoma, which accounts for an estimated 4% of skin cancer cases, but is responsible for approximately 80% of all deaths from skin cancer. The American Cancer Society projects 10,600 deaths from skin cancer in 2005 — 7,800 from melanoma and 2,800 from other skin cancers. Since 1973, the mortality rate for melanoma has increased by 50%. Since approximately 62% of melanomas and 45% of melanoma deaths occur prior to age 65, melanoma places significant burdens on the healthcare system well beyond Medicare.

Melanoma, if left untreated, can be fatal. If diagnosed and removed early in its evolution, when confined to the outermost skin layer and deemed to be “in situ,” it is virtually 100% curable. Invasive melanomas that are thin and extend into the uppermost regions of the second skin layer still have excellent cure rates (greater than 90%). However, once the cancer advances into the deeper layers of skin, the risk of metastasis (spreading to other parts of the body) increases. Metastases can occur when the tumor enters into lymphatic channels and newly formed blood vessels, potentially resulting in significant morbidity (illness) and mortality (death). Once the cancer has advanced and metastasized to other parts of the body, it is difficult to treat. At this advanced stage, the five year survival rate is reported to be only 10%. Moreover, survival prospects for those with advanced melanoma have not improved over the past three decades.

Melanoma is currently the subject of significant attention in the medical community. In part, this attention is due to the fact that it is the fastest growing cancer. It is also the most common cancer in young adults ages 20-30, and currently there are more new cases of melanoma than HIV/ AIDS. In women ages 25-30, melanoma is the primary cause of cancer death. In women ages 30-35, melanoma is the second leading cause of death after breast cancer. Recent published papers identify a strong correlation between breast cancer and melanoma.

Because early detection is critical to survival, the American Cancer Society recommends that individuals 40 years and older have complete skin examinations on an annual basis. The 2000 US Census indicates that there are over 100 million Americans over the age of 40 in the US. Furthermore, there are more than 20 million individuals in the US who have dysplastic nevi, a type of pigmented skin lesion that when present is associated with an increased risk of melanoma. Such individuals warrant more frequent observation.

## Our Strategy

Our objective is for MelaFind® to become an integral part of the standard of care in melanoma detection. To achieve this objective, we are pursuing the following strategy:

- *Pursue the timely FDA approval of MelaFind®:* We have entered into a binding Protocol Agreement with the FDA for the conduct of the pivotal trial of MelaFind®. Management estimates that the study will commence in early 2006 at over 20 US clinical study sites, and anticipates PMA approval to commercialize MelaFind® in 2007.
- *Establish MelaFind® as the leading technology for assisting in the detection of melanoma:* We have invested considerable capital and expertise into developing our core technology platform, which is protected by six US patents. We will continue to refine and optimize this technology to ensure that MelaFind® is the leading system for assisting in the detection of melanoma.
- *Obtain third party payor reimbursement to support our recurring revenue pricing model:* We intend to offer MelaFind® on a per patient basis, creating a recurring revenue stream. To do so, we will seek to obtain third party reimbursement as well as private pay alternatives. We are working with experts to create an evidence-based medicine evaluation model consistent with those used to support positive coverage decisions by CMS and private payors for similar products. The value drivers in the model include the cost savings associated with early detection (approximately \$168,000 per patient) and fewer biopsies. We believe that the use of MelaFind® could result in substantial savings to the US healthcare system.
- *Commercialize MelaFind® using multiple sales and marketing strategies:* Our internal sales and marketing effort will focus initially on “high volume/key opinion leader” dermatologists with specialties in the diagnosis and treatment of melanoma. To enter the larger US markets of general dermatologists, plastic surgeons, and primary care physicians, and for international markets, we intend to establish partnerships with pharmaceutical and/or diagnostic device companies with an established presence in these markets. While we believe obtaining a positive coverage decision from CMS may take an additional 18 to 36 months following PMA approval, and obtaining a positive coverage decision from private payors, managed care organizations and state Medicare administrative contractors may take at least 6 to 12 months following PMA approval, we intend to commence sales of MelaFind® immediately upon receiving PMA approval for physicians to offer MelaFind® to their patients on a self-pay basis.

## Limitations of Current Melanoma Diagnosis

The current primary method for detecting melanoma is based on physicians’ ability to recognize patterns using the naked eye; this is known as clinical examination. Physicians assess pigmented skin lesions using the “ABCDE” criteria, Asymmetry, Border irregularity, Color variation, Diameter greater than 6 mm, and Evolving — change in ABCD over time. This subjective interpretation relies on physician experience and skill. The ratio of benign lesions biopsied to melanomas confirmed can be variable, ranging as high as 40 to 1 for dermatologists and as high as 50 to 1 for primary care physicians. In contrast, MelaFind® delivers an objective assessment based on numerical scores assigned to the suspicious skin lesion under evaluation. Further, clinical examination is limited to the surface appearance of the suspicious pigmented skin lesion, whereas MelaFind® utilizes information derived from up to 2.5 mm deep into the skin.

Dermatologists who specialize in the management of pigmented skin lesions may also use dermoscopy, a method of viewing lesions under magnification. Although dermoscopy provides more information than unaided visual examination, mastery of the technique necessitates many years of training and experience. Proper use of dermoscopy can reduce the number of unnecessary biopsies of benign lesions, but even dermoscopy experts biopsy 3-10 benign lesions for every melanoma detected.

Most dermatologists generally use only visual clinical evaluation for melanoma detection. Consequently, they biopsy up to 40 benign lesions for every melanoma detected. While many primary care physicians immediately refer patients with suspicious pigmented skin lesions to a specialist, an increasing number perform biopsies on skin lesions themselves. Their lack of specialist training in identifying suspect

lesions makes their diagnostic accuracy much lower in terms of both sensitivity and specificity. This results in 40% misdiagnosed melanomas and a ratio of benign lesions biopsied to melanomas confirmed of up to 50 to 1.

## **MelaFind® Product Description**

MelaFind® is a non-invasive system for assisting in the early detection of melanoma. The MelaFind® system is comprised of a point-of-care, hand-held imaging device that, in commercial use, is intended to be connected via the internet to a central server in our offices. MelaFind® employs multiple wavelengths of light to obtain data from images of suspicious lesions; the data are analyzed against our proprietary database of melanomas and benign lesions using our sophisticated algorithms. When marketed, a report will be transmitted to the physician's office containing MelaFind®'s recommendation of whether the lesion should be biopsied. The key components of the MelaFind® system are listed below:

**A hand-held imaging device**, which is comprised of several components:

- an illuminator that shines 10 different specific wavelengths of light, including near infra-red bands;
- a lens system composed of nine elements that creates images of the light reflected from the lesions;
- a photon (light) sensor; and
- an image processor employing proprietary algorithms to extract many discrete characteristics or features from the images.

**Our proprietary database of pigmented skin lesions**, which includes *in vivo* MelaFind® images and corresponding histological results of over 5,000 biopsied lesions from over 3,500 patients, which we believe to be the largest such database in the US and a substantial barrier to competition.

**Our lesion classifiers, which are sophisticated mathematical algorithms** that analyze the MelaFind® images and extract lesion feature information from the images; the features are used to classify the lesions as either suspicious for melanoma or not suspicious for melanoma.

**A central server** located in our offices, which is intended to perform quality control functions and provide diagnostic reports to the physician.

The “brain” of the MelaFind® system, the *Lesion Classifier*, distinguishes melanoma from non-melanoma using the lesion features extracted and measured by the hand-held imaging device. The *Lesion Classifiers* are developed from our proprietary database of pigmented skin lesions and sophisticated mathematical algorithms. The mathematical formulas and algorithms used by the *Lesion Classifiers* are devised and optimized through the process of “classifier training” using lesions from our proprietary database. *Lesion Classifier* development and training is an iterative process involving: (1) selection of the lesion features that provide for optimal lesion discrimination; (2) optimization of the mathematical formulas to differentiate benign lesions from melanoma; and (3) expansion of the size and diversity of our proprietary lesion database. The performance of the *Lesion Classifiers* is directly related to the size of the database used in classifier training, as well as the degree to which the training database is representative of the lesions that will be evaluated by MelaFind® in commercial use.

As with many diagnostic systems, the diagnostic performance of MelaFind® is characterized using two measures: (1) **sensitivity** — the ability to detect disease when it is present; and (2) **specificity** — the ability to exclude disease when it is not present. Since sensitivity and specificity are typically trade-offs, meaning that as one parameter increases the other decreases, the MelaFind® *Lesion Classifier* is developed and trained with the intention that MelaFind® will detect all melanomas in the training data set with the highest possible specificity.

Reliable functioning of the MelaFind® system is critical to its utility and success in the marketplace. Automated self-calibration tests are performed by the hand-held device to ensure proper functionality. When marketed, the central server will also perform tests on the hand-held device to determine whether its functioning is within appropriate limits, that is, that the quantitative data on lesion and calibration image features provided by MelaFind® are within a pre-determined expected range of values. The server will not permit MelaFind® to provide diagnostic information unless the hand-held device is functioning properly.

## **MelaFind® Regulatory Status**

In late 2004, we entered into a binding Protocol Agreement with the FDA for our pivotal clinical study. A pivotal trial is a clinical study that is used by the FDA as the basis for determining the effectiveness of a device in a PMA application. The Protocol Agreement specified the inclusion criteria (description of patients and lesions eligible for the trial), sample size, endpoints, and performance criteria necessary to establish the safety and effectiveness of MelaFind®. The Protocol Agreement requires that the study include at least 1,200 pigmented skin lesions, and at least 93 eligible melanomas for analysis.

The primary endpoints of the study include: (1) greater than 95% (lower confidence bound (a statistically derived lower limit of a measured or observed value based on the number of observations used to derive the measured or observed value)) sensitivity for detection of melanoma (99% observed sensitivity); and (2) statistically significant greater specificity in ruling out melanoma when compared to study dermatologists. The lower confidence bound of 95% sensitivity is a statistically-derived lower limit of sensitivity based on an observed sensitivity of 99%. This means that in order to satisfy the sensitivity requirement, MelaFind® must correctly identify at least 92 of the 93 melanomas, that is, miss either none or one melanoma in the pivotal trial. In order to satisfy the specificity requirement, MelaFind® must demonstrate a higher specificity than study dermatologists at a level where the probability of obtaining such a result by chance is less than 5%. For illustrative purposes, assuming a specificity of 25% for study dermatologists, the specificity of MelaFind® would need to be at least 32% in order for the difference to be statistically significant at the 95% confidence level.

We initiated a clinical trial under the terms of the Protocol Agreement at the end of 2004. However, technical operational issues with the systems were experienced, requiring further refinement. We are continuing this study as a supportive pilot study. A pilot study is one that provides information regarding the operation of a device in the clinical setting as well as the feasibility of various clinical trial evaluations. Pilot studies are often used to help refine certain elements of a planned pivotal trial and serve to train study personnel in advance of a pivotal trial.

We are currently refining the hardware systems and expect to have new systems available in order to start the pivotal trial in early 2006. The pivotal trial for PMA approval of MelaFind® will be conducted under the terms of the Protocol Agreement. We have reviewed our strategy with the FDA and have obtained confirmation from the FDA that our plan to correct the technical issues by refining the hardware systems and to start a new pivotal trial to satisfy the Protocol Agreement is acceptable.

For commercialization outside the US, approvals from appropriate regulatory bodies within other countries will be required. Once PMA approval is obtained, we may proceed with applications to commercialize in various countries pending further assessment of market opportunities and the possible identification of strategic partners.

## **Clinical Studies of MelaFind®**

### ***Goals and Objectives***

MelaFind® has been studied on over 5,000 skin lesions from over 3,500 patients during the past five years at over 20 clinical sites in the US, as well as two sites in Europe and one in Australia. We aim to develop a system with a sensitivity of at least 95% in detecting melanoma. Our goals are to complete pre-commercialization design and testing of the hand-held imaging device and its associated software, as well as to establish a database of approximately 300 melanomas, including *in vivo* MelaFind® images and biopsy results, for MelaFind® *Lesion Classifier* algorithm development and training. Statistically, in order to have a high level of confidence of success, we set the lower confidence bound at 99%, which requires approximately 300 melanomas in the classifier training database. To date, the MelaFind® lesion database includes 225 melanomas.

We are developing in parallel several MelaFind® *Lesion Classifiers*, which differ in the algorithms, as well as in the specific lesion features and relative weights used in the mathematical formulas. Prior to conducting the analysis of the data from the pivotal trial under the Protocol Agreement, the optimal *Lesion Classifier* will be selected. The primary means by which the performance of the MelaFind® *Lesion*

*Classifiers* is evaluated through measures of **sensitivity** (the ability to detect disease when present) and **specificity** (the ability to exclude disease when not present).

The reference standard used for comparison of the results of MelaFind® and study dermatologists is histological analysis of the biopsied lesions by a group of expert pathologists. MelaFind® images of pigmented skin lesions (melanomas and non-melanomas) and the histological results of the corresponding biopsied lesions comprise our training database of lesions. When the *Lesion Classifiers* are tested on the database used in training, this is called a “training study.” When the *Lesion Classifiers* are tested on a set of lesions not used in training, this is called a “blinded test,” which is a simulation of anticipated real-life prospective classifier performance.

Our ultimate goal for MelaFind® is to demonstrate sensitivity of at least 95%, and superior specificity as compared to study dermatologists in the pivotal blinded test for PMA approval.

#### ***MelaFind® Development History — Hardware and Software***

In developing the MelaFind® system we have tested both a first and second generation hand-held imaging device, and are in the process of developing a pre-commercialization version for use in our pivotal clinical trial. Our research, development and clinical testing efforts have been designed to improve our MelaFind® technology platform, including the imaging device and lesion classifiers, and to enhance our lesion database.

We began using first generation hand-held imaging devices in clinical studies in 2001. In 2002, we expanded the clinical research program to additional study sites equipped with second generation hand-held imaging devices. The aim of the study, which is ongoing, is to build the MelaFind® proprietary lesion database for use in *Lesion Classifier* training. The study calls for the MelaFind® hand-held imaging device to acquire images of pigmented skin lesions scheduled for biopsy. After biopsy, the histological slides are collected and sent for central histological review by a panel of experts.

The results of initial training studies and blinded tests were not to the expected level of performance. We determined the cause to be a flaw in the second generation hand-held imaging devices, which were subsequently shown to exhibit highly variable levels of stray light, an optical artifact. Therefore, we ceased producing this generation of hand-held imaging devices and purged the training database of lesion images acquired with them. We also incorporated a manufacturing specification for stray light which, prior to this time, was not included. Subsequent training studies and blinded tests performed using only first generation hand-held imaging devices confirmed our earlier favorable results: MelaFind® missed none or very few melanomas, and was shown to have higher specificity than study dermatologists, as shown in the tables below. See “Our Business — Clinical Studies of MelaFind® — Results of Training Studies and Blinded Tests.”

We initiated a clinical study under the terms of the Protocol Agreement with the FDA in late 2004 using first generation hand-held imaging devices. However, several technical operating issues with these older systems were experienced, requiring further refinement. Third generation hand-held imaging devices were produced in 2004 and early 2005. These serve as the basis of the design that is currently being used to generate final, pre-commercialization hand-held imaging devices, which will be utilized in the pivotal study for PMA approval under the terms of the Protocol Agreement.

Along with hardware development efforts, we have also developed, tested, and continue to refine the software components of the system, including lesion filters, calibration algorithms, lesion classification algorithms, and hardware normalization software. We plan to finalize these key elements of the software prior to the analysis of the data obtained from the pivotal trial for PMA approval.

#### ***Results of Training Studies and Blinded Tests***

The first iteration of MelaFind® *Lesion Classifiers*, *Lesion Classifiers A-1 and B*, employed a single-step process, that is, an algorithm that differentiates melanoma from all other pigmented skin lesions. These MelaFind® classifiers were trained on a total of 1,129 lesions — 109 melanomas, 70 high grade dysplastic nevi, and 950 other pigmented skin lesions. For the blinded test, a different group of 477 pigmented skin lesions, including 26 melanomas, 11 high grade dysplastic nevi, and 440 other lesions were

included. None of these lesions were used in classifier training. The results of the training study and blinded tests for MelaFind® *Lesion Classifiers A-1* and *B*, as well as study dermatologists, are summarized below.

#### August 2003 — Training Study and Blinded Test Results

|  | Training Study |             | Blinded Test |             |
|--|----------------|-------------|--------------|-------------|
|  | Sensitivity    | Specificity | Sensitivity  | Specificity |
| MelaFind® <i>Lesion Classifier A-1</i> | 100%           | 45.6%       | 80.8%        | 44.3%       |
| MelaFind® <i>Lesion Classifier B</i>   | 96.3%          | 21.9%       | 80.8%        | 25.5%       |
| Study Dermatologists                   | N/A            | N/A         | 96.2%        | 17.3%       |

The performance of the MelaFind® *Lesion Classifiers* on the blinded data set was significantly below results from the training study. The first attempt to improve the performance was by developing a new MelaFind® *Lesion Classifier A*, employing a three-step process (*A-3*), which was accomplished in November 2003. A three-step process employs algorithms that differentiate melanoma from three other classes of pigmented skin lesions. The new classifier was re-trained on the original data set of lesions (109 melanomas, 70 high grade dysplastic nevi, and 950 other pigmented skin lesions), tested on the training set and then tested on the same blinded data set used in August 2003 (26 melanomas, 11 high grade dysplastic nevi, and 440 other lesions). The following table summarizes the results of the tests on the training and blinded data sets. Note that MelaFind® *Lesion Classifier B*, which accommodates a single-step process only, was not evaluated in these exercises.

#### November 2003 — Training Study and Blinded Test Results

|  | Training Study |             | Blinded Test |             |
|--|----------------|-------------|--------------|-------------|
|  | Sensitivity    | Specificity | Sensitivity  | Specificity |
| MelaFind® <i>Lesion Classifier A-3</i> | 100%           | 28.5%       | 100%         | 25.7%       |
| Study Dermatologists                   | N/A            | N/A         | 96.2%        | 17.3%       |

Review of the data indicated that the three-step MelaFind® *Lesion Classifier A-3*, which was trained with lesions acquired from first and second generation MelaFind® hand-held imaging devices, was much less specific on the training database (28.5%) than the single-step classifier MelaFind® *Lesion Classifier A-1*, which was trained on lesions acquired using only first generation hand-held imaging devices (45.6%). A complete analysis of all MelaFind® devices from the clinical sites indicated a systematic difference between the first generation and second generation MelaFind® hand-held imaging devices. The second generation hand-held imaging devices exhibited a significantly greater amount of stray light than the first generation hand-held imaging devices. Stray light induces variable imaging artifacts that cannot be predicted or accounted for in the software algorithms, and introduces higher probability for error. Therefore, in February 2004, all lesions acquired using second generation hand-held imaging devices were removed from the training and testing databases. The three-step MelaFind® *Lesion Classifier A-3* was then trained on a set of lesions acquired solely from first generation hand-held imaging devices including 113 melanomas, 69 high grade dysplastic nevi, and 987 other pigmented skin lesions. A blinded test was conducted on 262 lesions (21 melanoma, 8 high grade dysplastic nevi, and 233 other lesions) not used in classifier training and acquired using first generation hand-held imaging devices only. The following table summarizes the results.

#### February 2004 — Results of Training Study and Blinded Test after Removing Lesions Obtained from Second Generation Hand-Held Imaging Devices

|  | Training Study |             | Blinded Test |             |
|--|----------------|-------------|--------------|-------------|
|  | Sensitivity    | Specificity | Sensitivity  | Specificity |
| MelaFind® <i>Lesion Classifier A-3</i> | 100%           | 43.8%       | 100%         | 44.2%       |
| Study Dermatologists                   | N/A            | N/A         | 95.0%        | 28.3%       |

These results demonstrated the importance of minimizing stray light and establishing a product specification for stray light. This specification was instituted in our assembly process following this analysis.

As part of the continued development, a four-step MelaFind® *Lesion Classifier A-4* was introduced in March 2004. A four-step process employs algorithms that differentiate melanoma from four other classes of pigmented skin lesions. This classifier performed better compared with the three-step classifier, as summarized in the following table.

**March 2004 — MelaFind® Lesion Classifiers: Three-step vs. Four-step Training Study and Blinded Test Results**

|  | Training Study |             | Blinded Test |             |
|--|----------------|-------------|--------------|-------------|
|  | Sensitivity    | Specificity | Sensitivity  | Specificity |
| MelaFind® <i>Lesion Classifier A-3</i> | 100%           | 43.8%       | 100%         | 44.2%       |
| MelaFind® <i>Lesion Classifier A-4</i> | 100%           | 48.9%       | 100%         | 48.1%       |
| Study Dermatologists                   | N/A            | N/A         | 95.0%        | 28.3%       |

Due to the enhanced specificity of the four-step classifier *A-4* compared to the three-step classifier *A-3*, as seen in the preceding table, the four-step classifier was selected for further development and testing. In May 2004, the largest blinded test was performed on a separate set of 352 lesions (including 28 melanomas, 14 high grade dysplastic nevi, and 310 other pigmented skin lesions) that were not used in classifier training. The results of sensitivity and specificity of MelaFind® *Lesion Classifiers A-4 and B* and study dermatologists are summarized in the following table.

**May 2004 — Training Study and Blinded Test Results**

|  | Training Study |             | Blinded Test |             |
|--|----------------|-------------|--------------|-------------|
|  | Sensitivity    | Specificity | Sensitivity  | Specificity |
| MelaFind® <i>Lesion Classifier A-4</i> | 100%           | 53.2%       | 100%         | 48.4%       |
| MelaFind® <i>Lesion Classifier B</i>   | 100%           | 38.0%       | 96.4%        | 32.9%       |
| Study Dermatologists                   | N/A            | N/A         | 96.4%        | 28.4%       |

In January 2005, with no additional classifier training and in an effort to rigorously test the limits of the MelaFind® *Lesion Classifiers*, another blinded test was performed on 228 new lesions (28 melanomas, 4 high grade dysplastic nevi, and 196 other pigmented skin lesions). The lesions in this blinded test were acquired from the first generation MelaFind® hand-held imaging devices that had been at the clinical sites for a longer period of time than in any blinded test to date. *Lesion Classifier* training was not performed using MelaFind® hand-held imaging devices that had been at the clinical sites for longer periods of time. A new four-step MelaFind® *Lesion Classifier C-4* with a revised step was also evaluated in the blinded test. The results are summarized in the following table.

**January 2005 — Second Blinded Test Results using March 2004 Classifiers**

|  | Sensitivity | Specificity |
|--|-------------|-------------|
| MelaFind® <i>Lesion Classifier A-4</i> | 82.1%       | 37.2%       |
| MelaFind® <i>Lesion Classifier B</i>   | 96.4%       | 21.0%       |
| MelaFind® <i>Lesion Classifier C-4</i> | 92.9%       | 35.7%       |
| Study Dermatologists                   | 92.9%       | 23.0%       |

In evaluating the MelaFind® hand-held imaging devices used in the January 2005 blinded test, we found that several MelaFind® devices were not performing within specifications. Certain lesions had some feature measurements significantly outside of the range of the previous data. This led to the identification of specific problems with the hardware, which enabled a new and more robust design of MelaFind® hand-held imaging devices. Had these devices performed within specifications, we believe that the sensitivity of MelaFind® *Lesion Classifiers A-4 and C-4* would have been 96.4%, that is, they would have missed one melanoma, compared to study dermatologists who missed two melanomas.

We are utilizing the findings of the blinded tests to refine the design of hardware to further develop the lesion classification algorithms, to expand the training database, and to develop improved calibration methods to ensure appropriate functioning of each hand-held imaging device. As demonstrated in the



January 2005 blinded test, melanomas can be missed when MelaFind® systems that do not meet specifications are used to acquire images, and when melanoma lesion types (for instance, nodular melanomas, a melanoma type that is often missed by dermatologists in early stages) are not adequately represented in the training database. In order to address these situations, we have: (1) incorporated a weekly field calibration test to evaluate system performance in order to identify and disable MelaFind® systems that are not functioning within specifications; (2) intensified our effort to obtain images of nodular melanomas for inclusion in the targeted 300 melanoma database for the final *Lesion Classifier*; and (3) refined our algorithms to result in either a positive reading of melanoma when MelaFind® images reveal characteristics well outside the ranges of lesions in the final training database, or to report that MelaFind® cannot provide a diagnosis in this circumstance. As mentioned above, had these devices performed within specifications, we believe that the sensitivity of MelaFind® *Lesion Classifiers A-4 and C-4* would have been 96.4%, that is, they would have missed one melanoma, compared to study dermatologists who missed two melanomas.

### **Conclusion**

In the largest clinical study performed to date on 352 pigmented skin lesions, MelaFind® identified all melanomas (100% measured sensitivity) and had a specificity superior to study dermatologists on a statistically significant basis (48.4% versus 28.4%; the probability of obtaining this result by chance was less than 0.0001). Taken together, we believe the clinical studies performed to date demonstrate that MelaFind® hardware systems that are functioning within specifications and that use the most advanced MelaFind® software and classifiers, provide results consistent with the requirements of the Protocol Agreement, that is, specificity that is superior to study dermatologists on a statistically significant basis, and observed sensitivity of at least 99%.

The studies performed to date have been executed with prototype hardware systems as well as MelaFind® classifiers and software that were under development. We believe that results similar or superior to the results obtained in the largest study will be observed in the pivotal clinical study for PMA approval, which will employ pre-commercialization hardware systems with the most advanced software and MelaFind® classifiers. We believe that the pivotal study will demonstrate specificity superior to study dermatologists on a statistically significant basis and satisfy the requirements of the Protocol Agreement.

### **Sales and Marketing**

We plan to offer MelaFind® as a point-of-care online service. This approach is intended to provide us with the advantage of recurring revenues corresponding to the number of patients examined and to provide the physician with access to our technology without having to make a significant capital investment.

Our sales and marketing strategy is to initially establish focused sales, marketing, and distribution organization in North America. We plan to focus our commercialization efforts initially on “high volume/key opinion leader” dermatologists who are strongly focused on the diagnosis and treatment of melanoma. For the expansion to the larger US markets of general dermatologists, plastic surgeons, and primary care physicians, and for international markets, we intend to establish development and commercialization partnerships with pharmaceutical and/or diagnostic device companies with an established competency in the market to accelerate the product introduction and to maximize the breadth of the commercial opportunity. At this time, we have not yet established any commercialization partnerships.

We believe that the ultimate market for MelaFind® is in the primary care setting. When used by primary care physicians, MelaFind® could have a significant public health benefit and a favorable impact on healthcare costs. Primary care physicians are at the front line of early detection, but their lack of specialist training in identifying suspect lesions makes the achievement of a high level of diagnostic accuracy challenging. We believe that MelaFind® can significantly assist primary care physicians in improving their diagnostic acumen.

#### ***The MelaFind® Value Proposition for the Healthcare System***

We are currently working with experts on a quantitative analysis of the value proposition of the use of MelaFind® by both dermatologists and primary care physicians using Evidence-Based Medicine evaluation

techniques. This strategy is consistent with the approach that has been used to support positive coverage decisions by CMS and private payors for other products. The value drivers include: (1) the diagnosis of melanoma at the early curable stages, as opposed to advanced stages, allowing for both a greater opportunity to cure and a reduction in treatment costs by approximately 99%; and (2) reduced number of referrals for evaluation and biopsy of benign pigmented skin lesions. We believe that the use of MelaFind® could result in substantial savings to the US healthcare system.

### ***Our Reimbursement Strategy***

We are aware of no Current Procedural Terminology (CPT) code that is specifically applicable to the use of MelaFind®. Therefore, we have engaged the services of expert consultants with extensive experience in the CPT and coverage decision processes to assist us in the submission of appropriate applications to obtain a CPT code(s) and positive coverage decisions from CMS and private payors.

In advance of obtaining a CPT code, we intend to extend our efforts to secure coverage by private payors and state Medicare administrative contractors. Securing coverage first through private payors and state Medicare administrative contractors is a common strategy for facilitating national Medicare coverage. Our efforts to secure reimbursement for services using MelaFind® will focus first on private payors and state Medicare administrative contractors, particularly in sunbelt locations and in areas that have been shown to be underserved by dermatologists.

In the US, healthcare providers that utilize medical systems such as MelaFind®, generally rely on third-party payors, including Medicare, Medicaid, private health insurance carriers, and managed care organizations, to reimburse part, but not necessarily all, of the costs and fees associated with the procedures performed using these devices. Public and professional concern about the cost of medical care and new technologies has evoked a variety of remedies. Third-party payors are increasingly challenging the pricing of medical products and procedures. Guidelines have been established that recognize the need for clinical strategies to assess the cost-effectiveness of new diagnostic tools or procedures (Evidence-Based Medicine), in the hope of reducing the variations in diagnostic and treatment protocols and reducing healthcare expenditures.

Insurers are also attempting to curb utilization by applying a rational analysis of the costs versus benefits of new technologies.

The Evidence-Based Medicine evaluation that we are undertaking is central to our efforts to obtain positive coverage decisions from CMS and private insurers. The importance of Evidence-Based Medicine is underscored by recent actions by CMS, including its proposed Covered with Evidence Development initiative designed to provide quicker access to new technologies for beneficiaries while assuring that appropriate evidence for final coverage decisions will be obtained.

Assuming FDA approval of MelaFind® in 2007, we anticipate submitting an application for a new CPT code to the American Medical Association (AMA) CPT Editorial Panel in late 2007, anticipating possible issuance of a new CPT code and positive national or regional Medicare coverage determinations in the first or second quarter of 2009. The Evidence-Based Medicine evaluation will be included in the application. If the CPT Editorial Panel concurs that a new CPT code is needed and appropriate, and we are able to demonstrate that MelaFind® is reasonable and necessary for the Medicare population, we anticipate that the new code would be referred to the AMA's Relative Value Scale Update Committee (RUC) to determine the appropriate level of Medicare Part B reimbursement for the procedure, relative to other physician services. This analysis would include a survey of physicians utilizing MelaFind® in the commercial setting. In setting Medicare reimbursement rates, CMS is generally guided, though not bound, by the recommendation of the RUC. Medicare coverage and payment policies significantly influence the practices and policies of private payors, managed care organizations, and state Medicaid agencies. We expect to commence efforts to obtain positive coverage decisions from private payors, managed care organizations, Medicaid agencies, and state Medicare administrative contractors following the completion of the pivotal clinical trial or PMA submission. Presentations to the various committees that evaluate new technologies will be made. These will include the Evidence-Based Medicine evaluation and value proposition. We believe it is likely that the private payors, managed care organizations, and state Medicare

administrative contractors will desire to establish pilot programs of MelaFind® to determine the impact of the product in their systems following PMA approval. In the case of private payors, managed care organizations and state Medicare administrative contractors, we anticipate that obtaining a positive coverage decision for MelaFind® may take at least 6 to 12 months following PMA approval.

One of the keys to securing reimbursement is the desire of physicians to use a new technology in order to enhance their diagnostic acumen and improve the standard of care. Likewise, we believe that once patients become aware of the availability of MelaFind®, they may demand that their physicians utilize MelaFind®. We believe that MelaFind® will represent an improvement in the standard of care for the detection of melanoma. As such, we anticipate that its adoption by physicians and reimbursement by payors will be facilitated by medical and scientific evidence published in peer-reviewed journals and presentations at scientific and medical meetings including the American Academy of Dermatology annual and regional meetings. We plan to execute a publication strategy and to provide information for continuing medical education efforts in order to communicate the potential of MelaFind® to improve patient care. We also plan to sponsor clinical trials following PMA approval in order to evaluate MelaFind® in additional settings. We anticipate that the results of these studies will also be published in peer-reviewed journals and presented at scientific and medical meetings. We anticipate that these studies will help to demonstrate the potential of MelaFind® to improve patient care.

We recognize that a favorable reimbursement environment will have a significant impact on MelaFind®'s adoption and commercial success. Even if a procedure is eligible for reimbursement, the level of reimbursement may not be adequate. In addition, third-party payors may deny reimbursement if they determine that the device used in the treatment was not cost-effective or was used for a non-approved indication. We have anticipated this need and have employed an active strategy to obtain medical coverage, identify appropriate coding and establish adequate payment.

Pending approval of a CPT code and the availability of third party reimbursement, we plan to offer MelaFind® to physicians, who would pay for using MelaFind®, and may or may not charge patients directly for its use. For example, in capitated systems such as certain managed care plans (where physicians cannot pass costs on to patients, but rather are paid a fixed amount per patient managed under the plan, whether or not treated) physicians may conclude that it is cost-effective to use MelaFind® in order to reduce utilization of other services such as biopsies, for example, when the MelaFind® result indicates biopsy is not recommended. In addition, we believe that roughly ten percent of all dermatological practices are focused on cosmetic dermatology. Most procedures performed in cosmetic dermatological practices and Medi-Spas are provided on a patient self-pay basis. Medi-Spas are health and beauty clubs and spas in which medical care and supervision by licensed medical practitioners such as doctors, nurses and physicians assistants is provided; they specialize in aesthetic medicine. We believe that healthcare consumers that seek these services are likely to pay for MelaFind®, as well.

### **Competition**

We are not aware of any direct competitors to MelaFind®. A number of systems for visualization and assessment of pigmented skin lesions are in use or in development. These include clinical (naked eye) examination, whole body mole mapping systems, dermoscopes (also known as "dermatoscopes"), digital dermoscopes, spectrophotometric intercutaneous analysis (analysis of skin structures through measurement of how they absorb light of different wavelengths), confocal microscopy, and spectrophotometric (color) analysis. These systems rely on physician experience and expertise in recognizing patterns that are associated with melanoma and non-melanoma in order to render an interpretation and diagnosis.

The current primary method for detecting melanoma relies on physicians to interpret whether a pigmented skin lesion is suspicious for melanoma (thereby requiring biopsy) based on their ability to recognize patterns using clinical examination. Physicians use the "ABCDE" criteria, Asymmetry, Border irregularity, Color variation, Diameter greater than 6 mm, and Evolving in ABCD, in their assessment. Whole body mole mapping consists of periodic photography of patients, typically those at high risk for developing melanoma. The pictures are reviewed clinically. This service is provided at some diagnostic imaging centers and dermatology offices. DigitalDerm, Inc. offers a computerized system for acquisition, storage, and review of the pictures.

Dermoscopy, or epiluminescence microscopy, allows for non-invasive visualization of colors and microstructures of the epidermis, the dermal-epidermal junction, and the papillary dermis not visible to the naked eye. Manufacturers of dermoscopes include (but are not limited to) Welch Allyn, Inc. (US), Heine Optotechnik (Germany), and 3Gen, LLC (US). Digital dermoscopes allow for dermoscopic images to be visualized on a computer screen at larger magnification. In addition, images may be stored and compared to images taken previously. Manufacturers of digital dermoscopes include (but are not limited to) Derma Medical Systems, Inc. (Austria), ZN Vision Technologies AG (Germany), Polartechnics, Ltd. (Australia), Linos Photonics, Inc. (Germany), and Biomips Engineering (Italy). Dermoscopy is a tool used by approximately 25% of dermatologists in the US and is associated with a long learning curve. Physicians experienced in the use of dermoscopy have been shown to have an increased diagnostic accuracy of 10 to 20% over clinical examination. Although some digital dermoscopes provide information regarding the probability that a lesion may be melanoma compared to a database of lesions, no system, to our knowledge, is under PMA development for objective interpretation.

A recent published article describes the results of a study utilizing the DB-Mips system from Biomips Engineering. The database of lesions used in this study differs significantly from our proprietary database. For example, our database includes a substantial number of lesions such as seborrheic keratoses and pigmented basal cell carcinomas, which can be difficult to differentiate from melanoma. The DB-Mips database included none of these lesions. Further, our database includes many more melanomas that are minimally invasive as well as a much higher percentage of dysplastic nevi compared to the DB-Mips database. Minimally invasive melanomas are more difficult to diagnose than melanomas that have significantly invaded the skin, and dysplastic nevi can be very difficult to differentiate from melanoma. Thus, we believe that the DB-Mips database does not include as many pigmented lesions that are difficult to differentiate from melanoma as our database. This is further confirmed by the fact that the specificity of dermatologists in other DB-Mips studies was reported to be over 80% while the specificity of dermatologists in MelaFind® studies is typically under 30%. The DB-Mips system has a reported specificity of up to 79%, which is roughly equivalent to the specificity of the dermatologists in DB-Mips studies. The DB-Mips system has a reported sensitivity to melanoma of about 95%. We believe that because the DB-Mips database includes relatively few early melanomas, direct comparison with MelaFind®'s sensitivity is not meaningful.

Spectrophotometric intercutaneous analysis is a technique of visualizing collagen, blood, and pigment. Astron Clinica (UK) manufactures a device utilizing this technique. Confocal microscopy is an experimental approach for non-invasive visualization of skin structures at the cellular level; such a device utilizing this technique is in development by Lucid (US).

A spectrophotometer (an instrument for measuring absorption of light of different wavelengths) is offered by Medical High Technologies S.p.A. (Switzerland). In contrast to MelaFind®, the product does not perform automatic quality control of images and has an external light source. We believe that the reported sensitivity of 80.4% would not gain market approval. Further, we are not aware of comparative data on physicians' performance in corresponding data sets. The system does not have PMA approval, nor are we aware of efforts directed to obtain PMA approval of the product.

The broad market for precision optical imaging devices used for medical diagnosis is intensely competitive, subject to rapid change and significantly affected by new product introductions and other market activities of industry participants. If our products are approved for marketing, we will potentially be subject to competition from major optical imaging companies, such as General Electric Co., Siemens AG, Bayer AG, Eastman Kodak Company, Olympus Corporation, Carl Zeiss AG Deutschland and others, each of which manufactures and markets precision optical imaging products for the medical market and could decide to develop or acquire a product to compete with MelaFind®.

## **Manufacturing**

We are currently focusing our manufacturing efforts on hardware engineering in order to make the functioning of the MelaFind® hand-held imaging devices more consistent and robust, and to facilitate larger-scale manufacturing methods of the pre-commercialization devices that will be used in the pivotal

clinical trial. Data from the clinical studies as well as from engineering tests under stress and different environmental conditions are being used to refine appropriate manufacturing and field specifications before the design is fixed.

For this crucial phase in development, we have contracted with a third-party vendor, ASKION (Gera, Germany), which specializes in precision optics. The pre-commercialization hand-held imaging devices to be assembled by ASKION are expected to be available for pivotal trial initiation planned for early 2006. The pre-commercialization hand-held imaging devices are expected to be more robust while having at least the same or better performance than the hand-held imaging devices used in the clinical program to date.

We have recently been inspected by the FDA for the manufacturing and commercialization of DIFOTI®, our dental cavities detection product that has been discontinued for business reasons. The FDA inspectors observed deficiencies that were documented on FDA Form 483 that was issued to us following the inspection. We have had a follow-up meeting with the FDA and are working with the FDA and consultants to address the inspectional findings, particularly as they relate to current MelaFind® design development and ultimate MelaFind® commercial manufacturing. We believe that the issues can be addressed to the satisfaction of the FDA and will not materially adversely effect our operations.

### **Research and Development Efforts**

Our research and development efforts are currently focused on finalization and validation of the pre-commercialization hand-held imaging device, and completion of the development of the MelaFind® *Lesion Classifiers*. To date, we have developed and tested four-step classifiers (see “Results of Training Studies and Blinded Tests”), and we are currently working on five-step versions. The classifiers have been trained on 113 melanomas to date, and our goal is to use 300 melanomas (and over 4,000 non-melanoma pigmented lesions) for training. To date we have collected over 225 melanomas, which are available for classifier training.

We have engaged Battelle Memorial Institute to perform specific technical services supporting our algorithm and software development and other efforts.

Our R&D plan also includes further improvements such as incorporating wireless technology and an internet connection for hand-held imaging device quality monitoring, as well as faster and easier software downloads for future software versions. The internet based monitoring of the performance of our hand-held imaging device, known as Intelligent Device Management, is intended to enable us to continuously monitor our hand-held imaging device, advise the user of errors in handling, and thus enhance customer satisfaction and loyalty.

We have performed feasibility studies of a MelaFind® software add-on feature called MelaMeter™, an enhancement to MelaFind® that provides information regarding the depth of penetration of a pigmented skin lesion. This information may be useful to physicians in determining the necessary depth and breadth of biopsy of a pigmented skin lesion. Initial clinical studies of MelaMeter™ demonstrate the ability of MelaMeter™ to non-invasively estimate the Breslow thickness (the thickness of a cutaneous malignant melanoma measured from the epidermis to the deepest malignant cells present) comparably to histological examination of excised lesions. We plan to continue the development of MelaMeter™ and seek its FDA approval after receiving PMA approval of MelaFind®.

Following commercialization of MelaFind®, we intend to evaluate the potential use of our light based computer vision platform in other applications, including the non-invasive detection of basal cell carcinoma, the most common skin cancer. New hardware systems for the imaging of blood and blood vessel patterns are needed since the majority of basal cell carcinomas are not pigmented and, accordingly, the MelaFind® system as currently developed is not appropriate for this use. However, we believe MelaFind®’s software programs and algorithms will be applicable.

### **Intellectual Property**

Our policy is to protect our intellectual property by obtaining US and foreign patents to protect technology, inventions and improvements important to the development of our business. To date we have

been awarded 14 US patents with numerous foreign counterparts, of which six US patents and two Australian patents relate to various aspects of MelaFind®. In addition, we have applied for two additional US patents and have filed certain foreign patent applications relating to MelaFind®, of which two foreign patent applications are currently in the European regional phase. Also, we have obtained non-exclusive licenses from several of our suppliers for critical components of MelaFind®. We have not granted any significant licenses with respect to our intellectual property.

We cannot be certain that our patents will not be challenged or circumvented by competitors. Whether a patent is infringed and is valid, or whether a patent application should be granted, are all complex matters of science and law, and therefore we cannot be certain that, if challenged, our patents, patent applications and/or other intellectual property rights would be upheld. If one or more of those patents, patent applications and other intellectual property rights are invalidated, rejected or found unenforceable, that could reduce or eliminate any competitive advantage.

We also rely on trade secrets and technical know-how in the manufacture and marketing of MelaFind®. We require our employees, consultants and contractors to execute confidentiality agreements with respect to our proprietary information.

We have obtained US trademark registrations for the following marks: “MelaFind®” and “DIFOTI®,” as well as the corporate logo for “eos-electro-optical sciences, inc.®” The goods covered by these registrations are in International Class 010 and US Classes 26, 39 and 44. For MelaFind®, the description of goods and services covered by the trademark is: “medical devices, namely, electro-optical devices incorporating hardware for obtaining images in different spectral bands and software for analyzing the images for use in analyzing skin lesions and determining the existence of melanoma.” For DIFOTI®, the description of goods and services covered by the trademark is: “electro-optical apparatus to diagnose dental conditions.” For “eos-electro-optical sciences, inc.®,” the description of goods and services covered by the trademark is: “instrumentation comprising computer assisted optical imagers and image analyzers for use in the detection of dental cavities, cutaneous melanoma, and other pathologies of the teeth, skin and other tissues.” We also have registered the internet domain names: www.eo-sciences.com, www.eosciences.com, www.melafind.com, www.difoti.com, www.smartlightsensors.com, and www.skincare.com.

The following table lists the fundamental US patents that cover the MelaFind® methodology, apparatus, and systems:

#### US Patents Relating to MelaFind®

| Patent #  | Title   | Issued   | Expiration |
|-----------|---|----------|------------|
| 6,081,612 | Systems and Methods for the Multispectral Imaging and Characterization of Skin Tissue     | 06/27/00 | 02/27/17   |
| 6,208,749 | Systems and Methods for the Multispectral Imaging and Characterization of Skin Tissue     | 03/27/01 | 02/27/17   |
| 6,307,957 | Multispectral Imaging and Characterization of Biological Tissue                           | 10/23/01 | 02/27/17   |
| 6,626,558 | Apparatus for Uniform Illumination of an Object   | 09/30/03 | 08/31/21   |
| 6,657,798 | Method for Optimizing the Number of Good Assemblies Manufacturable From a Number of Parts | 12/02/03 | 02/10/23   |
| 6,710,947 | Method for Assembling Lens Elements   | 03/23/04 | 02/27/23   |

The first two listed patents improve the specificity and sensitivity of the software algorithms that classify lesions as suspicious for melanoma or as not suspicious. The third patent extends the prior patents for potential use in evaluating gastro-intestinal lesions. The fourth patent covers a novel way of providing illumination with which to capture images. The fifth and sixth patents describe cost-saving methods of lens assembly. We believe that our patented methods and apparatus, together with unpatented related trade-secret technology, give us a competitive advantage; however, we cannot be certain that, if challenged, our patented methods and apparatus and/or trade-secret technology would be upheld. If one or more of our

patented methods, patented apparatus or trade secret technology rights are invalidated, rejected or found unenforceable, that could reduce or eliminate any competitive advantage we might otherwise have had.

US patent No. 6,081,612 relates to the MelaFind® system and methods employed in building MelaFind® classification algorithms involving the use of novel multi-spectral lesion features by means of wavelet maxima representations. Wavelet maxima representations use specific types of mathematical transformations called wavelets to represent a signal, such as an image of a lesion taken by the MelaFind® system, at different detail levels. The wavelet maxima representation retains information of potential diagnostic value. This information is quantified in the form of statistical features used for automatic classification. Patent No. 6,208,749 relates to methods employed in building MelaFind® classification algorithms involving the use of novel features of multispectral lesion images that do not involve the use of wavelet transformations to determine whether the lesion is or is not a melanoma. We believe the inclusion of the described wavelets and non-wavelets features improves significantly the sensitivity and specificity of the melanoma classifiers. Patent No. 6,307,957 extends the use of the novel features of the MelaFind® system to endoscopy (examination of gastro-intestinal tissues using fiber-optic probes). We have no present plans to develop endoscopy applications of our technology.

Patent 6,626,558 covers the array of numerous light-emitting diodes (LED's) that are used in the MelaFind® hand-held device to provide uniform illumination of lesions in multiple spectral bands of illumination. Patent 6,657,798 involves the use of a computer algorithm to optimize the number of lens assemblies possible from a given number of sets of lens elements. Patent 6,710,947 describes a method for the economical assembly of the nine elements of the MelaFind® hand-held device's optical lens apparatus.

We also have developed trade secret calibration methods, classifier programs, and search engines; these programs have been developed over many years and incorporate decades of experience in optical computer vision. In addition, our proprietary MelaFind® database of over 5,000 lesions has been compiled over a number of years and would be difficult to replicate.

### **FDA Regulation**

Our product, MelaFind®, is regulated as a medical device and is subject to extensive regulation by the FDA and other regulatory authorities in the US. The FD&C Act and other federal and state statutes and regulations govern the research, design, development, preclinical and clinical testing, manufacturing, safety, approval or clearance, labeling, packaging, storage, record keeping, servicing, promotion, import and export, and distribution of medical devices.

Unless an exemption applies, each medical device we wish to commercially distribute in the US will require either prior premarket notification, or 510(k) clearance, or PMA approval, from the FDA. The FDA classifies medical devices into one of three classes. Devices requiring fewer controls because they are deemed to pose lower risk are placed in Class I or II. Class I devices are subject to general controls such as labeling, premarket notification, and adherence to the FDA's QSR. Class II devices are subject to special controls such as performance standards, postmarket surveillance, FDA guidelines, as well as general controls. Some Class I and Class II devices are exempted by regulation from the premarket notification, or 510(k), clearance requirement or the requirement of compliance with certain provisions of the QSR. Devices are placed in Class III, which requires approval of a PMA application, if insufficient information exists to determine that the application of general controls or special controls are sufficient to provide reasonable assurance of safety and effectiveness, or they are life-sustaining, life-supporting or implantable devices, or the FDA deems these devices to be "not substantially equivalent" either to a previously 510(k) cleared device or to a "preamendment" Class III device in commercial distribution before May 28, 1976, for which PMA applications have not been required. The FDA classifies MelaFind® as a Class III device, requiring PMA approval.

A PMA application must be supported by valid scientific evidence, which typically requires extensive data, including technical, pre-clinical, clinical, manufacturing and labeling data, to demonstrate to the FDA's satisfaction the safety and effectiveness of the device. A PMA application must include, among other things, a complete description of the device and its components, a detailed description of the methods, facilities and controls used to manufacture the device, and proposed labeling. A PMA application

also must be accompanied by a user fee, unless exempt. For example, the FDA does not require the submission of a user fee for a small business's first PMA. After a PMA application is submitted and found to be sufficiently complete, the FDA begins an in-depth review of the submitted information. During this review period, the FDA may request additional information, or clarification of information already provided. Also during the review period, the FDA has informed us that an advisory panel of experts from outside the FDA will be convened to review and evaluate the application and provide recommendations to the FDA as to the approvability of the device. In addition, the FDA generally will conduct a pre-approval inspection of the manufacturing facility to ensure compliance with the QSR, which requires manufacturers to follow design, testing, control, documentation and other quality assurance procedures.

We commenced the PMA application process for MelaFind® by filing a proposed Shell (an outline of a PMA) for a three module PMA on September 30, 2002. We filed as a Small Business Entity exempt from the user fee requirement. The Shell was accepted and two Modules have been filed and reviewed. The third Module will include the results of the pivotal clinical study, and cannot be filed until after that study is complete and its results have been evaluated. The FDA can delay, limit or deny approval of a PMA application for many reasons, including:

- MelaFind® may not be safe or effective to the FDA's satisfaction;
- the data from our pre-clinical studies and clinical trials may be insufficient to support approval;
- the manufacturing process or facilities we use may not meet applicable requirements; and
- changes in FDA approval policies or adoption of new regulations may require additional data.

If the FDA evaluations of both the PMA application and the manufacturing facilities are favorable, the FDA will either issue an approval letter, or approvable letter, which usually contains a number of conditions which must be met in order to secure final approval of the PMA. When and if those conditions have been fulfilled to the satisfaction of the FDA, the agency will issue a PMA approval letter authorizing commercial marketing of the device for certain indications. If the FDA's evaluation of the PMA or manufacturing facilities is not favorable, the FDA will deny approval of the PMA or issue a not approvable letter. The FDA may also determine that additional clinical trials are necessary, in which case the PMA approval may be delayed while the trials are conducted and the data acquired is submitted in an amendment to the PMA. Even with additional trials, the FDA may not approve the PMA application. The PMA process can be expensive, uncertain and lengthy and a number of devices for which FDA approval has been sought by other companies have never been approved for marketing.

New PMA applications or PMA supplements may be required for modifications to the manufacturing process, labeling and device specifications, materials or design of a device that is approved through the PMA process. PMA supplements often require submission of the same type of information as an initial PMA application, except that the supplement is limited to information needed to support any changes from the device covered by the original PMA application, and may not require as extensive clinical data or the convening of an advisory panel.

Clinical trials are almost always required to support a PMA application, and are sometimes required for a 510(k) clearance. These trials generally require submission of an application for an IDE to the FDA. We have not been required to file an IDE application for the MelaFind® clinical studies because FDA has considered the trials "non-significant risk" (NSR) studies subject to abbreviated IDE regulations, which do not require formal IDE submission. An IDE application must be supported by appropriate data, such as animal and laboratory testing results, showing that it is safe to test the device in humans and that the testing protocol is scientifically sound. The IDE application must be approved in advance by the FDA for a specified number of patients, unless the product is deemed a non-significant risk device and eligible for more abbreviated IDE requirements. Generally, clinical trials for a significant risk device may begin once the IDE application is approved by the FDA and the study protocol and informed consent form are approved by appropriate institutional review boards at the clinical trial sites. The FDA's approval of an IDE allows clinical testing to go forward, but does not bind the FDA to accept the results of the trial as sufficient to prove the product's safety and effectiveness, even if the trial meets its intended success criteria. All clinical trials must be conducted in accordance with the FDA's IDE regulations that govern



investigational device labeling, prohibit promotion of the investigational device, and specify an array of recordkeeping, reporting and monitoring responsibilities of study sponsors and study investigators. As stated above, the clinical studies of MelaFind® are considered by the FDA as NSR. Consequently, the trials are conducted under the auspices of an abbreviated IDE. Clinical trials must further comply with the FDA's regulations for IRB approval and for informed consent. Required records and reports are subject to inspection by the FDA. The results of clinical testing may be unfavorable or, even if the intended safety and effectiveness success criteria are achieved, may not be considered sufficient for the FDA to grant approval or clearance of a product. The commencement or completion of any of our clinical trials may be delayed or halted, or be inadequate to support approval of a PMA application, or 510(k) clearance, for numerous reasons, including, but not limited to, the following:

- the FDA, other regulatory authorities, or an IRB do not approve a clinical trial protocol or a clinical trial, or place a clinical trial on hold;
- patients do not enroll in clinical trials at the rate we expect;
- physicians do not comply with trial protocols;
- patient follow-up is not at the rate we expect;
- patients experience adverse events;
- IRBs and third-party clinical investigators may delay or reject our trial protocol;
- third-party clinical investigators decline to participate in a trial or do not perform a trial on our anticipated schedule or consistent with the clinical trial protocol, GCPs or other FDA requirements;
- third-party organizations do not perform data collection and analysis in a timely or accurate manner;
- regulatory inspections of our clinical trials or manufacturing facilities may, among other things, require us to undertake corrective action or suspend or terminate our clinical trials, or invalidate our clinical trials;
- changes in governmental regulations or administrative actions; and
- the interim or final results of the clinical trial are inconclusive or unfavorable as to safety or effectiveness.

Our clinical trials may not generate favorable data to support any PMA applications, and we may not be able to obtain such approvals on a timely basis, or at all. Delays in receipt of or failure to receive such approvals, the withdrawal of previously received approvals, or failure to comply with existing or future regulatory requirements would have a material adverse effect on our business, financial condition and results of operations. Even if granted, the approvals may include significant limitations on the intended use and indications for use for which our products may be marketed.

After a device is approved or cleared and placed in commercial distribution, numerous regulatory requirements apply. These include:

- establishment registration and device listing;
- QSR, which requires manufacturers to follow design, testing, control, documentation and other quality assurance procedures;
- labeling regulations, which prohibit the promotion of products for unapproved or "off-label" uses and impose other restrictions on labeling;
- medical device reporting regulations, which require that manufacturers report to the FDA if a device may have caused or contributed to a death or serious injury or malfunctioned in a way that would likely cause or contribute to a death or serious injury if it were to recur; and
- corrections and removal reporting regulations, which require that manufacturers report to the FDA field corrections and product recalls or removals if undertaken to reduce a risk to health posed by the device or to remedy a violation of the FD&C Act that may present a risk to health.

Also, the FDA may require us to conduct postmarket surveillance studies or order us to establish and maintain a system for tracking our products through the chain of distribution to the patient level. The FDA enforces regulatory requirements by conducting periodic, unannounced inspections and market surveillance. Inspections may include the manufacturing facilities of our subcontractors. Thus, we must continue to spend time, money, and effort to maintain compliance.

Failure to comply with applicable regulatory requirements, including those applicable to the conduct of our clinical trials, can result in enforcement action by the FDA, which may lead to any of the following sanctions:

- warning letters;
- fines and civil penalties;
- unanticipated expenditures;
- delays in approving or refusal to approve our applications, including supplements;
- withdrawal of FDA approval;
- product recall or seizure;
- interruption of production;
- operating restrictions;
- injunctions; and
- criminal prosecution.

We and our contract manufacturers, specification developers, and some suppliers of components, are also required to manufacture our products in compliance with cGMP requirements set forth in the QSR. The QSR requires a quality system for the design, manufacture, packaging, labeling, storage, installation and servicing of marketed devices, and includes extensive requirements with respect to quality management and organization, device design, equipment, purchase and handling of components, production and process controls, packaging and labeling controls, device evaluation, distribution, installation, complaint handling, servicing, and record keeping. The FDA enforces the QSR through periodic unannounced inspections that may include the manufacturing facilities of our subcontractors. We expect that our manufacturing facility and those of our subcontractors will be subject to domestic and international regulatory inspection and review. If the FDA believes we or any of our contract manufacturers or regulated suppliers are not in compliance with these requirements, it can shut down our manufacturing operations, require recall of our products, refuse to approve new marketing applications, institute legal proceedings to detain or seize products, enjoin future violations, or assess civil and criminal penalties against us or our officers or other employees. Any such action by the FDA would have a material adverse effect on our business. We cannot assure you that we will be able to comply with all applicable FDA regulations.

### **Government Regulation**

The advertising of our MelaFind® product will be subject to both FDA and Federal Trade Commission regulations. In addition, the sale and marketing of MelaFind® will be subject to a complex system of federal and state laws and regulations intended to deter, detect, and respond to fraud and abuse in the healthcare system. These laws and regulations restrict and may prohibit pricing, discounting, commissions and other commercial practices that may be typical outside of the healthcare business. In particular, anti-kickback and self-referral laws and regulations will limit our flexibility in crafting promotional programs and other financial arrangements in connection with the sale of our products and related services, especially with respect to physicians seeking reimbursement through Medicare or Medicaid. These federal laws include, by way of example, the following:

- the anti-kickback statute prohibits certain business practices and relationships that might affect the provision and cost of healthcare services reimbursable under Medicare, Medicaid and other federal healthcare programs, including the payment or receipt of remuneration for the referral of patients whose care will be paid by Medicare or other federal healthcare programs;

- the physician self-referral prohibition, commonly referred to as the Stark Law, which prohibits referrals by physicians of Medicare or Medicaid patients to providers of a broad range of designated healthcare services in which the physicians or their immediate family members have ownership interests or with which they have certain other financial arrangements;
- the anti-inducement law, which prohibits providers from offering anything to a Medicare or Medicaid beneficiary to induce that beneficiary to use items or services covered by either program;
- the Civil False Claims Act, which prohibits any person from knowingly presenting or causing to be presented false or fraudulent claims for payment by the federal government, including the Medicare and Medicaid programs; and
- the Civil Monetary Penalties Law, which authorizes HHS to impose civil penalties administratively for fraudulent or abusive acts.

Sanctions for violating these federal laws include criminal and civil penalties that range from punitive sanctions, damage assessments, money penalties, imprisonment, denial of Medicare and Medicaid payments, or exclusion from the Medicare and Medicaid programs, or both. These laws also impose an affirmative duty on those receiving Medicare or Medicaid funding to ensure that they do not employ or contract with persons excluded from the Medicare and other government programs.

Many states have adopted or are considering legislative proposals similar to the federal fraud and abuse laws, some of which extend beyond the Medicare and Medicaid programs to prohibit the payment or receipt of remuneration for the referral of patients and physician self-referrals regardless of whether the service was reimbursed by Medicare or Medicaid. Many states have also adopted or are considering legislative proposals to increase patient protections, such as limiting the use and disclosure of patient-specific health information. These state laws typically impose criminal and civil penalties similar to the federal laws.

In the ordinary course of their business, medical device manufacturers and suppliers have been and are subject regularly to inquiries, investigations and audits by federal and state agencies that oversee these laws and regulations. Recent federal and state legislation has greatly increased funding for investigations and enforcement actions, which have increased dramatically over the past several years. This trend is expected to continue. Private enforcement of healthcare fraud also has increased, due in large part to amendments to the Civil False Claims Act in 1986 that were designed to encourage private persons to sue on behalf of the government. These whistleblower suits by private persons, known as *qui tam* relators, may be filed by almost anyone, including physicians and their employees and patients, our employees, and even competitors. HIPAA, in addition to its privacy provisions, created a series of new healthcare-related crimes.

### **Environmental Regulation**

Our research and development and clinical processes involve the handling of potentially harmful biological materials as well as hazardous materials. We and our investigators and vendors are subject to federal, state and local laws and regulations governing the use, handling, storage and disposal of hazardous and biological materials and we incur expenses relating to compliance with these laws and regulations. If violations of environmental, health and safety laws occur, we could be held liable for damages, penalties and costs of remedial actions. These expenses or this liability could have a significant negative impact on our financial condition. We may violate environmental, health and safety laws in the future as a result of human error, equipment failure or other causes. Environmental laws could become more stringent over time, imposing greater compliance costs and increasing risks and penalties associated with violations. We are subject to potentially conflicting and changing regulatory agendas of political, business and environmental groups. Changes to or restrictions on permitting requirements or processes, hazardous or biological material storage or handling might require an unplanned capital investment or relocation. Failure to comply with new or existing laws or regulations could harm our business, financial condition and results of operations.

## **International Regulation**

International sales of medical devices are subject to foreign government regulations, which may vary substantially from country to country from having no regulations to having a premarket notice or premarket acceptance. The time required to obtain approval in a foreign country may be longer or shorter than that required for FDA approval, and the requirements may differ. There is a trend towards harmonization of quality system standards among the European Union, US, Canada and various other industrialized countries.

The European Union, which includes most of the major countries in Europe, has adopted numerous directives and standards regulating the design, manufacture, clinical trials, labeling and adverse event reporting for medical devices. Devices that comply with the requirements of a relevant directive will be entitled to bear the CE conformity marking, indicating that the device conforms to the essential requirements of the applicable directives and, accordingly, can be commercially distributed throughout Europe. The method of assessing conformity varies depending on the class of the product, but normally involves a combination of self-assessment by the manufacturer and a third party assessment by a "Notified Body." This third party assessment may consist of an audit of the manufacturer's quality system and specific testing of the manufacturer's product. An assessment by a Notified Body of one country within the European Union is required in order for a manufacturer to commercially distribute the product throughout the European Union. As part of the CE compliance, manufacturers are required to comply with the ISO 9000 series of standards for quality operations (an international standard for quality management requirements maintained by the International Organization for Standardization (ISO)). Other countries, such as Switzerland, have voluntarily adopted laws and regulations that mirror those of the European Union with respect to medical devices. Outside of the European Union, regulatory approval needs to be sought on a country-by-country basis in order for us to market our products.

## **Product Liability and Insurance**

Our business exposes us to the risk of product liability claims that is inherent in the testing, manufacturing and marketing of medical devices, including those which may arise from the misuse or malfunction of, or design flaws in, our products. We may be subject to product liability claims if MelaFind® causes, or merely appears to have caused, an injury. Claims may be made by patients, healthcare providers or others involved with MelaFind®. MelaFind® will require from the FDA approval prior to commercialization in the US. The clinical studies of MelaFind® are considered by the FDA as NSR. Consequently, the trials are conducted under the auspices of an abbreviated IDE. We therefore do not maintain domestic clinical trial liability insurance. We have placed clinical trial liability insurance in certain European countries where required by statute or clinical site policy. Although we have general liability insurance that we believe is appropriate, and anticipate obtaining adequate product liability insurance before commercialization of MelaFind®, this insurance is and will be subject to deductibles and coverage limitations. Our anticipated product liability insurance may not be available to us in amounts and on acceptable terms, if at all, and, if available, the coverages may not be adequate to protect us against any future product liability claims. If we are unable to obtain insurance at an acceptable cost or on acceptable terms with adequate coverage or otherwise protect against potential product liability claims, we will be exposed to significant liabilities, which may harm our business.

## **Employees**

As of June 30, 2005, we had 27 full-time and two part-time employees, of whom 13 were engaged in research and development (including clinical and regulatory affairs), seven in production (including document control and quality assurance) and nine in marketing, sales and administrative activities. We believe that our relationship with our employees is good.

## **Facilities**

We lease approximately 2,800 square feet of office space at 3 West Main Street, Suite 201, Irvington, New York, and an additional 3,700 square feet of office, laboratory, and assembly space in an adjacent building with the street address of 1 Bridge Street, Suite 15, Irvington, New York. The lease on the 2,800

square feet of space expires in November 2010. The lease on the 3,700 square feet of space expires in June 2009. We believe that these facilities are adequate to meet our current and reasonably foreseeable requirements. We believe that we will be able to obtain additional space, if required, on commercially reasonable terms.

**Legal Proceedings**

We are not currently a party to any legal proceedings.

**Discontinued Business**

As of April 5, 2005, we decided to discontinue all operations associated with our DIFOTI® product, a non-invasive imaging device for the detection of dental cavities, in order to focus our resources on the development and commercialization of MelaFind®. We are currently seeking an acquirer for the DIFOTI® assets. Once a disposition relating to the DIFOTI® assets is complete, we do not expect to have any significant continuing responsibility for the DIFOTI® business.

## MANAGEMENT

### Executive Officers and Directors

The following table sets forth the names, ages as of June 30, 2005 and a brief account of the business experience of each person who is a current executive officer or director of our company and each person who has been elected to serve as a director effective upon the close of this offering. Each director of our company will hold office until the next annual meeting of shareholders of our company or until his successor has been elected and qualified.

| Name                      | Age | Position   |
|---------------------------|-----|--|
| Joseph V. Gulfo, M.D.     | 42  | Director, President and Chief Executive Officer                |
| Karen Krumeich            | 51  | Vice President, Finance, Chief Financial Officer and Treasurer |
| Jon I. Klippel            | 50  | Vice President, Marketing and Sales                            |
| William R. Bronner        | 59  | Vice President, Legal Counsel and Compliance                   |
| Breaux Castleman(1)(2)    | 64  | Director, Chairman of the Board of Directors                   |
| Sidney Braginsky(1)       | 68  | Director   |
| George C. Chryssis(1)     | 58  | Director   |
| Martin D. Cleary(2)(3)(4) | 59  | Director Elect   |
| Dan W. Lufkin(2)(3)       | 73  | Director   |
| Gerald Wagner, Ph.D.      | 62  | Director   |

(1) Member of Compensation Committee

(2) Member of Nominating and Governance Committee

(3) Member of Audit Committee

(4) Director elected to serve effective as of the completion of this offering

### Executive Officers

**Joseph V. Gulfo, M.D., M.B.A.** has served as our President and Chief Executive Officer and a member of our board of directors since January 2004. From May 1999 to November 2004, he served as Chairman, Chief Executive Officer and President of Antigen Express, Inc., a development-stage company developing immunodiagnostics and therapeutics for cancer. Dr. Gulfo serves as a director of ProCetus BioPharm, Inc., a privately-held company. Dr. Gulfo received a B.S. in Biology from Seton Hall University, an M.D. from the University of Medicine and Dentistry of New Jersey and an M.B.A. in Finance from Seton Hall University.

**Karen Krumeich** has served as our Vice President, Finance and Chief Financial Officer since January 2005 and Treasurer since May 2005. From August 2004 to January 2005 she served as a financial consultant with Horn Murdock Cole, a financial consulting firm. From September 2002 to July 2004, she served as divisional Chief Financial Officer of the hospital group division of Henry Schein, Inc., a publicly-held medical and dental products distributor. From March 2000 to August 2002, she served as a financial consultant with Consulting Associates, a financial consulting firm. Ms. Krumeich received her B.S. in Pharmacy from the University of Toledo College of Pharmacy and completed additional coursework in accounting at Cleveland State University.

**Jon I. Klippel** has served as our Vice President, Marketing and Sales since December 2004. From April 2004 to November 2004, he was a marketing and sales consultant. From January 2003 to March 2004, he served as Senior Marketing Manager of PDI, Inc., a publicly-traded company offering outsourced marketing, sales and sale support services to biopharmaceutical and medical device companies. From February 2002 to December 2002, he was a marketing and sales consultant. From July 2000 to February 2002, he served as Director of Marketing and Business Development at National Imaging Associates, Inc., a privately-held diagnostic imaging management company. Mr. Klippel received a B.A. in Political Science from Albright College and an M.B.A. from Rutgers University Graduate School of Business.

**William R. Bronner** has served as our Vice President, Legal Counsel and Compliance since July 2000 and as our Secretary since May 2002. From 1986 to July 2000, Mr. Bronner served as Vice President, General Counsel and Secretary of Kronos, Inc. Mr. Bronner received a B.A. in Government from Dartmouth College and a J.D. from Columbia University Law School.

Our executive officers are elected by, and serve at the discretion of our board of directors. There are no family relationships between our directors and executive officers.

#### **Non-Executive Directors**

**Breaux Castleman** has served as a member of our board of directors and Chairman of our board since July 2003. Since August 2001, he has served as President, Chief Executive Officer and Chairman of Syntiro Healthcare Services, Inc. Mr. Castleman also serves as a director of FemPartners, Inc., Integrated Diagnostic Centers, Inc. and Radiology Practice Management, Inc., each of which are privately-held companies. From December 1999 to July 2001, he served as Chief Executive Officer of Physia Corp. He served as President of Scripps Clinic from July 1996 to October 1999. He holds a B.A. in economics from Yale University and attended New York University Graduate School of Business Administration.

**Sidney Braginsky** has served as a member of our board of directors since 2001. He also currently serves as the Chairman and Chief Executive Officer of Digilab, LLC (a spectroscopy instruments manufacturer), Chief Executive Officer and President of Ineedmd, Ltd., Chairman of Double D Venture Fund, LLC, Chairman of the Board of the City University of New York Robert Chambers Laboratory and Trustee on the Boards of Long Island High Tech Incubator and the Long Island Museum of Science and Technology. He formerly served as President of Olympus America and Mediscience Corp., Chairman of Atropos Technologies, LLC and International Standards Organization Optics, and a director for Noven Pharmaceuticals, Inc. Mr. Braginsky received his B.S. in biology from Queens College.

**George C. Chryssis** has served as a member of our board of directors since 2001. Since 2003, he has served as President, Chief Executive Officer and Chairman of the Board of MISTsoft Corp., a privately-held software company which he founded. Since 2000, he has served as the Managing Member of Arcadian Capital Management, LLC, and General Partner of Arcadian Venture Partners, LP, a venture capital firm with investments in early stage technology companies, including EOS. Since 2003, he has also served as Chairman of the Board of Directors of DelCom Corp., a privately-held telecommunications software company. Mr. Chryssis received a B.S. and M.S. in electrical engineering from Northeastern University.

**Martin D. Cleary** will become a member of our board of directors upon completion of this offering. Since February 2003, he has served as the President and Chief Executive Officer of Juvaris Biotherapeutics, Inc., a company engaged in the development of therapeutic vaccines for cancer and infectious diseases. From September 1999 to May 2002, he served as the President and Chief Executive Officer of Genteric, Inc., a company engaged in non-viral gene delivery. Mr. Cleary received a B.S. in accounting from Rutgers University in 1971, and a certificate in international studies from Columbia University in 1973.

**Dan W. Lufkin** has served as a member of our board of directors since July 2003. He is also a co-founder and former Chairman of the investment banking firm, Donaldson, Lufkin & Jenrette, Inc. Mr. Lufkin currently serves as a consultant to and/or board member of a number of private companies and non-profit endeavors. Mr. Lufkin received a B.A. degree from Yale University and an M.B.A. from Harvard Business School.

**Gerald Wagner, Ph.D.** was appointed as a member of our board of directors in May 2005. Since 2002, he has owned and operated Gerald Wagner Consulting LLC, an international consulting company specializing in: international project management; technology and application consulting; and company assessments. From March 1992 to September 2003, he was a Senior Vice President, Lab Testing Systems, at Bayer, Inc. Mr. Wagner received a Masters and Ph.D. in electro-mechanical design from Technical University, Darmstadt, Germany.

## **Board of Directors Composition**

Our current charter documents and the charter documents we expect to be in effect upon completion of this offering authorize up to nine (9) directors. We currently have six (6) directors and expect to have seven (7) directors upon completion of the initial public offering. Joseph V. Gulfo, M.D., Breaux Castleman, Dan W. Lufkin and George C. Chryssis were elected pursuant to voting provisions contained in a voting agreement that we entered into with certain holders of our common stock and preferred stock. Upon the closing of this offering, the voting agreement will be terminated and none of our stockholders will have any special rights regarding board representation. See “Related Party Transactions — Voting Agreement” for additional information regarding the voting agreement.

## **Board Committees**

*Audit Committee.* The current members of our audit committee are Messrs. Braginsky and Lufkin, each of whom we believe satisfies the independence requirements of the NASDAQ National Market and the SEC. Mr. Cleary will join the audit committee upon completion of the offering and will chair the committee. We believe Mr. Cleary satisfies the independence requirements of the NASDAQ National Market and the SEC. In addition, we believe Mr. Cleary is qualified as an audit committee financial expert under the regulations of the SEC, and has the accounting and related financial management expertise required by the NASDAQ National Market. Our audit committee assists our board in its oversight of:

- the integrity of our financial statements;
- our independent registered public accounting firm’s qualifications and independence; and
- the performance of our independent auditors.

The audit committee has the sole and direct responsibility for appointing, evaluating and retaining our independent registered public accounting firm and for overseeing their work. All audit services to be provided to us and all non-audit services, other than de minimis non-audit services, to be provided to us by our independent auditors must be approved in advance by our audit committee.

*Compensation Committee.* The members of our compensation committee are Messrs. Castleman, Braginsky and Chryssis, each of whom we believe satisfies the independence requirements of the NASDAQ National Market and the SEC. Mr. Castleman chairs this committee. The purpose of our compensation committee is to discharge the responsibilities of our board of directors relating to compensation of our executive officers. Specific responsibilities of our compensation committee include:

- reviewing and recommending compensation of our executive officers;
- administering our stock incentive plans; and
- reviewing and recommending incentive compensation and equity plans.

*Nominating and Governance Committee.* The members of our nominating and governance committee are Messrs. Lufkin and Castleman, each of whom we believe satisfies the independence requirements of the NASDAQ National Market. Mr. Lufkin will chair this committee. Mr. Cleary will join the nominating and governance committee upon completion of the offering. Our nominating and governance committee:

- identifies and recommends nominees for election to our board of directors;
- develops and recommends our corporate governance principles; and
- oversees the evaluation of our board of directors and management.

## **Compensation Committee Interlocks and Insider Participation**

We did not have a compensation committee until May 2005. Dr. Gulfo, our Chief Executive Officer, previously participated in the deliberations regarding executive compensation. None of our executive officers has served as a member of the compensation committee, or other committee serving an equivalent function, of any other entity, one of whose executive officers served as a member of our compensation committee.



## Election of Directors

The number of directors is determined by the stockholders at their annual meeting, subject to the right of the stockholders to change such number between annual meetings and to the right of our board to increase such number between annual meetings.

## Director Compensation

After completion of this offering, in addition to reimbursement of expenses incurred in attending meetings of our board of directors and committees of our board, our non-employee directors will receive an annual fee of \$10,000 for serving as directors and an additional \$500 per meeting for each meeting attended, whether in person or by telephone. In addition, after completion of this offering, the chairman of our board of directors, the chairman of our audit committee and the chairman of our nominating and governance committee will each receive an annual fee of \$10,000. After completion of this offering, each member of our board who is not a company employee will receive an annual stock option grant to purchase up to 5,000 shares of common stock. Such stock options will vest in full upon the first anniversary of issuance and have an exercise price equal to the fair market value of our common stock on the date of the grant. In addition, we reimburse each member of our Board who is not a company employee for reasonable travel and other expenses in connection with attending meetings of the Board.

## Scientific and Medical Advisory Committee

We have established a Scientific and Medical Advisory Committee made up of leading experts in the fields of dermatology and oncology. Members of our Scientific and Medical Advisory Committee consult with us regularly on matters relating to:

- our research and development programs;
- the design and implementation of our clinical trials;
- market opportunities from a clinical perspective;
- new technologies relevant to our research and development programs; and
- scientific and technical issues relevant to our business.

The current members of our Scientific and Medical Advisory Committee are:

| <u>Name</u>                    | <u>Professional Affiliation</u>   |
|--------------------------------|---|
| Jeffrey P. Callen, M.D.        | Professor and Chief of the Division of Dermatology, University of Louisville School of Medicine; Member of the Board of Directors of the American Board of Dermatology, Inc.  |
| Armand B. Coggnetta, Jr., M.D. | Dermatologist in private practice with Dermatology Associates of Tallahassee; Member, American Academy of Dermatology; former President of Florida Society of Dermatology; former President of Dermatology Photography Society.   |
| Robert Friedman, M.D.          | Clinical Assistant Professor, Department of Dermatology, New York University School of Medicine; Past Director, American Cancer Society, New York City Division, and Member, Professional Education Committee; American Academy of Dermatology; Member, Skin Cancer/ Melanoma Committee, Past Chairman, Industry Liaison Committee. |

| Name                                | Professional Affiliation  |
|-------------------------------------|---|
| Martin C. Mihm, Jr., M.D., Chairman | Professor and Chief of Dermatopathology at Harvard Medical School; Chief of Dermatopathology at Massachusetts General Hospital; Co-Director of the Pigmented Skin Lesion Clinic at Massachusetts General Hospital; Co-Chairman of the Melanoma Pathology Program of the World Health Organization; Co-Director of the Rare Tumor Institute of the World Health Organization; member of the editorial and advisory board of the American Journal of Dermatopathology and the International Journal of Surgical Pathology; Member of the American Academy of Dermatology; New England Pathology Society; American Society of Dermatopathology; American Society of Clinical Oncology; and College of American Pathologists. |
| Harold S. Rabinovitz, M.D.          | Dermatologist in private practice with Skin and Cancer Associates in Plantation, Florida; Voluntary Professor of Dermatology at the University of Miami-School of Medicine; Associate Editor of the Journal of Dermatologic Surgery; member of the Board of Directors of the South Florida Dermatology Foundation.  |
| Darrell S. Rigel, M.D.              | Clinical Professor of Dermatology, New York University Medical Center; Secretary and Treasurer of the American Dermatological Association; Past President, American Academy of Dermatology; Member, Board of Directors of the American Cancer Society New York City Division and Chairman of its Subcommittee on Skin Cancer.   |
| Arthur J. Sober, M.D.               | Professor of Dermatology, Harvard Medical School; Director of Dermatology Clinical Investigation Unit, Massachusetts General Hospital; Member, American Joint Commission on Cancer.   |

**Medical Advisor and Liaison to Our Board of Directors**

Robert Friedman, M.D., a member of our Scientific and Medical Advisory Committee, serves as a medical advisor to our board of directors and a liaison between our Scientific and Medical Advisory Committee and our board of directors. See “Consulting Agreements — Consulting Agreement with Robert Friedman, M.D.”

## Executive Compensation

The following table sets forth summary compensation information for the years ended December 31, 2002, December 31, 2003 and December 31, 2004 for our chief executive officer and each of our two other most highly compensated executive officers whose salary and bonus for 2004 was more than \$100,000. As of December 31, 2004, there were no other persons serving as executive officers. We have also included summary compensation information for two executive officers who would have been among the four other most highly compensated executive officers whose salary and bonus for 2004 would have been more than \$100,000 had they served as executive officers for the full year. We refer to these officers collectively as our named executive officers.

**Summary Compensation Table**

| <u>Name and Principal Position</u>                      | <u>Year</u> | <u>Annual Compensation</u> |                   | <u>Long Term Compensation</u>        | <u>All Other Compensation</u> |
|---|-------------|----------------------------|-------------------|--------------------------------------|-------------------------------|
|   |             | <u>Salary (\$)</u>         | <u>Bonus (\$)</u> | <u>Securities Underlying Options</u> |                               |
| Joseph V. Gulfo, M.D.                                   | 2004        | \$ 173,656                 | —                 | 81,753(1)                            | \$ 19,880(1)                  |
| President and Chief Executive Officer                   | 2003        | —                          | —                 | —                                    | —                             |
|   | 2002        | —                          | —                 | —                                    | —                             |
| Marek Elbaum, Ph.D.                                     | 2004        | 173,549                    | —                 | 10,000                               | —                             |
| Founder and former Chief Science and Technology Officer | 2003        | 81,085                     | —                 | 29,071                               | —                             |
|   | 2002        | 30,204                     | —                 | —                                    | —                             |
| William Bronner   | 2004        | 132,612                    | —                 | 37,000                               | —                             |
| Vice President, Legal Counsel and Compliance            | 2003        | 106,255                    | —                 | 32,161                               | —                             |
|   | 2002        | 26,444                     | —                 | 1,875                                | —                             |
| Karen Krumeich(2)                                       | 2004        | —                          | —                 | 60,000                               | —                             |
| Vice President Finance, Chief Financial Officer         | 2003        | —                          | —                 | —                                    | —                             |
|   | 2002        | —                          | —                 | —                                    | —                             |
| Jon I. Klippel(3)                                       | 2004        | 9,346                      | —                 | 45,000                               | —                             |
| Vice President Marketing and Sales                      | 2003        | —                          | —                 | —                                    | —                             |
|   | 2002        | —                          | —                 | —                                    | —                             |

(1) Dr. Gulfo has been granted another stock option which is not reflected in this table because the number of shares purchasable under the option can only be calculated at the time of PMA approval of MelaFind®. The number of shares granted under this option is equal to that number of shares of our common stock equal to four percent of our fully-diluted capital stock at that time of PMA approval of MelaFind® minus 81,753 shares of our common stock. The exercise price of this option is \$0.46 per share.

(2) Ms. Krumeich's employment with us began in January 2005 at an annual salary of \$165,000.

(3) Mr. Klippel's employment with us began in December 2004 at an annual salary of \$135,000.

## Stock Options Granted in 2004

The following table provides information regarding stock options granted during 2004 to the named executive officers in that period. We have not granted any stock appreciation rights.

| Name                     | Number of Securities Underlying Options Granted | % of Total Options Granted to Employees in Fiscal Year | Exercise or Base Price Per Share(1) | Expiration Date | Potential Realizable Value of Assumed Annual Rates of Stock Price Appreciation for Option Term(2) |              |
|--------------------------|---|--|-------------------------------------|-----------------|---|--------------|
|                          |   |  |                                     |                 | 5%  | 10%          |
| Joseph V. Gulfo, M.D.(3) | 75,227  | 11.07%   | \$ 0.46                             | 2/02/09         | \$ 829,493  | \$ 1,055,780 |
|                          | 6,526   | 0.09   | 0.46                                | 2/02/09         | 71,959  | 91,590       |
| Marek Elbaum, Ph.D.(4)   | 10,000  | 1.47   | 0.46                                | 2/02/09         | 110,265   | 140,346      |
| Karen Krumeich           | 60,000  | 8.82   | 0.46                                | 12/17/09        | 661,592   | 842,075      |
| William R. Bronner       | 17,000  | 2.50   | 0.46                                | 2/02/09         | 187,451   | 238,588      |
|                          | 20,000  | 2.94   | 0.46                                | 12/17/09        | 220,531   | 280,692      |
| Jon I. Klippel           | 45,000  | 6.62   | 0.46                                | 12/17/09        | 496,194   | 631,557      |

- (1) Exercise price is equal to the fair market value on the date of grant as determined by our board of directors.
- (2) The dollar amounts under these columns are the result of calculations at rates set by the SEC and, therefore, are not intended to forecast possible future appreciation, if any, in the price of the underlying common stock. The potential realizable values are calculated using an assumed initial public offering price of \$9.00 per share, the mid-point of our filing range, and assuming that the market price appreciates from this price at the indicated rate for the entire term of each option and that each option is exercised and sold on the last day of its term at the assumed appreciated price. Actual gains, if any, on stock option exercises depend on the future performance of the common stock and overall stock market conditions. The amounts reflected in the following table may not necessarily be achieved.
- (3) Dr. Gulfo has been granted another stock option which is not reflected in this table because the number of shares purchasable under the option can only be calculated at the time of PMA approval of MelaFind®. The number of shares granted under this option is equal to that number of shares of our common stock equal to four percent of our fully-diluted capital stock at that time of PMA approval of MelaFind® minus 81,753 shares of our common stock.
- (4) Formerly our Chief Science and Technology Officer.

## Aggregated Option Exercises in 2004 and Year-End Option Values

The following table provides information about the number of shares issued upon option exercises by our named executive officers as of December 31, 2004 and the value realized by our named executive officers. The table also provides information about the number and value of options held by our named executive officers at December 31, 2004.

| Name                     | Number of Unexercised Securities Underlying Options at December 31, 2004 |               | Value of Unexercised In-the-Money Options at December 31, 2004(1) |               |
|--------------------------|--|---------------|---|---------------|
|                          | Exercisable  | Unexercisable | Exercisable   | Unexercisable |
| Joseph V. Gulfo, M.D.(2) | 71,535   | 10,218        | \$ 610,909  | \$ 87,262     |
| Marek Elbaum, Ph.D.(3)   | 14,070   | 25,000        | 112,560   | 214,500       |
| Karen Krumeich           | 0  | 60,000        | —   | 512,400       |
| William R. Bronner       | 49,160   | 21,875        | 402,620   | 185,719       |
| Jon I. Klippel           | 0  | 45,000        | —   | 384,300       |

- (1) There was no public trading market for our common stock as of December 31, 2004. Accordingly, as permitted by the rules of the SEC, we have calculated the value of unexercised in-the-money options

assuming an initial public offering price of \$9.00 per share, the mid-point of our filing range, less the aggregate exercise price, without taking into account any taxes that might be payable in connection with the transaction.

- (2) Dr. Gulfo has been granted another stock option which is not reflected in this table because the number of shares purchasable under the option can only be calculated at the time of PMA approval of MelaFind®. The number of shares granted under this option is equal to that number of shares of our common stock equal to four percent of our fully-diluted capital stock at that time of PMA approval of MelaFind® minus 81,753 shares of our common stock.
- (3) Formerly our Chief Science and Technology Officer.

## **Equity Compensation Plans**

### ***2005 Stock Incentive Plan***

In 2005, we adopted our 2005 Stock Incentive Plan (2005 Plan). The 2005 Plan permits the granting of awards to key employees, directors, officers, consultants and scientific collaborators in the form of incentive or nonqualified stock options and equity-based awards. Stock options granted under the 2005 Plan may be “incentive stock options” meeting the requirements of Section 422 of the Code or nonqualified stock options, which do not meet the requirements of Section 422. Stock awards granted under the 2005 Plan to eligible participants may take the form of the issuance and transfer to the recipient of shares of common stock or a grant of stock units representing a future right to such shares of common stock. As of the date of this offering, there are 1,000,000 shares of our common stock authorized and reserved for issuance upon exercise of options which may be granted under the 2005 Plan and no options or other equity based awards have been issued under the 2005 Plan. Pursuant to the 2005 Plan on each of January 1, 2006 and January 1, 2007, the number of shares of common stock authorized for issuance will be automatically increased by an amount equal to 3% of the then outstanding shares of common stock unless the board decides to reduce the amount of the increase.

### ***2003 Stock Incentive Plan***

In 2003, we adopted our 2003 Stock Incentive Plan, as amended (2003 Plan). The 2003 Plan permitted the granting of awards to our employees and other key persons (including directors, officers, consultants and scientific collaborations) in the form of restricted stock, and incentive or nonqualified stock options. Stock options granted under the 2003 Plan may be “incentive stock options” meeting the requirements of Section 422 of the Code or nonqualified stock options which do not meet the requirements of Section 422. As of June 30, 2005, options to purchase 639,697 shares of our common stock are outstanding under the 2003 Plan. No options or other equity-based awards have been granted under the 2003 Plan since the adoption of the 2005 Plan, and no further options or other equity-based awards are issuable under the 2003 Plan. As of June 30, 2005, no options granted under the 2003 Plan have been exercised.

### ***1996 Stock Option Plan***

In 1996, we adopted our 1996 Stock Option Plan (1996 Plan). The 1996 Plan permitted the granting of awards to our officers, key employees, directors and collaborating scientists in the form of incentive or nonqualified stock options. Stock options granted under the 1996 Plan may be “incentive stock options” meeting the requirements of Section 422 of the Code or nonqualified stock options which do not meet the requirements of Section 422. Since the adoption of the 2003 Plan, we have not granted any stock options under the 1996 Plan. As of June 30, 2005, options to purchase 260,178 shares of our common stock are outstanding under the 1996 Plan. No further options or other equity-based awards are issuable under the 1996 Plan. As of June 30, 2005, no options granted under the 1996 Plan have been exercised.

## **Employment Agreement**

### ***Employment Agreement with Joseph V. Gulfo, M.D.***

On January 5, 2004, we entered into an employment agreement with Dr. Joseph V. Gulfo, our President and Chief Executive Officer. Pursuant to the agreement, Dr. Gulfo is required to devote

substantially all of his business time, attention and efforts to the performance of his duties under the agreement. The initial term of the employment agreement extends until December 31, 2005 and will automatically renew for successive twelve-month (12) terms unless either party sends a written notice of termination within 90 days of the expiration of the initial term or renewal term, as the case may be.

The employment agreement provides Dr. Gulfo with an annual base salary of \$175,000 subject to periodic review by our board of directors. Our board of directors has determined that Dr. Gulfo was entitled to a review and salary increase in an amount to be agreed by Dr. Gulfo and the Company as a result of the equity financing consummated in October 2004, but to date our board of directors has not conducted a review or granted a salary increase. Dr. Gulfo is also entitled to receive yearly bonuses at the discretion of our board of directors. The target for such bonuses is 50% of Dr. Gulfo's then current base salary.

In addition, Dr. Gulfo is entitled to be reimbursed for certain travel expenses up to \$1,100 per month, \$2,000 per month for lodging expenses and for certain communication expenses, including cellular phone service and broadband internet service.

If Dr. Gulfo's employment is terminated by us without cause or Dr. Gulfo resigns for good reason, then Dr. Gulfo would be entitled to receive severance pay equal to 15 months of his then current base salary and, if Dr. Gulfo is then covered by health insurance provided by us, the cost to Dr. Gulfo of COBRA coverage for 15 months. If we elect not to renew Dr. Gulfo's employment agreement, Dr. Gulfo is entitled to an amount equal to his then current base salary for nine months and, if Dr. Gulfo is covered by our health insurance policy at such time, the cost of COBRA for nine months (subject to reduction to the extent Dr. Gulfo received comparable benefits from a subsequent employer during such nine month period).

Dr. Gulfo is subject to a non-compete covenant upon termination of his employment by us or him. The term of Dr. Gulfo's non-compete covenant is one (1) year, which can be extended to two (2) years in the event we elect to pay him additional severance equal to twelve (12) months of his base salary at the time of termination and his most recent bonus (if any).

The employment agreement provides for three separate grants of stock options. As of May 15, 2005, the first two stock option grants for the purchase of a total of 81,753 shares of our common stock at an exercise price of \$0.46 per share have fully vested. The number of shares of our common stock subject to the third stock option can only be calculated at the time of PMA approval of MelaFind®. The number of shares purchasable under this option at an exercise price of \$0.46 per share is equal to that number of shares of our common stock equal to four percent of our fully-diluted capital stock at the time of PMA approval of MelaFind® minus the number of shares of common stock underlying options granted to Dr. Gulfo under the employment agreement, which is 81,753. Assuming that 9,513,164 shares are outstanding as of the completion of this offering and remain the total number of shares outstanding on the date we receive PMA approval of MelaFind®(assuming in both cases the exercise of all outstanding options and warrants and the conversion of all convertible securities), the number of shares subject to this option would be 345,699. This third stock option grant vests 50% at the time of PMA approval of MelaFind®, and the remaining 50% vests in four equal installments over the one year period following such PMA approval of MelaFind®.

## **Consulting Agreements**

### *Consulting Agreement with Breaux Castleman*

In June 2003, we entered into a consulting agreement with Breaux Castleman for consulting services related to FDA approval of MelaFind®, administrative matters, financial reporting, and our business and financial strategy. Under this agreement, Mr. Castleman receives compensation for each month of services rendered. During 2003 Mr. Castleman was paid at the rate of \$8,000 for each month of services rendered and thereafter from 2004 onward he has been paid at the rate of \$2,000 for each month of services rendered. We made payments pursuant to this consulting agreement of \$48,000 in 2003, \$22,000 in 2004, and \$12,000 in 2005. These payments did not exceed \$60,000 in any twelve-month period since June 2003. In connection with our consulting agreement with Mr. Castleman, we granted Mr. Castleman a restricted

stock award of 75,000 shares of our common stock under our 2003 Plan for an aggregate purchase price of \$34,500. Mr. Castleman issued an interest-bearing promissory note in the principal amount of \$34,500 as payment for these shares. During the second quarter of 2005, this note was repaid in full. Our consulting agreement with Mr. Castleman is terminable by either party on 30 days' written notice.

*Consulting Agreement with Marek Elbaum, Ph.D.*

Pursuant to a consulting agreement effective as of May 31, 2005, we retained Marek Elbaum, Ph.D., our founder and former Chief Science and Technology Officer, as our Chief Scientist to provide services relating to the integration of our product development, mentoring and advising our staff scientists, providing new product vision, supporting of our research and development and providing such other services as assigned to him by our Chief Executive Officer. Pursuant to the consulting agreement, Dr. Elbaum will provide us with a majority of his business time in consideration of a monthly fee of approximately \$14,500. The term of such agreement extends for a period of two years and is automatically renewable for an additional one year period unless either Dr. Elbaum or we decide to not so renew. In the event of a non-renewal, and in the event that Dr. Elbaum's services terminate as a result of his death or disability, we will pay to Dr. Elbaum a termination fee of \$100,000. In addition, upon termination of the consulting agreement for any reason other than a termination by us for cause, we will pay to Dr. Elbaum for 18 months an amount equal to what Dr. Elbaum would have had to pay to extend his insurance coverage under COBRA. Dr. Elbaum is subject to a non-compete covenant during the term of the consulting agreement and for a period of two years after the term of the consulting agreement. We have also agreed that all stock options previously granted to Dr. Elbaum will continue to vest in accordance with their original terms.

*Consulting Agreement with Robert Friedman, M.D.*

Pursuant to a consulting agreement effective as of June 1, 2005, we have retained the services of Robert Friedman, M.D. for an initial term of one year as a consultant, medical advisor to our board of directors, and as a liaison between our board of directors and our Scientific and Medical Advisory Committee, and in connection with the clinical testing of MelaFind®. In consideration of rendering of these services, Dr. Friedman will be paid at a rate of \$5,000 per day (assuming an eight-hour day) for up to 30 days of service. The consulting agreement is automatically renewed for successive one-year terms unless either party terminates the agreement at least 30 days prior to the expiration of the agreement.

*Consulting Agreement with Gerald Wagner, Ph.D.*

Pursuant to a consulting agreement dated as of June 1, 2005 with Gerald Wagner Consulting LLC (GWC), a company owned and operated by Dr. Gerald Wagner, GWC has agreed to direct our MelaFind® product development efforts and oversee the manufacturing process for a period that began June 1, 2005 and ends three months following the initiation of our pivotal clinical trial of MelaFind®. The consulting agreement provides for a flat fee of \$150,000, payable ratably over the course of the term, and the grant to Dr. Wagner immediately after completion of this offering of a non-qualified stock option to purchase up to 50,000 shares of our common stock at the public offering price per share.

**Limitation of Liability and Indemnification of Directors and Officers**

Our fourth amended and restated certificate of incorporation and third amended and restated bylaws provide that we will indemnify our directors and executive officers and may indemnify our other officers and employees and other agents to the fullest extent permitted by law. Our fourth amended and restated certificate of incorporation and third amended and restated bylaws also permit us to secure insurance on behalf of any officer, director, employee or other agent for any liability arising out of his or her actions in such capacity, regardless of whether the bylaws would permit indemnification. We maintain directors' and officers' liability insurance. We believe that these provisions and agreements are necessary to attract and retain qualified persons as directors and executive officers.

## RELATED PARTY TRANSACTIONS

We also describe below certain other transactions with our directors, executive officers and stockholders.

### *Common Stock*

In June 2003, we sold 75,000 shares of our common stock at a price of \$0.46 per share to Dr. Robert Friedman, a former member of our board of directors, and 75,000 shares of our common stock at a price of \$0.46 per share to Breaux Castleman, a member of our board of directors, and the chairman of our board. In May 2004, we issued 125,000 shares of our common stock at a per share purchase price of \$0.46 to investors who loaned an aggregate of \$1,000,000 to the Company, which loans were evidenced by convertible promissory notes, all of which converted into shares of our Series C preferred stock on October 26, 2004.

### *Preferred Stock*

All share numbers and share prices presented below for our preferred stock and Series C preferred stock warrants do not reflect the 1-for-2 reverse stock split approved by our board of directors on May 13, 2005 with respect to our common stock. The reverse split will be effective after the conversion of our preferred stock and thus the shares of our common stock into which our preferred stock will convert will be subject to the reverse stock split.

In 1998, we issued 198,000 shares of our Series A preferred stock at a per share purchase price of \$5.00 to 22 accredited investors for an aggregate consideration of \$990,000. All shares of Series A preferred stock will convert into an aggregate of 115,201 shares of our common stock upon completion of this offering.

In 2000 and 2001, we issued an aggregate of 947,986 shares of our Series B preferred stock in three transactions at per share purchase prices of \$5.1282 and \$6.50 to 149 accredited investors for an aggregate consideration of \$5,894,409. The rights of the holders of Series B preferred stock were identical except for the purchase prices paid for such stock. The purchasers of our Series B preferred stock included Arcadian Venture Partners L.P., a venture fund with which George C. Chryssis, a member of our board of directors, is affiliated, and Double D Venture Fund, LLC, a venture fund with which Sidney Braginsky, a member of our board of directors, is affiliated.

On June 20, 2003, we issued an aggregate of 45,000 shares of our Series B preferred stock to the original Series B preferred stock investors in consideration of certain amendments to their investment agreements, bringing the total number of shares of our Series B preferred stock outstanding to 992,986. All shares of our Series B preferred stock will convert into an aggregate of 575,532 shares of our common stock upon completion of this offering.

From June 2003 to October 2004, we sold an aggregate of 5,414,779 shares of our Series C preferred stock (together with warrants to purchase an aggregate of 2,610,643 shares of our common stock, all of which warrants will be converted into an aggregate of 1,305,321 shares of our common stock pursuant to the warrant exchange described below under "Warrants to Purchase Common Stock") to 73 accredited investors for an aggregate consideration of \$12,191,480. These investors included: Breaux Castleman, a member of our board of directors and chairman of our board; Dr. Robert Friedman, a member of our scientific and medical advisory committee and former member of our board of directors; Double D Venture Fund, LLC, a venture fund with which Sidney Braginsky, a member of our board of directors, is affiliated; and Dan W. Lufkin, a member of our board of directors. All shares of our Series C preferred stock will convert into an aggregate of 2,707,372 shares of our common stock upon completion of this offering.

### *Warrants to Purchase Preferred Stock*

In June 2003, we issued a warrant to purchase up to 24,890 shares of our Series C preferred stock at an exercise price of \$2.26 per share to Koji Miyazaki, one of our Series C preferred stock investors.



In February 2004, we issued a warrant to purchase up to 121,681 shares of our Series C preferred stock with an exercise price of \$2.26 per share to Health Partners I, LLC (HP I). In November 2004, HP I was dissolved and this warrant, together with all shares of our Series C preferred stock and warrants to purchase our common stock previously issued to HP I, were distributed to HP I's members, which included: Dr. Robert Friedman, a member of our scientific and medical advisory committee and a former member of our board of directors; Breaux Castleman, a member of our board of directors and chairman of our board; and Dan W. Lufkin, a member of our board of directors. Assuming conversion of our preferred stock prior to completion of this offering, these warrants and the warrant issued to Mr. Miyazaki will be exercisable for an aggregate of 73,280 shares of our common stock at an exercise price of \$4.52 per share.

#### *Warrants to Purchase Common Stock*

Prior to the closing of this offering, we will consummate an exchange of warrants to purchase our common stock for shares of our common stock under a plan of recapitalization to be adopted by our board of directors. During the period from June 2003 through October 2004, we issued warrants to purchase an aggregate of up to 2,610,643 shares of our common stock to certain holders of our Series C preferred stock. All of these warrants have an exercise price of \$13.00 per share. In June 2003, we also issued a warrant to Dr. Marek Elbaum, our former Chief Science and Technology Officer, to purchase up to 25,000 shares of our common stock at per share exercise price of \$13.00. In December 2004, we issued a warrant to Allen & Company LLC to purchase up to 75,000 shares of our common stock at an exercise price of \$7.00 per share (Allen & Company Warrant) in consideration of Allen & Company's agreement to provide certain advisory services to us. Warrants to purchase a total of 2,610,643 shares of our common stock will be exchanged for a total of 1,305,321 shares of our common stock based on an exchange ratio of one share of our common stock for every two shares of our common stock purchasable under the warrants (Warrant Exchange).

After completion of the Warrant Exchange, the only warrants that will remain outstanding as of the date of this offering are the Allen & Company Warrant, the underwriters' warrant (see "Underwriting") and warrants to purchase an aggregate of 146,571 shares of our Series C preferred stock, which assuming conversion of such Series C preferred stock will be exercisable for an aggregate of 73,280 shares of our common stock.

#### *Options*

From inception to June 30, 2005, we have granted an aggregate of 525,989 options to our current directors and named executive officers, with exercise prices ranging from \$0.46 to \$10.00 per share.

#### *Voting Agreement*

We entered into a voting agreement with certain holders of our common stock and preferred stock, which fixes the size of our board of directors at nine and entitles the holders of a majority of our common stock to designate two directors, the holders of a majority of our Series B preferred stock to designate one director and the holders of a majority of our Series C preferred stock to designate four directors. Currently, Joseph V. Gulfo, M.D. is the sole designee of the holders of our common stock, George C. Chrysis is the designee of the holders of our Series B preferred stock, and Breaux Castleman and Dan W. Lufkin are the sole designees of the holders of our Series C preferred stock. Upon the closing of this offering, the voting agreement will be terminated and none of our stockholders will have any special rights regarding board representation.

## PRINCIPAL STOCKHOLDERS

The following tables set forth as of June 30, 2005, and as adjusted to reflect the sale of the shares offered hereby, certain information regarding beneficial ownership of our common stock by:

- each person or group of affiliated persons known to us to beneficially own more than 5% of our common stock;
- each named executive officer;
- each of our directors; and
- all of our executive officers and directors as a group.

The percentage of ownership indicated in the following table is based on 6,513,164 shares of common stock outstanding on June 30, 2005 and 9,513,164 shares of common stock outstanding immediately following the completion of this offering, each of which assumes the conversion of all outstanding shares of our preferred stock and consummation of the Warrant Exchange. The table assumes no exercise of the underwriters' over-allotment option.

Information with respect to beneficial ownership has been furnished by each director, officer, beneficial owner of more than 5% of our common stock or selling stockholder and is determined in accordance with the rules of the SEC. Except as indicated by footnote and subject to community property laws where applicable, to our knowledge, the persons named in the table below have sole voting and investment power with respect to all shares of common stock shown as beneficially owned by them. In computing the number of shares beneficially owned by a person and the percentage of ownership of that person, shares of common stock subject to options or warrants held by that person that are currently exercisable or will become exercisable within 60 days after June 30, 2005 are deemed outstanding, while such shares are not deemed outstanding for purposes of computing percentage ownership of any other person.

| Name of Beneficial Owner   | Number of<br>Shares of Common<br>Stock Beneficially<br>Owned |   | Percentage of Shares<br>Beneficially Owned |                       |
|--|--|---|--|-----------------------|
|  | Shares   | Options and<br>Warrants<br>Exercisable<br>Within 60<br>Days | Before the<br>Offering                     | After the<br>Offering |
| <b>Named Executive Officers</b>  |  |   |  |                       |
| Joseph V. Gulfo, M.D.  | —  | 81,753  | 1.2%                                       | *                     |
| Marek Elbaum, Ph.D.(1)   | 462,500  | 14,070  | 7.3  | 5.0%                  |
| Karen Krumeich   | —  | 60,000  | *  | *                     |
| William R. Bronner   | 4,850  | 70,285  | 1.1  | *                     |
| Jon I. Klippel   | —  | 45,000  | *  | *                     |
| <b>Directors</b>   |  |   |  |                       |
| Breaux Castleman   | 91,570   | 6,168   | 1.5  | 1.0                   |
| Sidney Braginsky(2)  | 51,500   | 5,000   | *  | *                     |
| George C. Chryssis(3)  | 94,717   | 12,500  | 1.6  | 1.1                   |
| Dan W. Lufkin(4)   | 356,231  | 29,187  | 5.9  | 4.0                   |
| Gerald Wagner, Ph.D.   | —  | —   | —  | —                     |
| All directors and named executive officers as a group (all 10 persons) | 1,061,368  | 323,963   | 20.3%                                      | 14.1%                 |
| <b>Holders of more than 5%</b>   |  |   |  |                       |
| Patricia and Stanley Brilliant(5)                                      | 349,532  | 2,342   | 5.4  | 3.7                   |
| S. Donald Sussman(6)   | 917,767  | 11,693  | 14.2                                       | 9.8                   |
| Eric Dobkin(7)   | 351,523  | 7,015   | 5.5  | 3.8                   |

---

\* Less than one percent.

- (1) Marek Elbaum, Ph.D. resigned as a director and our Chief Science and Technology Officer effective as of May 31, 2005.
- (2) Includes 51,500 shares of common stock held by Double D Venture Fund, LLC, an investment fund with which Mr. Braginsky is affiliated. Mr. Braginsky expressly disclaims ownership of these shares except to the extent of his pecuniary interest in Double D Venture Fund, LLC
- (3) Includes 94,717 shares of common stock held by Arcadian Venture Partners, L.P., an investment fund with which Mr. Chryssis is affiliated. Mr. Chryssis expressly disclaims ownership of these shares except to the extent of his pecuniary interest in Arcadian Venture Partners, L.P.
- (4) Includes 140,570 shares of common stock held by trusts the beneficiaries of which are family members of Mr. Lufkin and 5,840 shares of common stock issuable upon exercise of Series C preferred stock warrants. Mr. Lufkin expressly disclaims ownership of the shares held by these trusts.
- (5) Patricia and Stanley Brilliant are husband and wife. Their business address is: 180 East End Avenue, Apt. 4A, New York, NY 10128.
- (6) The business address of S. Donald Sussman is: 2 American Lane, Greenwich, CT 06836.
- (7) The business address of Eric Dobkin is: 160 Old Church Lane, Pound Ridge, NY 10576.

## DESCRIPTION OF CAPITAL STOCK

The following information describes our common stock and preferred stock and provisions of our fourth amended and restated certificate of incorporation and our third amended and restated bylaws as in effect upon the closing of this offering. This description is only a summary. You should also refer to the fourth restated certificate of incorporation and third amended and restated bylaws which will be filed with the SEC as exhibits to our registration statement of which this prospectus forms a part. The descriptions of the common stock and preferred stock reflect changes to our capital structure that will occur upon the receipt of the requisite board and stockholder approvals and upon the closing of this offering in accordance with the terms of the fourth amended and restated certificate of incorporation.

Upon completion of this offering, and after giving effect to the conversion of all outstanding convertible preferred stock into common stock and the amendment of our fourth amended and restated certificate of incorporation, our authorized capital stock will consist of 30,000,000 shares of common stock, \$0.001 par value per share, and 10,000,000 shares of preferred stock, \$0.10 par value per share. As of June 30, 2005, there were 6,513,164 shares of our common stock outstanding held of record by 242 stockholders.

### Common Stock

Subject to preferences that may be applicable to any shares of preferred stock outstanding at the time, the holders of common stock are entitled to the following:

*Dividends.* The holders of outstanding shares of our common stock are entitled to receive dividends out of assets legally available for the payment of dividends at the times and in the amounts as our board of directors from time to time may determine, subject to any preferential dividend rights of any holder of outstanding shares of our preferred stock.

*Voting.* Each holder of common stock is entitled to one vote for each share of common stock held on all matters submitted to a vote of stockholders, including the election of directors. We have not provided for cumulative voting for the election of directors in our fourth restated certificate of incorporation. This means that the holders of a majority of the shares voted can elect all of the directors then standing for election.

*Preemptive rights, conversion and redemption.* Our common stock is not entitled to preemptive rights and is not subject to conversion or redemption.

*Liquidation, dissolution and winding-up.* Upon our liquidation, dissolution or winding-up, the holders of common stock are entitled to share ratably in all assets remaining after payment of liabilities and the liquidation preferences of any preferred stock.

Each outstanding share of common stock is, and all shares of common stock to be issued in this offering when they are paid for, will be duly and validly issued, fully paid and non-assessable.

### Options

As of June 30, 2005, options to purchase a total of 899,875 shares of common stock were outstanding. All options issued under the 2003 Plan or issuable under the 2005 Plan are subject to 180-day lock-up provisions under the terms of the 2003 Plan and the 2005 Plan, respectively. Options to purchase a total of 1,000,000 shares of common stock remain available for grant under the 2005 Plan. Following this offering, no options to purchase, or other equity-based awards with respect to shares of our common stock, will be available under the 2003 Plan or the 1996 Plan.

### Preferred Stock

Upon the closing of this offering, all outstanding shares of our preferred stock will convert into an aggregate of 3,398,105 shares of common stock.

Following the offering, our board of directors will be authorized, subject to the limits imposed by the Delaware General Corporation Law, to issue 10,000,000 shares of preferred stock in one or more series, to establish from time to time the number of shares to be included in each series, to fix the rights, preferences and privileges of the shares of each wholly unissued series and any of its qualifications, limitations and restrictions. Our board of directors can also increase or decrease the number of shares of

any series, but not below the number of shares of that series then outstanding, without any further vote or action by our stockholders.

Our board of directors may authorize the issuance of preferred stock with voting or conversion rights that adversely affect the voting power or other rights of our common stockholders. The issuance of preferred stock, while providing flexibility in connection with possible acquisitions, financings and other corporate purposes, could have the effect of delaying, deferring or preventing a change in control and may cause the market price of our common stock to decline or impair the voting and other rights of the holders of our common stock. We have no current plans to issue shares of preferred stock.

#### **Warrants**

See “Related Party Transactions — Warrants to Purchase Preferred Stock” and “Related Party Transactions — Warrants to Purchase Common Stock.”

#### **Registration Rights**

Under a second amended and restated investors’ rights agreement, following this offering, the holders of 5,090,001 shares of common stock (including shares of our common stock purchasable pursuant to warrants to purchase our common stock) have the right to require us to register their shares with the SEC so that those shares may be publicly resold or to include their shares in any registration statement we file with the SEC.

##### *Demand Rights*

At any time after the earlier of October 26, 2009 or the date which is one year after the effective date of this offering, if the holders of more than 20% of the outstanding shares of common stock issued or issuable upon conversion of our existing Series B preferred stock or Series C preferred stock or upon exercise of warrants to purchase our common stock held by holders of our existing Series B preferred stock or Series C preferred stock, request that we file a registration statement with the SEC having an aggregate offering price to the public (after deduction of underwriter’s discounts and expenses) of not less than \$2,000,000, we are obligated to use our commercially reasonable efforts to cause such shares to be registered and to include in such registration, if requested, additional shares of our common stock requested to be included by holders of registration rights who deliver a written notice to us within 20 days of our receipt of notice from the initiating holders. We are only required to effect two such registrations, and we are not required to effect any such registration during period commencing 90 days before a company initiated registration and ending 90 days after a company initiated registration. Our board of directors has the right to defer for not more than 90 days and not more than twice in any 12-month period any such registration if in its good faith judgment such registration would be detrimental to us and not in our best interest.

If we are eligible to file a registration statement on Form S-3, holders of shares having registration rights have the right to demand on or prior to the fifth anniversary of the effective date of this offering that we file a registration statement on Form S-3. We are only required to effect two such registrations in any 12-month period, and we are not required to effect any such registration during period commencing 90 days before a company-initiated registration and ending 90 days after a company-initiated registration.

##### *Piggy Back Registration Rights*

The holders of shares having registration rights are entitled to unlimited “piggy-back” registration rights on all registrations of our stock other than a registration relating solely to employee benefit plans, a registration on Form S-4 or any other form that does not permit secondary sales or a registration pursuant to the demand rights described above. Pursuant to the lock-up agreements we expect to enter into with our directors, officers and certain stockholders, any such person holding “piggy-back” registration rights will waive such rights with respect to this offering.

##### *Limitations on Registration Rights*

We and the underwriters of any underwritten offering will have the right to limit the number of shares having registration rights to be included in the registration statement. The underwriters have excluded any sales by existing investors in this offering.

### *Expenses of Registration*

We shall bear all registration expenses, exclusive of underwriting discounts, selling commissions, stock transfer taxes and fees and disbursements of counsel for the holders of registration rights (other than customary fees of one counsel in the case of a demand registration), of all demand and piggy-back registrations.

### **Delaware Anti-Takeover Law**

We are subject to the provisions of Section 203 of the Delaware General Corporation Law, or Delaware law, regulating corporate takeovers. In general, these provisions prohibit a Delaware corporation from engaging in any business combination with any interested stockholder for a period of three years following the date that the stockholder became an interested stockholder, unless:

- the transaction is approved by the board of directors before the date the interested stockholder attained that status;
- upon consummation of the transaction that resulted in the stockholder becoming an interested stockholder, the interested stockholder owned at least 85% of the voting stock of the corporation outstanding at the time the transaction commenced; or
- on or after the date the business combination is approved by the board of directors and authorized at a meeting of stockholders, by at least two-thirds of the outstanding voting stock that is not owned by the interested stockholder.

Section 203 defines “business combination” to include the following:

- any merger or consolidation involving the corporation and the interested stockholder;
- any sale, transfer, pledge or other disposition of 10% or more of the assets of the corporation involving the interested stockholder;
- subject to certain exceptions, any transaction that results in the issuance or transfer by the corporation of any stock of the corporation to the interested stockholder;
- any transaction involving the corporation that has the effect of increasing the proportionate share of the stock of any class or series of the corporation beneficially owned by the interested stockholder; or
- the receipt by the interested stockholder of the benefit of any loans, advances, guarantees, pledges or other financial benefits provided by or through the corporation.

In general, Section 203 defines an interested stockholder as any entity or person beneficially owning 15% or more of the outstanding voting stock of the corporation and any entity or person affiliated with or controlling or controlled by any of these entities or persons.

A Delaware corporation may opt out of this provision either with an express provision in its original certificate of incorporation or in an amendment to its certificate of incorporation or bylaws approved by its stockholders. However, we have not opted out of this provision. The statute could prohibit or delay mergers or other takeover or change in control attempts and, accordingly, may discourage attempts to acquire us.

### **Provisions of our Certificate of Incorporation and Bylaws and Certain Regulatory Requirements That May Have an Anti-Takeover Effect or Entrench Current Management**

Our fourth amended and restated certificate of incorporation and third amended and restated bylaws will contain certain provisions that are intended to enhance the likelihood of continuity and stability in the composition of our board of directors and the policies formulated by our board of directors. These provisions are also expected to discourage certain types of coercive takeover practices and inadequate takeover bids and to encourage persons seeking to acquire control of us to first negotiate with us. These provisions, as well as certain provisions of contracts to which we are a party, may discourage or hinder

attempts to acquire us or remove incumbent directors or management even if some, or a majority, of our stockholders believe that such action is in their best interest.

#### *Certificate of Incorporation and Bylaws.*

The provisions in our fourth amended and restated certificate of incorporation and third amended and restated bylaws with the intent described above include:

- *Vacancies Filled by the Board.* Vacancies on our board of directors may be filled by a majority of the remaining directors (even if they constitute less than a quorum), or by a sole remaining director.
- *Removal of Directors.* None of our directors may be removed other than for cause.
- *Stockholder Meetings.* Only our board of directors, the chairman of our board of directors or our chief executive officer may call special meetings of stockholders. Stockholders cannot call special meetings of stockholders.
- *No Action by Written Consent.* Stockholders may take action only at an annual or special meeting of stockholders. Stockholders may not act by written consent.
- *Requirements for Advance Notification of Stockholder Proposals and Director Nominations.* Stockholders must comply with advance notice procedures with respect to stockholder proposals and the nomination of candidates for election as directors. In general, these provisions will provide that notice of intent to nominate a director or raise matters at such meetings must be received in writing by us not less than 90 nor more than 120 days prior to the anniversary of the date of the proxy statement for the previous year's annual meeting of stockholders, and must contain certain information concerning the person to be nominated or the matters to be brought before the meeting and concerning the stockholder submitting the proposal.
- *No Cumulative Voting.* There is no cumulative voting in the election of directors.
- *"Blank Check" Preferred Stock.* We will be authorized to issue, without any further vote or action by the stockholders, up to 10,000,000 shares of preferred stock in one or more classes or series and, with respect to each such class or series, to fix the number of shares constituting the class or series and the designation of the class or series, the voting powers (if any) of the shares of the class or series, and the preferences and relative, participating, optional and other special rights, if any, and any qualifications, limitations or restrictions, of the shares of such class or series.
- *Regulatory Approval.* We are also required to obtain the approval of certain regulatory agencies, such as the NASD, for certain transactions that could result in a change of control. See "Our Business — Regulation."

#### **Transfer Agent and Register**

The transfer agent and registrar for the common stock is the American Stock Transfer and Trust Company.

#### **Listing**

We have applied to have our common stock approved for listing, subject to official notice of issuance, on the NASDAQ National Market under the symbol "MELA." We have not applied to list our common stock on any other exchange or quotation system.

#### **SHARES ELIGIBLE FOR FUTURE SALE**

Prior to this offering, there has been no market for our common stock, and a liquid trading market for our common stock may not develop or be sustained after this offering. Future sales of substantial amounts of our common stock, including shares issued upon exercise of outstanding options and warrants or in the public market after this offering, or the anticipation of those sales, could adversely affect the price of our common stock from time to time and could impair our ability to raise capital through sales of our equity securities. Upon completion of this offering, we will have outstanding an aggregate of 9,513,164 shares of

common stock, after giving effect to the issuance of 3,000,000 shares of common stock in this offering and the conversion of all outstanding shares of our convertible preferred stock into an aggregate of 3,398,105 shares of our common stock.

### Sales of Restricted Shares

Of the shares to be outstanding after the completion of this offering, the 3,000,000 shares sold in this offering will be freely tradable without restriction under the Securities Act of 1933, as amended (Securities Act) unless purchased by our “affiliates,” as that term is defined in Rule 144 under the Securities Act. Of the remaining 6,513,164 shares of common stock, 598,868 are held by current “affiliates” and 1,034,045 are held by former “affiliates” (that is, persons whose affiliate status terminated less than 90 days before the date of this prospectus). The shares of common stock held by affiliates and all other shares of common stock other than those sold in this offering are “restricted securities” within the meaning of Rule 144. All of the shares of common stock held by affiliates will be subject to the 270-day lock-up period described below. After the 270-day lock-up period, these restricted securities may be sold in the public market only if registered or if they qualify for an exemption from registration under Rules 144, 144(k) or 701 promulgated under the Securities Act, which are summarized below. Sales of the restricted securities in the public market, or the availability of such shares for sale, could adversely affect the market price of our common stock.

Our directors, officers and certain significant stockholders have entered into lock-up agreements in connection with the offering generally providing that they will not offer, sell, contract to sell or grant any option to purchase or otherwise dispose of our common stock or any securities exercisable for or convertible into our common stock owned by them for a period of 270 days after the date of this prospectus without the prior written consent of the underwriters, which consent may be withheld in their sole discretion. Taking into account the lock-up agreements, and assuming the underwriters do not release any stockholders from these agreements, we estimate that the number of restricted shares that will be available for sale in the public market under the provisions of Rule 144 and Rule 144(k) will be approximately as follows:

- beginning on the effective date of this prospectus, in addition to the shares sold in the offering, approximately 1,229,577 of our restricted shares will be eligible for sale under Rule 144, of which approximately 408,402 shares will be eligible for sale subject to the volume, manner of sale and other limitations under Rule 144 and approximately 821,175 shares will be eligible for sale as unrestricted shares under Rule 144(k);
- beginning 270 days after the effective date of this prospectus, approximately 6,347,015 of our restricted shares will be eligible for sale under Rule 144 (which includes the 1,229,577 restricted shares referred to above), of which approximately 3,226,819 shares will be eligible for sale subject to the volume, manner of sale and other limitations under Rule 144 and approximately 3,120,196 shares will be eligible for sale as unrestricted shares under Rule 144(k); and
- beginning October 27, 2006, approximately an additional 166,149 of restricted shares will be eligible for sale subject to the volume, manner of sale and other limitations under Rule 144.

In general, under Rule 144 as currently in effect, after the expiration of the lock-up agreements, a person who has beneficially owned restricted securities for at least one year would be entitled to sell within any three-month period a number of shares that does not exceed the greater of:

- one percent of the number of shares of common stock then outstanding, which will equal approximately 95,136 shares immediately after the offering; or
- the average weekly trading volume of our common stock during the four calendar weeks preceding the filing of a notice on Form 144 with respect to that sale.

Sales under Rule 144 are also subject to requirements with respect to manner of sale, notice and the availability of current public information about us. However, under Rule 144(k), generally, a person who is not deemed to have been our affiliate at any time during the three months preceding a sale and who has beneficially owned the shares proposed to be sold for at least two years, is entitled to sell such shares



without complying with the manner of sale, public information, volume limitation or notice provisions of Rule 144.

### **Rule 701**

In general, under Rule 701 of the Securities Act as currently in effect, any of our employees, directors or consultants who purchased shares of our common stock from us in connection with our stock option plans before the effective date of the registration statement of which this prospectus is a part, or who hold stock options as of that date, may rely on the resale provisions of Rule 701. Under Rule 701, these persons who are not our affiliates may generally sell their eligible securities, commencing 90 days after the effective date of the registration statement in reliance on Rule 144, but without compliance with some of the restrictions, including the holding period and volume limitations contained in Rule 144. Rule 152 under the Securities Act provides a safe harbor for transactions not involving any public offering even if the issuer subsequently files a registration statement. Also, Rule 701 states that offers and sales exempt under Rule 701 are deemed to be part of a single, discrete offering and are not subject to integration with other offers or sales (whether registered or not). We therefore believe that the issuance of common stock upon the exercise of options by our employees, directors or consultants should not be integrated with the issuance of common stock in this offering.

Subject to the 270-day lock-up period described above, as of the date 90 days after the effective date of this offering, holders of vested options exercisable for approximately 573,550 shares of our common stock will be eligible to exercise their options and to sell their shares in accordance with Rule 701.

### **Stock Options**

We intend to file a registration statement under the Securities Act covering the shares of common stock reserved for issuance upon exercise of outstanding options under our 2005 Plan, our 2003 Plan and our 1996 Plan. The registration statement is expected to be filed 270 days after the closing of this offering and become effective as soon as practicable after filing. Accordingly, shares registered under the registration statement will be available for sale in the open market after the effective date of the registration statement subject to manner of sale, public information, volume limitation and notice provisions of Rule 144 applicable to our affiliates, and any limitations on sale under the applicable option plan and the lock-up agreements described above. See “Risk Factors — If there are substantial sales of our common stock, our stock price could decline.”

## **MATERIAL US FEDERAL INCOME AND ESTATE TAX CONSIDERATIONS FOR NON-US HOLDERS**

The following is a general discussion of the material US federal income and estate tax consequences of the ownership and disposition of our common stock by a non-US holder that purchases shares pursuant to this offer. As used in this discussion, the term non-US holder means a beneficial owner of our common stock that is not, for US federal income tax purposes:

- an individual who is a citizen or resident of the US;
- a corporation or partnership (including any entity treated as a corporation or partnership for US federal income tax purposes) created or organized in or under the laws of the US or any State thereof or the District of Columbia, other than a partnership treated as foreign under US Treasury regulations;
- an estate whose income is includible in gross income for US federal income tax purposes regardless of its source; or
- a trust (1) if a US court is able to exercise primary supervision over the administration of the trust and one or more US persons have authority to control all substantial decisions of the trust, or (2) that has a valid election in effect under applicable Treasury regulations to be treated as a US person.

This discussion does not consider:

- US federal gift tax consequences, US state or local or non-US tax consequences;
- specific facts and circumstances that may be relevant to a particular non-US holder's tax position, including, if the non-US holder is a partnership or trust that the US tax consequences of holding and disposing of our common stock may be affected by certain determinations made at the partner or beneficiary level;
- the tax consequences for the stockholders, partners or beneficiaries of a non-US holder;
- special tax rules that may apply to particular non-US holders, such as financial institutions, insurance companies, tax-exempt organizations, hybrid entities, US expatriates, broker-dealers, and traders in securities; or
- special tax rules that may apply to a non-US holder that holds our common stock as part of a straddle, hedge, conversion transaction, synthetic security or other integrated investment.

The following discussion is based on provisions of the Code, applicable US Treasury regulations and administrative and judicial interpretations, all as in effect on the date of this prospectus, and all of which are subject to change, retroactively or prospectively. The following summary assumes that a non-US holder holds our common stock as a "capital asset" within the meaning of section 1221 of the Code (generally, property held for investment). Each non-US holder should consult a tax advisor regarding the US federal, state, local and non-US income and other tax consequences of acquiring, holding and disposing of shares of our common stock.

### **Dividends**

We do not plan to pay any dividends on our common stock for the foreseeable future. However, in the event that we pay dividends on our common stock, we will have to withhold a US federal withholding tax at a rate of 30%, or a lower rate under an applicable income tax treaty, from the gross amount of dividends paid to a non-US holder.

Dividends that are effectively connected with a non-US holder's conduct of a trade or business in the US or, if an income tax treaty applies, attributable to a permanent establishment in the US (effectively connected income or ECI), are taxed on a net income basis at the regular graduated rates and in the manner applicable to US persons. In that case, we will not have to withhold US federal withholding tax if

the non-US holder complies with applicable certification and disclosure requirements. In addition to the US tax on ECI, in the case of a holder that is a foreign corporation and has ECI, a branch profits tax may be imposed at a 30% rate, or a lower rate under an applicable income tax treaty, on the dividend equivalent amount.

In order to claim the benefit of an income tax treaty or claim exemption from withholding because the income is effectively connected with the conduct of a trade or business in the US, the non-US holder must provide a properly executed Form W-8BEN, for treaty benefits, or W-8ECI, for effectively connected income, prior to the payment of dividends. These forms must be periodically updated. Non-US holders should consult their tax advisors regarding their entitlement to benefits under a relevant income tax treaty and their ability to claim exemption from withholding because the income is effectively connected with the conduct of a trade or business in the US, and related certification requirements.

A non-US holder that is eligible for a reduced rate of US federal withholding tax under an income tax treaty may obtain a refund or credit of any excess amounts withheld by filing an appropriate claim for a refund with the US Internal Revenue Service (IRS) in a timely manner.

### **Gain on Disposition of Common Stock**

A non-US holder generally will not be taxed on gain recognized on a disposition of our common stock unless:

- the gain is effectively connected with a non-US holder's conduct of a trade or business in the US or, alternatively, if an income tax treaty applies, is attributable to a permanent establishment maintained by the non-US holder in the US; in these cases, the gain will be taxed on a net income basis at the regular graduated rates and in the manner applicable to US persons, unless an applicable treaty provides otherwise, and, if the non-US holder is a foreign corporation, the branch profits tax described above may also apply;
- the non-US holder is an individual who holds our common stock as a capital asset, is present in the US for 183 days or more in the taxable year of the disposition and meets other requirements; in this case, the non-US holder will be subject to a 30% tax on the gain derived from the disposition; or
- we are or have been a US real property holding corporation (USRPHC) for US federal income tax purposes at any time during the shorter of the five-year period ending on the date of disposition or the period that the non-US holder held our common stock; in this case, the non-US holder may be subject to US federal income tax on its net gain derived from the disposition of our common stock at regular graduated rates. Generally, a corporation is a USRPHC if the fair market value of its US real property interests equals or exceeds 50% of the sum of the fair market value of its worldwide real property interests plus its other assets used or held for use in a trade or business. If we are, or were to become, a USRPHC, gain realized upon disposition of our common stock by a non-US holder that did not directly or indirectly own more than 5% of our common stock during the shorter of the five-year period ending on the date of disposition or the period that the non-US holder held our common stock generally would not be subject to US federal income tax, provided that our common stock is "regularly traded on an established securities market" within the meaning of Section 897(c)(3) of the Code. We believe that we are not currently, and we do not anticipate becoming in the future, a USRPHC.

### **Federal Estate Tax**

Common stock owned or treated as owned by an individual who is a non-US holder at the time of death, unless an applicable estate tax or other treaty provides otherwise, will be included in the individual's gross estate for US federal estate tax purposes, and therefore may be subject to US federal estate tax.

## **Information Reporting and Backup Withholding Tax**

We must report annually to the IRS and to each non-US holder the amount of dividends paid to that holder and the tax withheld from those dividends. These reporting requirements apply regardless of whether withholding was reduced or eliminated by an applicable income tax treaty. Copies of the information returns reporting those dividends and withholding may also be made available to the tax authorities in the country in which the non-US holder is a resident under the provisions of an applicable income tax treaty or agreement.

Under some circumstances, US Treasury regulations require additional information reporting and backup withholding (currently at a rate of 28%) on some payments on our common stock. The gross amount of dividends paid to a non-US holder that fails to certify its non-US holder status in accordance with applicable US Treasury regulations generally will be reduced by backup withholding at the applicable rate.

The payment of the proceeds of the disposition of our common stock by a non-US holder to or through the US office of any broker generally will be reported to the IRS and reduced by backup withholding unless the non-US holder either certifies its status as a non-US holder under penalties of perjury or otherwise establishes an exemption. The payment of the proceeds of the disposition of our common stock by a non-US holder to or through a non-US office of a non-US broker generally will not be reduced by backup withholding or reported to the IRS unless the non-US broker has certain enumerated connections with the US. In general, the payment of proceeds from the disposition of our common stock by or through a non-US office of a broker that is a US person or that has certain enumerated connections with the US will be reported to the IRS and may, in limited circumstances, be reduced by backup withholding, unless the broker receives a statement from the non-US holder, signed under penalty of perjury, certifying its non-US status or the broker has documentary evidence in its files that the holder is a non-US holder.

Non-US holders should consult their own tax advisors regarding the application of the information reporting and backup withholding rules to them.

Backup withholding is not an additional tax. Any amounts withheld under the backup withholding rules from a payment to a non-US holder will be refunded, or credited against the holder's US federal income tax liability, if any, provided that the required information or appropriate claim for refund is furnished to the IRS in a timely manner.

## UNDERWRITING

Under the terms and subject to the conditions in an underwriting agreement dated \_\_\_\_\_, 2005, we have agreed to sell to the underwriters named below, for whom Ladenburg Thalmann & Co. Inc. and Stanford Group Company are acting as the representatives, the following respective numbers of shares of common stock:

| <u>Underwriters</u>           | <u>Number of Shares</u> |
|-------------------------------|-------------------------|
| Ladenburg Thalmann & Co. Inc. |                         |
| Stanford Group Company        |                         |
| Total                         | <u>3,000,000</u>        |

Subject to the terms and conditions of the underwriting agreement, the underwriters have agreed to purchase from us 3,000,000 shares of our common stock at the public offering price, less the underwriting discounts and commissions set forth on the cover page of this prospectus. The underwriting agreement provides that the underwriters' obligations to purchase our shares are subject to approval of legal matters by counsel and to the satisfaction of other conditions. The underwriters are obligated to purchase all of the shares (other than those covered by the over-allotment option described below) if they purchase any shares. The underwriting agreement also provides that, if an underwriter defaults, the purchase commitments of non-defaulting underwriters may be increased or this offering may be terminated.

### Commissions and Expenses

The underwriters propose to offer the shares to the public at the public offering price set forth on the cover of this prospectus. The underwriters may offer the shares to securities dealers at the price to the public less a concession not in excess of \$ \_\_\_\_\_ per share. Securities dealers may reallocate a concession not in excess of \$ \_\_\_\_\_ per share to other dealers. After the shares are released for sale to the public, the underwriters may vary the offering price and other selling terms from time to time. The underwriters will also receive a nonaccountable expense allowance equal to 1% of the public offering price set forth on the cover of this prospectus for the sale of all the shares sold (excluding shares sold pursuant to the over-allotment option, if any).

The following table shows the underwriting discounts and commissions that we are to pay to the underwriters in connection with this offering. These amounts are shown assuming no exercise and full exercise of the underwriters' over-allotment option to purchase additional shares.

|           | <u>No Exercise</u> | <u>Full Exercise</u> |
|-----------|--------------------|----------------------|
| Per Share | \$ _____           | \$ _____             |
| Total     | \$ _____           | \$ _____             |

We estimate that the total expenses of this offering, excluding underwriting discounts and commissions, will be approximately \$ \_\_\_\_\_.

### Warrant

We have agreed to sell to the representatives, for nominal consideration, a warrant (Underwriters' Warrant) to purchase up to a total of 225,000 shares of our common stock. The Underwriters' Warrant is not exercisable during the first year after the date of this prospectus and thereafter is exercisable at an exercise price equal to 125% of the public offering price per share set forth on the cover of this prospectus for a period commencing on the first anniversary of the date of this prospectus and ending on the fifth anniversary of the date of this prospectus. The Underwriters' Warrant contains customary antidilution provisions and certain demand and participatory registration rights. The Underwriters' Warrant also includes a "cashless" exercise provision entitling the holder to convert the Underwriters' Warrant into shares of our common stock. The Underwriters' Warrant may not be sold, transferred, assigned or hypothecated for a period of one year from the date of this prospectus, except to officers or partners of the underwriters and members of the selling group and/or their officers or partners.

### **Over-Allotment Option**

We have granted to the underwriters an option, exercisable not later than 45 days after the date of this prospectus, to purchase up to an aggregate of 450,000 additional shares of common stock at the public offering price set forth on the cover page of this prospectus less the underwriting discounts and commissions. The underwriters may exercise this option in whole or in part only to cover over-allotments, if any, made in connection with the sale of shares offered hereby.

### **Lock-Up and Related Agreements**

Except as noted below, our directors, executive officers and certain significant stockholders have agreed with the representatives that for a period of 270 days following the date of this prospectus, they will not offer, sell, assign, transfer, pledge, contract to sell or otherwise dispose of or hedge any of our shares of common stock or any securities convertible into or exchangeable for shares of common stock. The representatives may, in their sole discretion, at any time without prior notice, release all or any portion of the shares from the restrictions in any such agreement. We have entered into an agreement with the representatives, stating that we will not issue additional shares (with the exception of shares issued pursuant to the over-allotment option) of our common stock prior to the end of the 270 day period following the date of this prospectus, other than with respect to our issuing shares pursuant to employee benefit plans, qualified option plans or other employee compensation plans already in existence, or pursuant to currently outstanding options, warrants or other rights to acquire shares of our common stock. There are no agreements between the representatives and any of our directors, executive officers or principal stockholder releasing them from these lock-up agreements, or with us pertaining to our issuance of additional shares, prior to the expiration of the 270 day period.

### **Indemnification**

We have agreed to indemnify the underwriters against certain civil liabilities, including liabilities under the Securities Act and liabilities arising from breaches of representations and warranties contained in the underwriting agreement, and to contribute to payments the underwriters may be required to make in respect of any such liabilities.

### **Stabilization, Short Positions and Penalty Bids**

The representatives may engage in over-allotment, stabilizing transactions, syndicate covering transactions, and penalty bids or purchases for the purpose of pegging, fixing or maintaining the price of the common stock, in accordance with Regulation M under the Securities Exchange Act of 1934:

- Over-allotment transactions involve sales by the underwriters of shares in excess of the number of shares the underwriters are obligated to purchase, which creates a syndicate short position. The short position may be either a covered short position or a naked short position. In a covered short position, the number of shares over-allotted by the underwriters is not greater than the number of shares that they may purchase in the over-allotment option. In a naked short position, the number of shares involved is greater than the number of shares in the over-allotment option. The underwriters may close out any short position by either exercising their over-allotment option and/or purchasing shares in the open market.
- Stabilizing transactions permit bids to purchase the underlying security so long as the stabilizing bids do not exceed a specific maximum.
- Syndicate covering transactions involve purchases of the common stock in the open market after the distribution has been completed in order to cover syndicate short positions. In determining the source of shares to close out the short position, the underwriters will consider, among other things, the price of shares available for purchase in the open market as compared to the price at which they may purchase shares through the over-allotment option. If the underwriters sell more shares

than could be covered by the over-allotment option, a naked short position, the position can only be closed out by buying shares in the open market. A naked short position is more likely to be created if the underwriters are concerned that there could be downward pressure on the price of the shares in the open market after pricing that could adversely affect investors who purchase in the offering.

- Penalty bids permit the representatives to reclaim a selling concession from a syndicate member when the common stock originally sold by the syndicate member is purchased in a stabilizing or syndicate covering transaction to cover syndicate short positions.

These stabilizing transactions, syndicate covering transactions and penalty bids may have the effect of raising or maintaining the market price of our common stock or preventing or retarding a decline in the market price of our common stock. As a result, the price of our common stock may be higher than the price that might otherwise exist in the open market. These transactions may be effected on the NASDAQ National Market or otherwise and, if commenced, may be discontinued at any time. Neither we nor any of the underwriters make any representation or prediction as to the direction or magnitude of any effect that the transactions described above may have on the price of our common stock. In addition, neither we nor any of the underwriters make any representation that the representatives will engage in these stabilizing transactions or that any transaction, once commenced, will not be discontinued without notice.

#### **Offering Price Determination**

Prior to this offering, there has been no market for our common stock. The public offering price has been, due to our lack of operating history, arbitrarily determined by negotiations between us and the representatives, bears no relationship to our earnings, book value, net worth or other financial criteria of value and may not be indicative of the market price for the common stock after this offering. After completion of this offering, the market price of the common stock will be subject to change as a result of market conditions and other factors.

#### **Discretionary Accounts**

The representatives of the underwriters have advised us that they do not intend to confirm sales of the shares to discretionary accounts.

### **LEGAL MATTERS**

The validity of the common stock being offered hereby is being passed upon for us by Dreier LLP. We have received certain advice from our legal counsel in connection with the matters described herein. Certain legal matters relating to the offering will be passed upon for the underwriters by Greenberg Traurig, LLP, New York, New York. Prospective investors should consult with their own legal and other counsel.

### **EXPERTS**

The financial statements of Electro-Optical Sciences, Inc. as of December 31, 2003 and 2004, and for each of the three years in the period ended December 31, 2004, as set forth in their report, have been included herein and in the Registration Statement in reliance upon the report of Eisner LLP, independent registered public accounting firm, appearing elsewhere herein, and upon the authority of said firm as experts in accounting and auditing.

## WHERE YOU CAN FIND MORE INFORMATION

We have filed with the SEC a registration statement on Form S-1 under the Securities Act with respect to the shares of common stock we are offering to sell. This prospectus, which constitutes part of the registration statement, does not include all of the information contained in the registration statement. You should refer to the registration statement and its exhibits for additional information. Whenever we make reference in this prospectus to any of our contracts, agreements or other documents, the references are not necessarily complete and you should refer to the exhibits attached to the registration statement for copies of the actual contract, agreement or other document. When we complete this offering, we will also be required to file annual, quarterly and special reports, proxy statements and other information with the SEC. We anticipate making these documents publicly available, free of charge, on our website at [www.eo-sciences.com](http://www.eo-sciences.com) as soon as reasonably practicable after filing such documents with the Securities and Exchange Commission.

You can read the registration statement and our future filings with the SEC, over the internet at the SEC's website at <http://www.sec.gov>. You may also read and copy any document that we file with the Securities and Exchange Commission at its public reference room at 450 Fifth Street, N.W., Washington, DC 20549.

You may also obtain copies of the documents at prescribed rates by writing to the Public Reference Section of the SEC at 450 Fifth Street, NW, Washington, DC 20549. Please call the SEC at 1-800-SEC-0330 for further information on the operation of the public reference room.



**ELECTRO-OPTICAL SCIENCES, INC.**

**CONTENTS**

|  |     |
|--|-----|
| Financial Statements:  |     |
| Report of Independent Registered Public Accounting Firm  | F-2 |
| Balance sheets as of December 31, 2004 and 2003 and June 30, 2005 (unaudited)  | F-3 |
| Statements of operations for the years ended December 31, 2004, 2003 and 2002 and six months ended June 30, 2004 and 2005 (unaudited)                          | F-4 |
| Statements of changes in stockholders' (deficiency) equity for the years ended December 31, 2004, 2003 and 2002 and six months ended June 30, 2005 (unaudited) | F-5 |
| Statements of cash flows for the years ended December 31, 2004, 2003 and 2002 and six months ended June 30, 2004 and 2005 (unaudited)                          | F-6 |
| Notes to financial statements  | F-7 |

## REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Stockholders  
Electro-Optical Sciences, Inc.

We have audited the accompanying balance sheets of Electro-Optical Sciences, Inc. (the "Company") as of December 31, 2004 and 2003, and the related statements of operations, stockholders' (deficiency) equity and cash flows for each of the years in the three year period ended December 31, 2004. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Electro-Optical Sciences, Inc. as of December 31, 2004 and 2003, and the results of its operations and its cash flows for each of the years in the three year period ended December 31, 2004, in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 13, the Company has restated its financial statements as of December 31, 2004 and for the year then ended to adjust for the recalculation of the fair value of warrants and a related beneficial conversion feature.

Eisner LLP

New York, New York  
May 31, 2005, except as to Notes 8 and 13,  
the date of which is August 3, 2005, and Note 1  
(Reverse Stock Split), the date of which is August 8, 2005

**ELECTRO-OPTICAL SCIENCES, INC.**

**BALANCE SHEETS**

|  | December<br>31, 2003 | December<br>31, 2004               | June 30,<br>2005                     | Pro-Forma<br>June 30,<br>2005 |
|--|----------------------|------------------------------------|--------------------------------------|-------------------------------|
|  | (audited)            | (audited)<br>(Restated<br>Note 13) | (unaudited)<br>(Restated<br>Note 13) | (unaudited)<br>(Note 1)       |
| <b>ASSETS</b>  |                      |                                    |                                      |                               |
| <b>Current Assets:</b>   |                      |                                    |                                      |                               |
| Cash and cash equivalents  | \$ 116,691           | \$ 108,705                         | \$ 176,208                           | \$ 176,208                    |
| Marketable securities  | —                    | 6,594,751                          | 3,617,713                            | 3,617,713                     |
| Accounts receivable, net   | 16,679               | 7,128                              | —                                    | —                             |
| Inventories  | 72,865               | 69,755                             | —                                    | —                             |
| Prepaid expenses and other current assets  | 10,697               | 32,844                             | 23,550                               | 23,550                        |
| Assets held for sale   | —                    | —                                  | 156,677                              | 156,677                       |
| Deferred registration costs  | —                    | —                                  | 752,042                              | 752,042                       |
| <b>Total Current Assets</b>  | <u>216,932</u>       | <u>6,813,183</u>                   | <u>4,726,190</u>                     | <u>4,726,190</u>              |
| Property and equipment, net  | 18,418               | 89,306                             | 154,510                              | 154,510                       |
| Patents and trademarks, net  | 178,157              | 163,459                            | 86,517                               | 86,517                        |
| Other assets   | 18,248               | 30,201                             | 30,201                               | 30,201                        |
| <b>Total Assets</b>  | <u>\$ 431,755</u>    | <u>\$ 7,096,149</u>                | <u>\$ 4,997,418</u>                  | <u>\$ 4,997,418</u>           |
| <b>LIABILITIES AND STOCKHOLDERS' (DEFICIENCY) EQUITY</b>   |                      |                                    |                                      |                               |
| <b>Current Liabilities:</b>  |                      |                                    |                                      |                               |
| Accounts payable (includes related parties of \$2,000 as of December 31, 2004, and \$79,645 as of June 30, 2005)   | \$ 211,810           | \$ 338,821                         | \$ 233,504                           | \$ 233,504                    |
| Accrued expenses   | 363,270              | 228,583                            | 339,283                              | 339,283                       |
| Accrued registration costs   | —                    | —                                  | 672,873                              | 672,873                       |
| Deferred revenues  | —                    | 106,335                            | —                                    | —                             |
| Notes payable — stockholders and employees   | 48,000               | —                                  | —                                    | —                             |
| Notes payable — other  | 15,000               | —                                  | —                                    | —                             |
| Other current liabilities  | 11,976               | 17,284                             | —                                    | —                             |
| <b>Total Current Liabilities</b>   | <u>650,056</u>       | <u>691,023</u>                     | <u>1,245,660</u>                     | <u>1,245,660</u>              |
| <b>REDEEMABLE CONVERTIBLE PREFERRED STOCK</b>  |                      |                                    |                                      |                               |
| Redeemable preferred stock Series B convertible 992,986 shares designated (liquidation preference \$2.26 per share); issued and outstanding 992,986 shares at December 31, 2003 and 2004 and June 30, 2005 and 0 shares at June 30, 2005, pro forma  | <u>2,244,147</u>     | <u>2,244,147</u>                   | <u>2,244,147</u>                     | <u>—</u>                      |
| Redeemable preferred stock Series C convertible 5,744,340 shares designated (liquidation preference \$2.26 per share); issued and outstanding 907,077 shares at December 31, 2003 and 5,414,779 shares at December 31, 2004 and June 30, 2005 and 0 shares at June 30, 2005, pro forma                       | <u>1,822,950</u>     | <u>7,711,027</u>                   | <u>8,357,522</u>                     | <u>—</u>                      |
| <b>COMMITMENTS AND CONTINGENCIES</b>   |                      |                                    |                                      |                               |
| <b>Stockholders' (Deficiency) Equity:</b>  |                      |                                    |                                      |                               |
| Preferred stock — \$.10 par value; authorized 16,936,704 shares: Series A convertible preferred stock, 199,380 shares designated — (liquidation preference \$5.00 per share); issued and outstanding 198,000 shares at December 31, 2003 and 2004 and June 30, 2005 and 0 shares at June 30, 2005, pro forma | 972,311              | 972,311                            | 972,311                              | —                             |
| Common stock — \$.001 par value; authorized 30,000,000 shares; issued and outstanding 1,684,760 shares at December 31, 2003 and 1,809,758 shares at December 31, 2004 and June 30, 2005 and 6,513,164 shares at June 30, 2005, pro forma   | 1,685                | 1,810                              | 1,810                                | 6,513                         |
| Additional paid-in capital   | 5,119,923            | 9,611,094                          | 9,035,398                            | 20,604,675                    |
| Notes receivable for stock subscriptions   | (69,000)             | (69,000)                           | —                                    | —                             |
| Deferred compensation  | (22,500)             | (159,300)                          | (143,370)                            | (143,370)                     |
| Accumulated deficit  | (10,287,817)         | (13,906,963)                       | (16,716,060)                         | (16,716,060)                  |
| <b>Stockholders' (Deficiency) Equity</b>   | <u>(4,285,398)</u>   | <u>(3,550,048)</u>                 | <u>(6,849,911)</u>                   | <u>3,751,758</u>              |
| <b>Total Liabilities and Stockholders' (Deficiency) Equity</b>   | <u>\$ 431,755</u>    | <u>\$ 7,096,149</u>                | <u>\$ 4,997,418</u>                  | <u>\$ 4,997,418</u>           |

See accompanying notes to financial statements

## ELECTRO-OPTICAL SCIENCES, INC.

## STATEMENTS OF OPERATIONS

## Restated Note 13

|  | Year Ended                        |                                   |  | Six Months Ended                |  |
|--|-----------------------------------|-----------------------------------|--|---------------------------------|--|
|  | December 31,<br>2002<br>(audited) | December 31,<br>2003<br>(audited) | December 31,<br>2004<br>(audited)<br>(Restated<br>Note 13) | June 30,<br>2004<br>(unaudited) | June 30,<br>2005<br>(unaudited)<br>(Restated<br>Note 13) |
| Revenue from grants  | \$ 547,290                        | \$ —                              | \$ —   | \$ —                            | \$ —   |
| Operating expenses:  |                                   |                                   |  |                                 |  |
| Cost of grant revenue  | 563,598                           | —                                 | —  | —                               | —  |
| General and administrative expenses  | 511,225                           | 1,034,397                         | 1,234,210  | 639,079                         | 995,931  |
| Research and development   | 404,331                           | 828,239                           | 1,891,551  | 693,052                         | 1,545,824  |
| Operating loss from continuing operations  | (931,864)                         | (1,862,636)                       | (3,125,761)  | (1,332,131)                     | (2,541,755)  |
| Interest income  | (2,189)                           | (1,373)                           | (27,935)   | (543)                           | (62,769)   |
| Interest expense   | 10,117                            | 76,923                            | 94,976   | 82,340                          | —  |
|  | 7,928                             | 75,550                            | 67,041   | 81,797                          | (62,769)   |
| Loss from continuing operations  | (939,792)                         | (1,938,186)                       | (3,192,802)  | (1,413,928)                     | (2,478,986)  |
| Loss from discontinued operations  | (201,259)                         | (11,917)                          | (426,344)  | (101,853)                       | (330,111)  |
| Net loss   | (1,141,051)                       | (1,950,103)                       | (3,619,146)  | (1,515,781)                     | (2,809,097)  |
| Less:  |                                   |                                   |  |                                 |  |
| Preferred stock deemed dividends   | 214,245                           | 321,830                           | 676,218  | 242,693                         | 719,064  |
| Preferred stock accretion  | 180,009                           | 25,228                            | 257,545  | 25,228                          | 646,496  |
| Stock distribution of preferred Series B shares  | —                                 | 101,700                           | —  | —                               | —  |
| <b>Net Loss Attributable to Common Stockholders</b>  | <b>\$ (1,535,305)</b>             | <b>\$ (2,398,861)</b>             | <b>\$ (4,552,909)</b>                                      | <b>\$ (1,783,702)</b>           | <b>\$ (4,174,657)</b>                                    |
| Net loss per share, basic and diluted:   |                                   |                                   |  |                                 |  |
| Continuing operations  | (0.87)                            | (1.48)                            | (2.34)   | (0.98)                          | (2.13)   |
| Discontinued operations  | (0.13)                            | (0.01)                            | (0.24)   | (0.06)                          | (0.18)   |
| Basic and diluted net loss per common share  | <u>\$ (1.00)</u>                  | <u>\$ (1.49)</u>                  | <u>\$ (2.58)</u>   | <u>\$ (1.04)</u>                | <u>\$ (2.31)</u>   |
| Basic and diluted weighted average number of shares outstanding                              | <u>1,534,760</u>                  | <u>1,614,897</u>                  | <u>1,766,608</u>   | <u>1,722,743</u>                | <u>1,809,758</u>   |
| Pro forma basic and diluted loss from continuing operations per common share (unaudited)     |                                   |                                   | <u>\$ (0.80)</u>   |                                 | <u>\$ (0.38)</u>   |
| Pro forma basic and diluted weighted average number of common shares outstanding (unaudited) |                                   |                                   | <u>3,967,024</u>   |                                 | <u>6,513,164</u>   |

See accompanying notes to financial statements

ELECTRO-OPTICAL SCIENCES, INC.

STATEMENT OF STOCKHOLDERS' (DEFICIENCY) EQUITY  
 Years ended December 31, 2002, 2003 and 2004, and the six months ended June 30, 2005 (unaudited)  
 (Restated Note 13)

|   | Convertible Preferred Stock Series A |            | Common Stock |          | Additional Paid-In Capital | Notes Receivable | Deferred Compensation | Accumulated Deficit | Total Stockholders' (Deficiency) |
|---|--------------------------------------|------------|--------------|----------|----------------------------|------------------|-----------------------|---------------------|----------------------------------|
|   | Shares                               | Amount     | Shares       | Amount   |                            |                  |                       |                     |                                  |
| Balance at January 1, 2002  | 198,000                              | \$ 972,311 | 1,534,760    | \$ 1,535 | \$ 2,932,174               |                  | \$ (117,000)          | \$ (7,196,663)      | \$ (3,407,643)                   |
| Amortization of deferred compensation                                     |                                      |            |              |          |                            |                  | 72,000                |                     | 72,000                           |
| Net loss  |                                      |            |              |          |                            |                  |                       | (1,141,051)         | (1,141,051)                      |
| Preferred stock accretion   |                                      |            |              |          | (180,009)                  |                  |                       |                     | (180,009)                        |
| Balance at December 31, 2002  | 198,000                              | \$ 972,311 | 1,534,760    | \$ 1,535 | \$ 2,752,165               | —                | \$ (45,000)           | \$ (8,337,714)      | \$ (4,656,703)                   |
| Preferred stock accretion   |                                      |            |              |          | (25,228)                   |                  |                       |                     | (25,228)                         |
| Amortization of deferred compensation                                     |                                      |            |              |          |                            |                  | 22,500                |                     | 22,500                           |
| Issuance of common stock in exchange for notes receivable                 |                                      |            | 150,000      | 150      | 68,850                     | (69,000)         |                       |                     | —                                |
| Adjustment for reduction to liquidation value of Series B preferred stock |                                      |            |              |          | 2,329,000                  |                  |                       |                     | 2,329,000                        |
| Stock distribution of preferred Series B shares                           |                                      |            |              |          | (101,700)                  |                  |                       |                     | (101,700)                        |
| Common stock options issued for consulting fees                           |                                      |            |              |          | 96,836                     |                  |                       |                     | 96,836                           |
| Net loss  |                                      |            |              |          |                            |                  |                       | (1,950,103)         | (1,950,103)                      |
| Balance at December 31, 2003  | 198,000                              | \$ 972,311 | 1,684,760    | \$ 1,685 | \$ 5,119,923               | \$ (69,000)      | \$ (22,500)           | \$ (10,287,817)     | \$ (4,285,398)                   |
| Sale of common stock  |                                      |            | 124,998      | 125      | 137,375                    |                  |                       |                     | 137,500                          |
| Deferred compensation-stock option awards to employees                    |                                      |            |              |          | 159,300                    |                  | (159,300)             |                     | —                                |
| Issuance of options to non-employee directors                             |                                      |            |              |          | 150,450                    |                  |                       |                     | 150,450                          |
| Preferred stock accretion   |                                      |            |              |          | (257,545)                  |                  |                       |                     | (257,545)                        |
| Warrants issued in connection with preferred Series C stock               |                                      |            |              |          | 2,643,392                  |                  |                       |                     | 2,643,392                        |
| Beneficial conversion feature in connection with preferred Series C stock |                                      |            |              |          | 1,465,003                  |                  |                       |                     | 1,465,003                        |
| Issuance of options to consultants  |                                      |            |              |          | 72,800                     |                  |                       |                     | 72,800                           |
| Issuance of warrants to consultant  |                                      |            |              |          | 120,396                    |                  |                       |                     | 120,396                          |
| Amortization of deferred compensation                                     |                                      |            |              |          |                            |                  | 22,500                |                     | 22,500                           |
| Net loss  |                                      |            |              |          |                            |                  |                       | (3,619,146)         | (3,619,146)                      |
| Balance at December 31, 2004  | 198,000                              | \$ 972,311 | 1,809,758    | \$ 1,810 | \$ 9,611,094               | \$ (69,000)      | \$ (159,300)          | \$ (13,906,963)     | \$ (3,550,048)                   |
| Preferred stock accretion   |                                      |            |              |          | (646,496)                  |                  |                       |                     | (646,496)                        |
| Value of options vesting on attainment of milestone                       |                                      |            |              |          | 70,800                     |                  |                       |                     | 70,800                           |
| Retirement of note receivable   |                                      |            |              |          |                            | 69,000           |                       |                     | 69,000                           |
| Amortization of deferred compensation                                     |                                      |            |              |          |                            |                  | 15,930                |                     | 15,930                           |
| Net loss  |                                      |            |              |          |                            |                  |                       | (2,809,097)         | (2,809,097)                      |
| Balance at June 30, 2005 (unaudited)                                      | 198,000                              | \$ 972,311 | 1,809,758    | \$ 1,810 | \$ 9,035,398               | \$ —             | \$ (143,370)          | \$ (16,716,060)     | \$ (6,849,911)                   |

See accompanying notes to financial statements

**ELECTRO-OPTICAL SCIENCES, INC.**

**STATEMENTS OF CASH FLOWS**

|  | Year Ended           |                      |                      | Six Months Ended   |                    |
|--|----------------------|----------------------|----------------------|--------------------|--------------------|
|  | December 31,<br>2002 | December 31,<br>2003 | December 31,<br>2004 | June 30,<br>2004   | June 30,<br>2005   |
|  | (audited)            | (audited)            | (audited)            | (unaudited)        | (unaudited)        |
| <b>Cash flows from operating activities:</b>                                       |                      |                      |                      |                    |                    |
| Loss from continuing operations  | \$ (939,792)         | \$ (1,938,186)       | \$ (3,192,802)       | \$ (1,413,928)     | \$ (2,478,986)     |
| Loss from discontinued operations  | (201,259)            | (11,917)             | (426,344)            | (101,853)          | (330,111)          |
| Net loss   | \$ (1,141,051)       | \$ (1,950,103)       | \$ (3,619,146)       | \$ (1,515,781)     | \$ (2,809,097)     |
| <b>Adjustments to reconcile net loss to net cash used in operating activities:</b> |                      |                      |                      |                    |                    |
| Allowance for doubtful accounts  | —                    | (13,288)             | (9,000)              | —                  | (1,000)            |
| Depreciation and amortization  | 33,329               | 30,987               | 35,860               | 14,578             | 25,098             |
| Noncash compensation and amortization of deferred compensation                     | 72,000               | 22,500               | 172,950              | 11,250             | 86,730             |
| Common stock options and warrant issued for consulting fees                        | —                    | 96,836               | 193,196              | —                  | —                  |
| Retirement of stock subscription receivable for consulting services                | —                    | —                    | —                    | —                  | 34,500             |
| Amortization of discount on marketable securities                                  | —                    | —                    | (10,001)             | —                  | (30,072)           |
| Imputed interest expense attributable to preferred Series C                        | —                    | 45,000               | —                    | —                  | —                  |
| Imputed interest expense on bridge loan  | —                    | —                    | 80,000               | 80,000             | —                  |
| <b>Changes in operating assets and liabilities:</b>                                |                      |                      |                      |                    |                    |
| (Increase) decrease in receivables   | (3,326)              | 53,585               | 20,662               | (64,794)           | 8,128              |
| Decrease (increase) in inventories   | 67,279               | (39,296)             | 3,110                | (8,826)            | (16,122)           |
| Decrease (increase) in prepaid expenses and other current assets                   | 6,060                | (3,464)              | (36,211)             | (4,768)            | 9,293              |
| Deferred registration costs  | —                    | —                    | —                    | —                  | (79,169)           |
| Increase (decrease) in accounts payable and accrued expenses                       | 237,660              | 137,414              | (7,676)              | (76,936)           | 5,382              |
| (Decrease) increase in deferred revenues   | —                    | (57,300)             | 106,335              | 10,000             | (106,335)          |
| Increase (decrease) in other current liabilities                                   | 44,373               | (21,879)             | 5,308                | (11,976)           | (17,284)           |
| <b>Net cash used in operating activities</b>                                       | <b>(683,676)</b>     | <b>(1,699,008)</b>   | <b>(3,064,613)</b>   | <b>(1,567,253)</b> | <b>(2,889,948)</b> |
| <b>Cash flows from investing activities:</b>                                       |                      |                      |                      |                    |                    |
| Patent costs   | —                    | (5,986)              | (3,166)              | (2,712)            | (2,822)            |
| Purchases of property and equipment  | —                    | (2,432)              | (88,884)             | (6,050)            | (81,337)           |
| Maturities (purchase) of marketable securities                                     | 518,050              | —                    | (6,584,750)          | —                  | 3,007,110          |
| <b>Net cash provided by (used in) investing activities</b>                         | <b>518,050</b>       | <b>(8,418)</b>       | <b>(6,676,800)</b>   | <b>(8,762)</b>     | <b>2,922,951</b>   |
| <b>Cash flows from financing activities:</b>                                       |                      |                      |                      |                    |                    |
| Proceeds from issuance of Series C preferred stock                                 | —                    | 1,500,000            | 9,171,480            | 1,100,000          | —                  |
| Expenses related to Series C preferred stock offering                              | —                    | (252,278)            | (447,553)            | —                  | —                  |
| Proceeds from (repayment of) notes payable to stockholders                         | —                    | 48,000               | (48,000)             | —                  | —                  |
| Proceeds from issuance of notes payable  | —                    | 520,000              | 920,000              | 920,000            | —                  |
| Proceeds from sale of common stock   | —                    | —                    | 137,500              | 137,500            | —                  |
| Payment for stock subscription receivable  | —                    | —                    | —                    | —                  | 34,500             |
| <b>Net cash provided by financing activities</b>                                   | <b>—</b>             | <b>1,815,722</b>     | <b>9,733,427</b>     | <b>2,157,500</b>   | <b>34,500</b>      |
| Net (decrease) increase in cash and cash equivalents                               | (165,626)            | 108,296              | (7,986)              | 581,485            | 67,503             |
| Cash and cash equivalents at beginning of period                                   | 174,021              | 8,395                | 116,691              | 116,691            | 108,705            |
| <b>Cash and cash equivalents at end of period</b>                                  | <b>\$ 8,395</b>      | <b>\$ 116,691</b>    | <b>\$ 108,705</b>    | <b>\$ 698,176</b>  | <b>\$ 176,208</b>  |
| <b>Supplemental Cash Flow Information:</b>   |                      |                      |                      |                    |                    |
| Cash paid for interest   | \$ —                 | \$ 24,378            | \$ 14,976            | \$ —               | \$ —               |
| <b>Supplemental Schedule of Noncash Financing Activities:</b>                      |                      |                      |                      |                    |                    |
| Notes payable exchanged for Series C preferred stock                               | \$ —                 | \$ 505,000           | \$ 1,015,000         | \$ —               | \$ —               |
| Notes receivable received for common stock   | \$ —                 | \$ 69,000            | \$ —                 | \$ —               | \$ —               |
| Preferred stock accretion  | \$ 180,009           | \$ 25,228            | \$ 257,545           | \$ 25,228          | \$ 646,496         |
| Reduction to liquidation value Series B preferred stock                            | —                    | \$ 2,329,000         | —                    | —                  | —                  |
| Beneficial conversion feature in connection with Series C preferred stock          | —                    | —                    | \$ 1,465,003         | —                  | —                  |
| Fair value of warrants issued in connection with Series C preferred stock          | —                    | —                    | \$ 2,643,392         | —                  | —                  |
| Accrued registration costs   | —                    | —                    | —                    | —                  | \$ 672,873         |
| Reclassification of inventories and patents to assets held for sale                | —                    | —                    | —                    | —                  | \$ 156,677         |

See accompanying notes to financial statements

**ELECTRO-OPTICAL SCIENCES, INC.**

**NOTES TO FINANCIAL STATEMENTS**

**(In thousands, except for share and per share data)**

**(Information for the six months ended June 30, 2004 and 2005 is unaudited)**

**1. PRINCIPAL BUSINESS ACTIVITIES AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:**

**Organization and Business**

Electro-Optical Sciences, Inc., a Delaware corporation (the "Company") is focused on the design and development of a non-invasive, point-of-care instrument for assisting in the early diagnosis of melanoma. The Company has entered into a Protocol Agreement with the Food and Drug Administration (FDA) which is an agreement for the conduct of the pivotal trial and to establish the safety and effectiveness of the MelaFind® device. Upon obtaining premarket approval, or PMA, from the FDA, the Company plans to launch MelaFind® in the United States.

To date the Company has not generated any revenues from MelaFind®. All of the Company's historical revenues have come from activities and products that have since been discontinued, including our DIFOTI® product, a non-invasive imaging device for the detection of dental cavities. The Company discontinued all operations associated with its DIFOTI® product effective as of April 5, 2005, in order to focus its resources on the development and commercialization of MelaFind®. The Company is currently seeking a buyer for the DIFOTI® assets, and does not expect to have any significant continuing responsibility for the DIFOTI® business after the sale of the DIFOTI® assets. (See note 12)

**Interim Financial Statements**

The accompanying balance sheet as of June 30, 2005, and the statements of operations, stockholders' equity (deficiency) and cash flows for the six months ended June 30, 2004 and 2005 are unaudited. The unaudited interim financial statements have been prepared on the same basis as the annual financial statements and, in the opinion of management, reflect all adjustments, which include only normal recurring adjustments necessary to present fairly the Company's financial position and results of operations and cash flows for the six months ended June 30, 2004 and 2005. The financial data and other information disclosed in these notes to financial statements related to the six month periods are unaudited. The results for the six months ended June 30, 2005 are not necessarily indicative of the results to be expected for the year ending December 31, 2005.

**Pro Forma Balance Sheet**

The Pro Forma Balance Sheet gives effect as of June 30, 2005 to the conversion of all of the Company's outstanding preferred stock into 3,398,105 shares of common stock which will occur upon the closing of the proposed initial public offering. Upon such conversion, the deemed dividends on the convertible preferred stock will be forfeited. Additionally, it is assumed for pro forma purposes that 2,610,643 of the Company's warrants to purchase the Company's common stock will be exchanged for a total of 1,305,321 shares of the Company's common stock based on an exchange ratio of one share of the Company's common stock for every two shares of the Company's common stock purchaseable under the warrants and will occur prior to the closing of the proposed initial public offering.

**Reverse Stock Split**

The Board of Directors approved on May 13, 2005, a one-for-two reverse stock split, which became effective on the date of the filing of the Registration Statement which was declared effective with respect to the Company's initial public offering. All references to common stock, common shares outstanding, average number of common shares outstanding, per share amounts, common stock options and warrants in these financial statements and notes to financial statements have been restated to reflect the one-for-two common stock reverse split on a retroactive basis.

**ELECTRO-OPTICAL SCIENCES, INC.**  
**NOTES TO FINANCIAL STATEMENTS — (Continued)**

**Cash and Cash Equivalents**

The Company maintains cash in bank deposit accounts which, at times, may exceed federally insured limits. The Company has not experienced any losses on these accounts. Cash equivalents include all highly-liquid debt instruments with an original maturity of three months or less at the date of acquisition.

**Marketable Securities**

Marketable securities consist of debt securities that the Company has the intent and ability to hold to maturity. The Company classifies the marketable securities as held-to-maturity in accordance SFAS No. 115, "Accounting for Certain Investments in Debt and Equity Securities." Held-to-maturity securities are recorded at amortized cost.

**Accounts Receivable**

Accounts receivable are reported at their outstanding unpaid principal balances reduced by an allowance for doubtful accounts. The Company estimates doubtful accounts based on historical bad debts, factors related to specific customers' ability to pay and current economic trends. The Company writes off accounts receivable against the allowance when a balance is determined to be uncollectible.

**Inventories**

Inventories, which consist primarily of DIFOTI® supplies, are stated at the lower of cost, determined by the first-in, first-out method, or market.

**Assets Held for Sale**

Assets held for sale at June 30, 2005 consisted of DIFOTI® related inventories and patents.

**Deferred Registration Costs**

The costs associated with the Company's proposed initial public offering have been recorded as deferred registration costs and will reduce additional paid-in capital if the offering is effective. Should the offering not be consummated, the deferred registration costs will be recognized as a charge to operations.

**Property and Equipment**

Depreciation of property and equipment is provided for by the straight-line method over the estimated useful lives of the related assets. Leasehold improvements are amortized over the lesser of the assets' useful lives or the remaining term of the lease.

**Patents**

Patents are carried at cost less accumulated amortization which is calculated on a straight-line basis over a period of 15 years.

**Revenue Recognition**

During April 2005, the Company discontinued the sale of the DIFOTI® product line. (Note 12). Revenue from DIFOTI® product sales was recognized at the time of delivery and acceptance, and after consideration of all the terms and conditions of the customer contract. Certain of the Company's products which were being sold prior to December 31, 2004 included a 30-day return policy. Revenue on these products was recognized after the shipment was made and the 30-day return period had elapsed. Effective January 1, 2005 all products were sold without a right of return and revenue was therefore recognized



**ELECTRO-OPTICAL SCIENCES, INC.**  
**NOTES TO FINANCIAL STATEMENTS — (Continued)**

upon shipment. Deferred revenues at December 31, 2004 consisted of revenues that were billed and paid in advance of the shipment of the product.

The Company has not received FDA approval for the sale of Melafind® and has had no revenues from products other than DIFOTI®.

Grant revenue generated in 2002 represents federal grants received by the Company in conjunction with an undertaking to perform certain research. The cost of grant revenue consists primarily of payroll and related costs amounting to \$564.

**Warranty Costs**

The Company generally warranted its only commercialized product, DIFOTI®, for one year after the sale had been completed. Through March 31, 2005, warranty costs were de minimus, and were recorded by the Company as incurred. During the quarter ended June 30, 2005, in connection with the discontinuance of its DIFOTI® product line, the Company recorded a reserve for warranty expense in accordance with the requirements of Statement of Financial Accounting Standards No. 5 “Accounting for Contingencies” (SFAS No. 5), in the amount of \$20 since the Company believes it is probable that such discontinuance will lead to warranty claims. As of June 30, 2005, prior sales of approximately \$200 were subject to possible warranty claims.

**Income Taxes**

Deferred tax assets and liabilities are recognized for the estimated future tax consequences attributable to differences between the amounts of existing assets and liabilities recorded in the financial statements and their respective tax bases and the benefits arising from the realization of operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using tax rates in effect for the year in which those temporary differences are expected to be recovered or settled. A valuation allowance is established when necessary to reduce deferred tax assets to the amount expected to be realized.

**Estimates**

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires the use of estimates and assumptions by management that affect reported amounts of assets and liabilities and disclosures 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 these estimates.

**Long-lived Assets**

The Company reviews long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. An asset is considered to be impaired when the sum of the undiscounted future net cash flows expected to result from the use of the asset and its eventual disposition exceeds its carrying amount. The amount of impairment loss, if any, is measured as the difference between the net book value of the asset and its estimated fair value.

**Research and Development**

Research and development costs are expensed as incurred.

**ELECTRO-OPTICAL SCIENCES, INC.**  
**NOTES TO FINANCIAL STATEMENTS — (Continued)**

**Stock-Based Compensation**

The Company applies the intrinsic-value method of accounting prescribed by the Accounting Principles Board (APB) Opinion No. 25 and related interpretations to account for the Company's fixed-plan employee stock options. Under this method, compensation expense is recorded on the date of grant only if the then current market price of the underlying stock exceeded the exercise price. Statement of Financial Accounting Standards (SFAS) No. 123, Accounting for Stock-Based Compensation, as amended by SFAS No. 148, *Accounting for Stock-Based Compensation, Transition and Disclosure*, established accounting and disclosure requirements using a fair-value based method of accounting for stock-based employee compensation plans. As allowed by SFAS No. 123 and No. 148, the Company has elected to continue to apply the intrinsic-value based method of accounting for employee stock options described above, and has adopted only the disclosure requirements of SFAS No. 123. Had the Company elected to recognize compensation cost based on the fair value of the options granted at the grant date, as prescribed by SFAS No. 123, the Company's net loss and net loss per share would have been adjusted to the pro forma amounts indicated below:

|   | December 31,      |                   |                   | June 30,         |                   |
|---|-------------------|-------------------|-------------------|------------------|-------------------|
|   | 2002              | 2003              | 2004              | 2004             | 2005              |
| Net loss attributable to common stockholders, as reported   | \$ (1,535)        | \$ (2,399)        | \$ (4,553)        | \$ (1,784)       | \$ (4,175)        |
| Add: stock-based employee compensation included in reported net loss, net of income tax effect                        | 72                | 23                | 173               | 11               | 87                |
| Deduct: stock-based employee compensation expense determined under fair-value-based method, net of related tax effect | (75)              | (65)              | (186)             | (8)              | (90)              |
| Pro forma net loss  | <u>\$ (1,538)</u> | <u>\$ (2,441)</u> | <u>\$ (4,566)</u> | <u>(1,781)</u>   | <u>\$ (4,178)</u> |
| Basic and diluted loss per share, as reported   | <u>\$ (1.00)</u>  | <u>\$ (1.49)</u>  | <u>\$ (2.58)</u>  | <u>\$ (1.04)</u> | <u>\$ (2.31)</u>  |
| Basic and diluted loss per share, pro forma   | <u>\$ (1.00)</u>  | <u>\$ (1.51)</u>  | <u>\$ (2.58)</u>  | <u>\$ (1.04)</u> | <u>\$ (2.31)</u>  |

The per share weighted-average fair value of stock options granted during 2002, 2003 and 2004 was \$0.26, \$0.34, and \$3.00, respectively, on the dates of grant using the Black-Scholes option-pricing model.

During the six months ended June 30, 2005, the Company did not grant any stock options. The per share weighted average fair value of stock options granted during the six months ended June 30, 2004 was determined using the Black-Scholes option pricing model resulting in a weighted average fair value of \$0.25 per share. The following weighted-average assumptions were used:

|                                 | December 31, |       |       | June 30, |      |
|---------------------------------|--------------|-------|-------|----------|------|
|                                 | 2002         | 2003  | 2004  | 2004     | 2005 |
| Expected volatility             | 1%           | 1%    | 60%   | 60%      | —    |
| Risk-free interest rate         | 4.52%        | 4.52% | 3.17% | 3.39%    |      |
|                                 | to           | to    | to    |          |      |
|                                 | 5.43%        | 5.43% | 3.94% |          |      |
| Expected option life (in years) | 10           | 10    | 5     | 5        |      |
| Expected dividend yield         | 0%           | 0%    | 0%    | 0%       |      |

**ELECTRO-OPTICAL SCIENCES, INC.**  
**NOTES TO FINANCIAL STATEMENTS — (Continued)**

Options or warrants issued to non-employees for services are recorded at fair value and accounted for in accordance with Emerging Issues Task Force (EITF) No. 96-18, *Accounting for Equity Instruments That Are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling, Goods or Services*. For equity instruments that are not immediately vested, compensation cost is measured on the date such instruments vest or a performance commitment, as defined in EITF 96-18, is reached. The costs are classified in the accompanying statements of operations based on the nature of the services performed.

**Deferred Compensation**

Deferred compensation attributable to unvested common stock options is measured at the measurement date for the respective grants, and reflected as a deduction from stockholders' equity. Compensation expense is recognized ratably over the vesting period.

**Financial Instruments**

The Company's financial instruments consist principally of cash and cash equivalents, marketable securities, accounts receivable and accounts payable. The Company believes the financial instruments' recorded values approximate current values because of their nature and respective durations. The Company maintains cash in bank deposit accounts, which, at times, may exceed federally insured limits. The Company has not experienced any losses on these accounts.

**Net Loss per Common Share**

Net loss per share is presented in accordance with the provisions of SFAS No. 128, "Earnings Per Share" (EPS). Basic EPS excludes dilution for potentially dilutive securities and is computed by dividing loss attributable to common stockholders by the weighted average number of common shares outstanding during the period. Diluted EPS gives effect to dilutive options, warrants and other potential common shares outstanding during the period. Diluted net loss per common share is equal to basic net loss per common share since all potentially dilutive securities are anti-dilutive for each of the periods presented. Diluted net loss per common share for the years ended December 31, 2002, 2003 and 2004 does not include the effects of options to purchase 142,581, 290,678 and 965,203 shares of common stock, respectively and 407,182 and 899,875 shares for the six months ended June 30, 2004 and 2005 respectively; 690, 369,993 and 2,758,923 common stock warrants for the years ended December 31, 2002, 2003 and 2004, respectively, and 673,662 and 2,758,923 common stock warrants for the six months ended June 30, 2004 and 2005, respectively.

The pro forma basic and diluted loss from continuing operations per common share for the year ended December 31, 2004 and for the six months ended June 30, 2005 gives effect to the conversion of the existing shares of preferred stock into 3,398,105 shares of common stock at the conversion ratios which would apply upon consummation of the proposed initial public offering and the exchange of 2,610,643 warrants for 1,305,321 shares of common stock as described in Note 9. In addition, the loss from continuing operations used in the computation of unaudited pro forma basic and diluted loss from continuing operations per share has been adjusted to reverse the accretion on the Company's preferred stock and also excludes the preferred stock dividends for the respective periods.

**Recently Issued Pronouncements**

In December 2004, the Financial Accounting Standards Board (FASB) issued the revised SFAS No. 123, Share-Based Payment (SFAS 123R), which addresses the accounting for share-based payment transactions in which the Company obtains employee services in exchange for (a) equity instruments of the Company or (b) liabilities that are based on the fair value of the Company's equity instruments or that may be settled by the issuance of such equity instruments. SFAS 123R eliminates the ability to account for employee share-based payment transactions using APB No. 25 and requires instead

**ELECTRO-OPTICAL SCIENCES, INC.**  
**NOTES TO FINANCIAL STATEMENTS — (Continued)**

that such transactions be accounted for using the grant-date fair value based method. SFAS 123R will be effective as of the beginning of the first interim or annual reporting period that begins after December 15, 2005 (January 1, 2006 for the Company) and applies to all awards granted or modified after the effective date. In addition, compensation cost for the unvested portion of previously granted awards that remain outstanding on the effective date shall be recognized on or after the effective date, as the related services are rendered, based on the awards' grant-date fair value as previously calculated for the pro-forma disclosure under SFAS 123. The Company expects that upon the adoption of SFAS 123R it will apply the modified prospective application transition method, as permitted by the statement. Under such transition method, upon the adoption of SFAS 123R, the Company's financial statements for periods prior to the effective date of the statement will not be restated. The impact of this statement on the Company's financial statements or its results of operations in 2005 and beyond will depend upon various factors, among them, its future compensation strategy. The Company expects that the effect of applying this statement on its results of operations in 2005 as it relates to existing option plans would not be materially different from the SFAS 123 pro forma effect previously reported.

In March 2004, the FASB issued EITF Issue No. 03-1, "The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments," which provides new guidance for assessing impairment losses on debt and equity investments. Additionally, EITF Issue No. 03-1 includes new disclosure requirements for investments that are deemed to be temporarily impaired. In September 2004, the FASB delayed the accounting provisions of EITF Issue No. 03-1; however, the disclosure requirements remain effective and have been adopted by the Company in the financial statements. The Company will evaluate the effect, if any, of EITF Issue No. 03-1 when final guidance is released.

**2. MARKETABLE SECURITIES:**

The Company's investments mature within one year. Investments in marketable securities are summarized as follows at December 31, 2004 and June 30, 2005:

|                             | <u>December 31, 2004</u>             |                       |                           | <u>June 30, 2005</u>                 |                       |                           |
|-----------------------------|--------------------------------------|-----------------------|---------------------------|--------------------------------------|-----------------------|---------------------------|
|                             | <u>Gross<br/>Unrealized<br/>Loss</u> | <u>Fair<br/>Value</u> | <u>Amortized<br/>Cost</u> | <u>Gross<br/>Unrealized<br/>Loss</u> | <u>Fair<br/>Value</u> | <u>Amortized<br/>Cost</u> |
| Corporate commercial paper  | \$ —                                 | \$ 2,500              | \$ 2,500                  | \$ —                                 | \$ —                  | \$ —                      |
| Corporate debt              | (10)                                 | 2,497                 | 2,507                     | (2)                                  | 2,024                 | 2,026                     |
| United States Treasury note | (8)                                  | 1,580                 | 1,588                     | (7)                                  | 1,585                 | 1,592                     |
|                             | <u>\$ (18)</u>                       | <u>\$ 6,577</u>       | <u>\$ 6,595</u>           | <u>\$ (9)</u>                        | <u>\$ 3,609</u>       | <u>\$ 3,618</u>           |

**3. PROPERTY AND EQUIPMENT:**

Property and equipment, at cost, consists of the following:

|  | <u>December 31,</u> |             | <u>June 30,<br/>2005</u> | <u>Estimated<br/>Useful Life</u> |
|--|---------------------|-------------|--------------------------|----------------------------------|
|  | <u>2003</u>         | <u>2004</u> |                          |                                  |
| Leasehold improvements                         | \$ 23               | \$ 32       | \$ 65                    | 5-10 years                       |
| Laboratory and research equipment              | 61                  | 119         | 119                      | 5 years                          |
| Office furniture and equipment                 | 113                 | 135         | 184                      | 5 years                          |
|  | 197                 | 286         | 368                      |                                  |
| Less accumulated depreciation and amortization | 179                 | 197         | 213                      |                                  |
|  | <u>\$ 18</u>        | <u>89</u>   | <u>\$ 155</u>            |                                  |

**ELECTRO-OPTICAL SCIENCES, INC.**  
**NOTES TO FINANCIAL STATEMENTS — (Continued)**

Depreciation expense amounted to approximately \$16, \$15 and \$18, for the years ended December 31, 2002, 2003 and 2004, respectively and \$6 and \$15 for the six months ended June 30 2004 and 2005 respectively.

**4. PATENTS:**

Patents are shown in the accompanying balance sheets net of accumulated amortization of \$83 and \$101 at December 31, 2003 and 2004, respectively. At June 30, 2005, accumulated amortization applicable to patents in use amounted to \$61. In connection with the discontinuance of DIFOTI® operations in April 2005, patents with a net book value of \$71 have been reclassified as assets held for sale. Amortization expense related to the patents was approximately \$17, \$17 and \$18 for the years ended December 31, 2002, 2003 and 2004, respectively and \$9 and \$10 for the six months ended June 30, 2004 and 2005, respectively.

The estimated future amortization expense related to the patents is as follows:

|                         |              |
|-------------------------|--------------|
| Year ended December 31, |              |
| 2005                    | \$ 14        |
| 2006                    | 10           |
| 2007                    | 10           |
| 2008                    | 10           |
| 2009                    | 10           |
| Thereafter              | 40           |
|                         | <u>\$ 94</u> |

**5. NOTES PAYABLE-STOCKHOLDERS:**

During 2003, the Company had notes payable to two of its stockholders totaling \$48. These notes were payable in October 2004, bore interest at 6%, and were repaid during 2004. Interest expense amounted to approximately \$1 and \$2 for the years ended December 31, 2003 and 2004, respectively. In addition, the Company had a demand note payable to one of its stockholders in the amount of \$15 with interest accruing at 12% per annum. During October 2004, the note and accrued interest of \$1 were converted into 6,999 shares of Series C preferred stock.

**6. COMMITMENTS AND CONTINGENCIES:**

The Company is obligated under two non cancelable operating leases for office space expiring June 2009 and November 2010. The leases are subject to escalations for increases in operating expenses. The approximate aggregate minimum future payments under these leases are due as follows:

|                         |                 |
|-------------------------|-----------------|
| Year ended December 31, |                 |
| 2005                    | \$ 205          |
| 2006                    | 204             |
| 2007                    | 213             |
| 2008                    | 217             |
| 2009                    | 170             |
| Thereafter              | 105             |
|                         | <u>\$ 1,114</u> |

**ELECTRO-OPTICAL SCIENCES, INC.**  
**NOTES TO FINANCIAL STATEMENTS — (Continued)**

Rent expense charged to operations amounted to approximately \$88, \$113 and \$110 for the years ended December 31, 2002, 2003 and 2004, respectively, and \$54 and \$94 for the six months ended June 30, 2004 and 2005, respectively.

During January 2004, the Company entered into an employment agreement with its President and Chief Executive Officer through December 31, 2005, which provides for a base salary of \$175, stock options and performance bonuses. The agreement provides for automatic one year renewal terms.

During January 2004 the Company amended its employment agreement with its former president, who now holds the title Chief Science and Technology Officer. The agreement was originally entered into in May 2003 with a three-year term. The agreement now includes a salary of \$175 and provides for stock options and performance bonuses. As of May 31, 2005, this former employee is now a consultant to the Company.

The Company had been involved in various claims and legal actions arising in the ordinary course of business. The ultimate outcome of these matters did not have a material adverse impact on the financial position of the Company or the results of its operations.

**7. EMPLOYEE BENEFIT PLAN:**

The Company has a defined contribution plan under Section 401(k) of the Internal Revenue Code covering all qualified employees. An officer of the Company serves as trustee of the plan. The Company provides a matching contribution of up to 3% of each employee's salary. Contributions to this plan amounted to approximately \$29, \$12 and \$25 for the years ended December 31, 2002, 2003 and 2004, respectively, and \$11 and \$15 for the six months ended June 30, 2004 and 2005, respectively.

**8. STOCKHOLDERS' (DEFICIENCY) EQUITY AND REDEEMABLE PREFERRED STOCK  
(as restated — see Note 13):**

During January 2003, the Company received \$180 in exchange for issuing a convertible promissory note bearing interest at 10% per annum. The note was convertible at a discount of 20% on the next round of financing. In June 2003, the note was converted into Series C redeemable convertible preferred stock. (See discussion below.) Upon conversion of the note the Company recorded a charge of \$45 to reflect the value of the beneficial conversion of the shares since the shares were converted at \$1.81 per share, a 20% discount. In addition, the Company granted the note holder five-year warrants to purchase 25% of the total number of securities issued upon conversion of the note, which amounted to 99,558 shares (or 24,890 warrants), at an exercise price equal to the per share price of the next financing as defined in the loan agreement. The value of these warrants was de minimus. For the year ended December 31, 2003, interest on these notes amounted to approximately \$8.

During February 2003, certain stockholders loaned the Company \$325 bearing interest at 12% per annum. In June 2003, these loans were converted into 143,802 shares of Series C redeemable convertible preferred stock at \$2.26 per share. For the year ended December 31, 2003, interest on these notes amounted to approximately \$21.

During June 2003, the Company completed a private placement whereby investors agreed to acquire up to 1,400,000 preferred Series C units. Each unit consists of one share of Series C redeemable convertible preferred stock and one warrant to purchase one share of common stock at an exercise price of \$13.00 per share. Of the 1,400,000 units, the first tranche of 663,717 units was sold for an aggregate of \$1,500. Costs associated with this issuance amounted to \$252. This amount will be accreted to the Series C over the redemption period. For the year ended December 31, 2003, \$25 was accreted. The value of the warrants was de minimus.

In order to complete the June 2003 private placement, the Series A and B stockholders consented to modifications to certain of their rights, preferences, and privileges. The Series A preferred shares were split 1,000 for 1 and due to the anti-dilution provision, the conversion ratio of Series A was changed to 0.5818

**ELECTRO-OPTICAL SCIENCES, INC.**

**NOTES TO FINANCIAL STATEMENTS — (Continued)**

to 1 (totaling 16,202 shares of common stock). Additionally, the Company granted a stock distribution of 45,000 shares of Series B preferred stock to the Series B stockholders, valued at \$102 or \$2.26 per share. As a result of these modifications, the Company adjusted the carrying amount of the Series B preferred stock. Due to the anti-dilution provision, the conversion ratio of Series B was changed to 0.5796 to 1 (totaling 79,043 shares of common stock). The Series C redeemable convertible preferred stock converts to common stock at a ratio of 0.50 to 1.

In connection with the private placement, 150,000 shares of common stock were sold to the promoters, who are related parties, at \$.46 per share. Notes of \$69 were received for this purchase and is shown as a reduction in stockholders' equity (deficiency). The note bears interest at 3.06% and is due June 20, 2008. Interest income amounted to approximately \$2 and \$1 for the years ended December 31, 2004 and 2003, respectively. During June 2005, the notes of \$69 were retired by a cash payment and consulting services rendered.

During 2004, the second tranche of the Series C private placement was completed and an additional 486,725 of Series C units were issued for total proceeds of \$1,100. An additional 427 units were distributed in order to comply with minimum ownership provisions. The value of the distribution was de minimus. In order to induce the investment in this second tranche, the Company issued additional warrants to purchase 60,840 shares of Series C redeemable convertible preferred stock at a price of \$4.52 per share. These warrants were valued at \$179.

During May 2004, the Company obtained bridge loans in the amount of \$1,000 from related parties. The loans bear interest at 1.57% and were payable on December 31, 2004. During October 2004 these loans were converted into 442,469 preferred Series C units at a price of \$2.26 per unit. The warrants were valued at \$327. The Company also sold approximately 125,000 shares of common stock to the lenders at \$.46 per share for \$57. The Company ascribed a value to the common stock and recorded an imputed interest charge of \$80.

During October 2004, the Company completed a second private placement and sold 3,578,081 preferred Series C units for total proceeds of approximately \$8,100 at a price of \$2.26 per unit. The warrants were valued at \$2,653. Costs of the Series C private placement amounted to approximately \$448. This amount will be accreted to the Series C over the redemption period.

During 2004, the Company issued 4,507,702 shares of Series C redeemable convertible preferred stock with 2,253,792 warrants to purchase common stock at \$13.00 per share and 60,840 Series C redeemable convertible preferred stock warrants at an exercise price of \$4.52 per share for gross proceeds of \$10,186. The net proceeds of \$9,738 were allocated to redeemable convertible preferred stock and additional paid-in capital based on the relative fair values of the preferred stock and warrants. The fair value of the warrants was determined using the Black-Scholes method. The assumptions used to value these warrants are described in Note 9. The Company recorded a beneficial conversion feature of \$1,465 which is being accreted to redemption for the Series C redeemable convertible preferred stock based on the earliest redemption date of June 2008.

The total accretion to redemption value for the Series C amounted to \$25, \$258, and \$647 for the years ended December 31, 2003 and 2004 and the six months ended June 30, 2005, respectively.

The following table summarizes the recorded accretion for the aforementioned periods:

|                                    | Total<br>Amount | Accretion<br>Period in<br>Months | Year Ended<br>December 31, |               | Six Months<br>Ended<br>June 30, 2005 |
|------------------------------------|-----------------|----------------------------------|----------------------------|---------------|--------------------------------------|
|                                    |                 |                                  | 2003                       | 2004          |                                      |
| June 2003 Series C financing costs | \$ 252          | 60                               | \$ 25                      | \$ 51         | \$ 25                                |
| Oct. 2004 Series C financing costs | 448             | 44                               |                            | 20            | 61                                   |
| Value of Series C warrants         | 2,643           | 44                               |                            | 120           | 361                                  |
| Beneficial Conversion — Series C   | 1,465           | 44                               | —                          | 67            | 200                                  |
| <b>Total</b>                       | <b>\$ 4,808</b> |                                  | <b>\$ 25</b>               | <b>\$ 258</b> | <b>\$ 647</b>                        |

**ELECTRO-OPTICAL SCIENCES, INC.**  
**NOTES TO FINANCIAL STATEMENTS — (Continued)**

The rights, preferences, and privileges of the Series B and C redeemable preferred stock are as follows:

**Voting Rights**

All holders of redeemable convertible preferred stock have voting rights equal to the number of shares of common stock into which the respective preferred stock is convertible.

**Liquidation Preference**

In the event of liquidation, dissolution, or winding-up of the Company, and before any distribution to common stockholders, the holders of Series B and C redeemable convertible preferred stock are entitled to receive \$2.26 per share plus all accrued but unpaid dividends.

**Deemed Dividends**

Dividends on the Series B and Series C redeemable convertible preferred stock may be declared at the discretion of the board of directors at an annual rate equal to 10%, as adjusted, of the accreted value per share and shall be payable in preference and priority to any declaration or payment of any distribution on Series A preferred stock or common stock and will be cumulative. At December 31, 2004 and June 30, 2005 there are approximately \$1,510 and \$2,229 of deemed but unpaid dividends. In the event the preferred stock is converted into common stock, any related deemed dividends would be forfeited.

**Redemption Provisions**

Pursuant to the modification of the Series B preferred stock terms adopted at the closing of the Series C private placement, the requirement to redeem the preferred shares, at the option of the holder, has been extended to June 2008. The redemption of Series B requires approval of the Series C shareholders. The preferred Series C stock is redeemable at the option of the holder, on the fifth and sixth anniversary of the first issuance of Series C preferred stock (June 2003). Series B has been classified as temporary equity at its redemption value; Series C has been so classified at its accreted value.

**Series C Preferred Stock Carrying Value**

The following table summarizes the changes in carrying amount of the Company's Series C redeemable convertible preferred stock for the year ended December 31, 2004, and the six months ended June 30, 2005.

|   |          |
|---|----------|
| Balance at December 31, 2003  | \$ 1,823 |
| Issuance of Series C preferred stock in 2004, less associated costs of \$447, value of warrants sold therewith of \$2,643, and allocation to beneficial conversion feature of \$1,465 | 5,630    |
| Preferred stock accretion   | 258      |
| Balance at December 31, 2004  | \$ 7,711 |
| Preferred stock accretion   | 647      |
| Balance at June 30, 2005  | \$ 8,358 |



**ELECTRO-OPTICAL SCIENCES, INC.**  
**NOTES TO FINANCIAL STATEMENTS — (Continued)**

**9. STOCK OPTIONS AND WARRANTS:**

**Warrants**

Warrants outstanding consist principally of warrants issued in connection with the Company's Series C financing and generally expire seven years from the date of grant.

During 2003, in connection with the sale of Series C redeemable convertible preferred stock, 356,851 warrants to purchase common stock at an exercise price of \$13.00 per share were issued. The fair value of these warrants was determined to be de minimus using the Black-Scholes method. The assumptions used in determining the fair value were the following: common stock value per share of \$0.46, warrant life of 7 years, a risk-free interest rate of 3.67%, and an expected volatility of 1%. The Company also issued 12,445 warrants to purchase shares of Series C redeemable convertible preferred stock at an exercise price of \$4.52. The fair value of these warrants was determined to be de minimus using the Black-Scholes method assuming a stock price of \$4.52 per share, warrant life of 5 years, a risk-free interest rate of 3.67%, and an expected volatility of 1%.

During 2004, in connection with the sale of Series C redeemable convertible preferred stock, 2,253,792 warrants to purchase common stock at an exercise price of \$13.00 per share were issued. The fair value of these warrants ranged from \$0.02 to \$1.48 using the Black-Scholes method. The assumptions used in determining the fair value were the following: common stock value per share ranged from \$0.46 to \$4.00, warrant life of 7 years, a risk-free interest rate of 3.67%, and an expected volatility of 60%. The Company also issued 60,840 warrants to purchase shares of Series C redeemable convertible preferred stock at an exercise price of \$4.52. The fair value of these warrants was determined to be \$2.94 using the Black-Scholes method assuming a stock price of \$4.52 per share, warrant life of 7 years, a risk-free interest rate of 3.67%, and an expected volatility of 60%. The total fair value of the aforementioned warrants issued in 2004 aggregated \$3,159.

During 2004, the Company issued a 5 year warrant to purchase 75,000 shares of common stock at an exercise price of \$7.00 per share to one of its consultants. These warrants have been valued at \$120 using the Black-Scholes method and was recorded as compensation expense. The assumptions used in determining the fair value were the following: common stock value per share of \$4.00, warrant life of 5 years, a risk-free interest rate of 3.67%, and an expected volatility of 60%.

Warrant activity during the periods indicated is as follows:

|                                  | Warrants         | Weighted-Average Exercise Price |
|----------------------------------|------------------|---------------------------------|
| Outstanding at January 1, 2002   | 10,505           | \$ 10.00                        |
| Expired                          | (9,815)          | 10.00                           |
| Outstanding at December 31, 2002 | 690              | \$ 10.00                        |
| Granted                          | 369,303          | 12.72                           |
| Outstanding at December 31, 2003 | 369,993          | 12.70                           |
| Granted                          | 2,389,620        | 12.60                           |
| Expired                          | (690)            | 10.00                           |
| Outstanding at December 31, 2004 | <u>2,758,923</u> | <u>\$ 12.61</u>                 |

There was no warrant activity during the six months ended June 30, 2005.

**ELECTRO-OPTICAL SCIENCES, INC.**  
**NOTES TO FINANCIAL STATEMENTS — (Continued)**

On April 5, 2005, the Board of Directors approved, subject to stockholder approval, the issuance of 1,305,321 shares of the Company's common stock in exchange for 2,610,643 outstanding warrants (a conversion ratio of one share of common stock for two warrants.) The Company considers this transaction to be an exchange of equity instruments at fair value which will have no net effect on stockholders' equity. The fair value of the warrants was determined using the Black-Scholes method and assumed the following: common stock value of \$10.00 per share, remaining warrant life of 6.25 years, risk-free interest rate of 3.2%, and an expected volatility of 60%.

**Stock Options**

The Company has three stock option plans (the "Plans") which allow the board of directors to grant incentives to employees, directors and collaborating scientists in the form of incentive stock options, nonqualified stock options and restricted stock. At December 31, 2004 and June 30, 2005, options to purchase 965,203 and 899,875 shares of common stock, respectively, at exercise prices ranging from \$.40 to \$10.00 per share are outstanding and are exercisable at various dates through 2013. The total number of shares reserved under the Company's stock option plans is 1,000,000.

In January 2003, the Company issued an option to acquire 24,209 shares of common stock at an exercise price of \$1.00 per share valued at approximately \$97 to outside consultants. During 2004, the Company issued options to acquire 27,750 shares of common stock at an exercise price of \$.46 per share valued at approximately \$73 to outside consultants. The fair value for these options granted to outside consultants was calculated using the Black-Scholes method. For the options granted during 2004 to outside consultants, the assumptions used in the Black-Scholes model were: common stock valued ranged from \$0.46 to \$4.00, expected life of 5 years, risk-free interest rate ranged from 3.39% to 3.94%, and an expected volatility of 60%.

During 2004 the Company issued 262,500 options to certain employees and Board members. The value of the options resulted in a charge to operations in the amount of \$150 and \$71 during the year ended December 31, 2004 and for the six months ended June 30, 2005, respectively. The share based compensation expense for these option grants represent the amount by which the fair value per common share of \$4.00 exceeds the exercise price per share of \$0.46.

**ELECTRO-OPTICAL SCIENCES, INC.**  
**NOTES TO FINANCIAL STATEMENTS — (Continued)**

Stock option activity during the periods indicated is as follows:

|  | Number<br>of Shares | Weighted-<br>average<br>Exercise<br>Price |
|--|---------------------|---|
| Outstanding at January 1, 2002           | 128,050             | \$ 2.28                                   |
| Granted                                  | 14,531              | 1.00                                      |
| Outstanding at December 31, 2002         | 142,581             | 2.16                                      |
| Granted                                  | 158,565             | .94                                       |
| Expired/ Forfeited                       | (10,468)            | .96                                       |
| Outstanding at December 31, 2003         | 290,678             | 1.12                                      |
| Granted                                  | 679,525             | .46                                       |
| Expired/ Forfeited                       | (5,000)             | 1.00                                      |
| Outstanding at December 31, 2004         | 965,203             | .66                                       |
| Expired/ Forfeited                       | (65,328)            | .89                                       |
| Outstanding at June 30, 2005             | 899,875             | \$ .64                                    |
| Options exercisable at December 31, 2004 | 428,729             | \$ .89                                    |
| Options exercisable at June 30, 2005     | 446,675             | .82                                       |

The following table summarizes information about fixed stock options outstanding at December 31, 2004:

| Range of<br>Exercise Prices | Options Outstanding   |  |   | Options Exercisable   |   |
|-----------------------------|-----------------------|--|---|-----------------------|---|
|                             | Number<br>Outstanding | Weighted-<br>average<br>Remaining<br>Contractual<br>Life | Weighted-<br>average<br>Exercise<br>Price | Number<br>Exercisable | Weighted-<br>average<br>Exercise<br>Price |
| \$.01-\$.46                 | 694,525               | 4.7 years  | \$ .46                                    | 173,989               | \$ .46                                    |
| \$.47-\$1.00                | 265,678               | 6.5 years  | 1.00                                      | 249,740               | 1.00                                      |
| \$1.01-\$10.00              | 5,000                 | .4 years   | 10.00                                     | 5,000                 | 10.00                                     |
| \$.01-\$10.00               | 965,203               | 5.7 years  | \$ .66                                    | 428,729               | \$ .89                                    |

As of June 30, 2005, of the total 899,875 options outstanding, 445,701 of these options will vest upon the attainment of certain milestones and will be charged to operations based on the then current Company's market price per share.

The employment agreement with Dr. Gulfo includes three separate grants of common stock options. The first two stock option grants for a total of 81,753 shares of the Company's common stock have fully vested. The number of shares of the Company's common stock subject to the third stock option can only be calculated at the time of PMA approval of MelaFind®. The number of shares under this option is equal to that number of shares of our common stock equal to four percent of the Company's fully diluted capital stock at the time of PMA approval of MelaFind® minus the 81,753 options granted to Dr. Gulfo under the employment agreement.

In May 2005, the Company amended option agreements for 125,000 shares in the aggregate of three key employees to immediately vest upon the completion of a successful initial public offering. The Company will record a charge to operations based upon the initial public offering price.

**ELECTRO-OPTICAL SCIENCES, INC.**  
**NOTES TO FINANCIAL STATEMENTS — (Continued)**

**10. INCOME TAXES:**

At December 31, 2004 and June 30, 2005, the Company had net operating loss carryforwards of approximately \$12,208 and \$15,017, respectively, available to offset future taxable income expiring at various dates through the year 2025. The Company's ability to utilize its net operating losses may be significantly limited due to changes in the Company's ownership as defined by federal income tax regulations. Without regard to any such limitations, the Company had a deferred tax asset of approximately \$3,443, \$4,883 and \$6,007 at December 31, 2003, 2004 and June 30, 2005, respectively. Because the Company anticipates continued losses for the foreseeable future, the Company has recorded a 100% valuation allowance against its deferred income tax assets for all periods. The increase in the valuation allowance for the years ended December 31, 2002, 2003, 2004 and six months ended on June 30, 2005 amounted to \$428, \$753, \$1,440 and \$1,124, respectively.

**11. RELATED PARTY CONSULTING AGREEMENTS:**

The Company has in place the following consulting agreements with related parties.

**Consulting Agreement with Breaux Castleman**

In June 2003, the Company entered into a consulting agreement with Breaux Castleman, the Chairman of the Company's Board of Directors, for consulting services related to the FDA approval of MelaFind®, and the Company's business and financial strategy. Under this agreement, Mr. Castleman receives compensation for each month of services rendered. The Company made payments pursuant to this consulting agreement \$48 in 2003, \$22 in 2004, and \$12 through June 30, 2005. This consulting agreement is terminable by either party on 30 days' written notice.

**Consulting Agreement with Marek Elbaum, Ph.D.**

Pursuant to a consulting agreement effective as of May 31, 2005, the Company retained Marek Elbaum, Ph.D., the Company's founder and former Chief Science and Technology Officer, as the Company's Chief Scientist. In consideration of the services to be provided, the Company has agreed to pay Dr. Elbaum a monthly fee of \$15. The term of this agreement extends for a period of two years and is automatically renewable for an additional one year period. In the event of a non-renewal, and in the event that Dr. Elbaum's services terminate as a result of his death or disability, we will pay to Dr. Elbaum a termination fee of \$100.

**Consulting Agreement with Robert Friedman, M.D.**

Effective as of June 1, 2005, the Company retained the services of Robert Friedman, M.D., for an initial term of one year as a consultant, medical advisor to our Board of Directors, and in connection with the clinical testing of MelaFind®. In consideration for these services, Dr. Friedman will be paid at a rate of \$5,000 per day. This consulting agreement is automatically renewed for successive one-year terms unless either party terminates the agreement at least 30 days prior to the expiration of the agreement.

**Consulting Agreement with Gerald Wagner, Ph.D.**

On June 1, 2005, the Company entered into a consulting agreement with Gerald Wagner, Ph.D., a member of the Company's Board of Directors, to direct our MelaFind® product development efforts and oversee the manufacturing process. The agreement ends three months following the initiation of the Company's pivotal clinical trial of MelaFind®. The consulting agreement provides for a flat fee of \$150,000, payable ratably over the course of the term, and a stock option grant to purchase 50,000 shares of the Company's common stock, subject to and immediately after completion of the Company's initial public offering at the public offering price per share.

**ELECTRO-OPTICAL SCIENCES, INC.**  
**NOTES TO FINANCIAL STATEMENTS — (Continued)**

**12. DISCONTINUED OPERATIONS AND ASSETS HELD FOR SALE:**

On March 9 through March 21, 2005, the Company was inspected by the FDA in connection with its DIFOTI® product, a non-invasive imaging device for the detection of dental cavities. On March 21, 2005, the Company was cited for failures to comply fully with FDA quality system regulation, or QSR, mandated procedures. These inspectional findings were discussed in a subsequent meeting with the FDA on April 28, 2005.

The Company is in the process of addressing the deficiencies noted.

The Company decided to discontinue all operations associated with its DIFOTI® product effective as of April 5, 2005, in order to focus its resources and attention on the development and commercialization of MelaFind®. The Company is currently seeking an acquirer for the DIFOTI® assets, and does not expect to have any significant continuing responsibility for the DIFOTI® business after its disposition.

Losses attributable to DIFOTI® operations discontinued in April 2005 amounted to \$201, \$12, \$426, \$102, and \$330 for the years ended December 31, 2002, 2003, 2004, and the six months ended June 30, 2004 and 2005, respectively.

SFAS No. 144 requires that long-lived assets to be disposed by sale be measured at the lower of carrying amount or fair value less cost to sell. SFAS No. 144 also broadened the reporting of discontinued operations to include all components of an entity with operations that will be eliminated from ongoing operations of the entity in a disposal transaction. At June 30, 2005, assets held for sale consisted of DIFOTI® related inventories and patents.

In accordance with the provisions of SFAS No. 144, the results of operations of the discontinued business have been reported as discontinued operations for all periods presented in the accompanying financial statements.

**ELECTRO-OPTICAL SCIENCES, INC.**  
**NOTES TO FINANCIAL STATEMENTS — (Continued)**

**13. REVISIONS TO PREVIOUSLY ISSUED FINANCIAL STATEMENTS AS OF AND FOR THE YEAR ENDED DECEMBER 31, 2004 AND SIX MONTHS ENDED JUNE 30, 2005.**

The Company has recomputed the relative fair value of warrants and related beneficial conversion feature in connection with the issuance of Series C preferred stock in October 2004 referred to in Note 8. Such recomputation resulted in a change in the preferred stock accretion for the historical year ended December 31, 2004 and the six months ended June 30, 2005. The following table summarizes the recomputation of the fair values.

|  | <u>As Previously<br/>Reported</u> | <u>As Restated</u> | <u>Adjustment</u> |
|--|-----------------------------------|--------------------|-------------------|
| Value of warrants                      | \$ 3,158,948                      | \$ 2,643,392       | \$ 515,556        |
| Value of beneficial conversion feature | 2,385,063                         | 1,465,003          | 920,060           |

A summary of the changes to the Company's previously issued financial statements is as follows:

|  | <u>Series C<br/>Preferred<br/>Stock</u> | <u>Additional<br/>Paid-in<br/>Capital</u> | <u>Stockholders'<br/>(Deficiency)<br/>Equity</u> |
|--|---|---|--|
| As previously reported, December 31, 2004  | \$ 6,340,666                            | \$ 10,981,455                             | \$ (2,179,687)                                   |
| Adjustment of relative fair value of warrants issued with Series C preferred stock | 515,556                                 | (515,556)                                 | (515,556)  |
| Adjustment of amount of beneficial conversion feature                              | 920,060                                 | (920,060)                                 | (920,060)  |
|  | <u>1,435,616</u>                        | <u>(1,435,616)</u>                        | <u>(1,435,616)</u>                               |
| Adjustment of accretion applicable to Series C preferred stock                     | (65,255)                                | 65,255                                    | 65,255   |
| As restated, December 31, 2004   | <u>\$ 7,711,027</u>                     | <u>\$ 9,611,094</u>                       | <u>\$ (3,550,048)</u>                            |

|  | <u>Series C<br/>Preferred<br/>Stock</u> | <u>Additional<br/>Paid-in<br/>Capital</u> | <u>Stockholders'<br/>(Deficiency)<br/>Equity</u> |
|--|---|---|--|
| As previously reported, June 30, 2005                          | \$ 7,182,925                            | \$ 10,209,995                             | \$ (5,675,314)                                   |
| Net effect of above 2004 adjustments                           | 1,370,361                               | (1,370,361)                               | (1,370,361)                                      |
| Adjustment of accretion applicable to Series C preferred stock | (195,764)                               | 195,764                                   | 195,764  |
| As restated, June 30, 2005                                     | <u>\$ 8,357,522</u>                     | <u>\$ 9,035,398</u>                       | <u>\$ (6,849,911)</u>                            |

Net loss attributable to common stockholders for the respective periods was reduced as follows as a result of reductions in preferred stock accretion:

|  | <u>Year Ended<br/>December 31, 2004</u> | <u>Six Months<br/>Ended June 30, 2005</u> |
|--|---|---|
| As previously reported                               | \$ (4,618,164)                          | \$ (4,370,421)                            |
| Reduction in accretion applicable to preferred stock | 65,255                                  | 195,764                                   |
| As restated  | <u>\$ (4,552,909)</u>                   | <u>\$ (4,174,657)</u>                     |



electro-optical sciences, inc.

**3,000,000 Shares**

# **Electro-Optical Sciences, Inc.**

**Common Stock**

---

**PROSPECTUS**

---

Until \_\_\_\_\_, 2005, all dealers that effect transactions in these securities, whether or not participating in this offering, may be required to deliver a prospectus. This is in addition to the dealers' obligation to deliver a prospectus when acting as underwriters and with respect to their unsold allotments or subscriptions.

**Ladenburg Thalmann & Co. Inc.**

**Stanford Group Company**

, 2005

---

**PART II**  
**INFORMATION NOT REQUIRED IN PROSPECTUS**

**ITEM 13. Other Expenses of Issuance and Distribution.**

The following table sets forth the costs and expenses to be paid by the Registrant in connection with the sale of the shares of common stock being registered hereby. All amounts are estimates except for the SEC registration fee, the NASD filing fee and the NASDAQ National Market filing fee.

|   |    |                  |
|---|----|------------------|
| Securities and Exchange Commission registration fee | \$ | 3,884            |
| NASD filing fee                                     |    | 4,640            |
| NASDAQ National Market filing fee                   |    | 5,000            |
| Accounting fees and expenses                        |    | 275,000          |
| Legal fees and expenses                             |    | 585,000          |
| One percent nonaccountable underwriters expense     |    | 270,000          |
| Printing and engraving expenses                     |    | 270,000          |
| Blue sky fees and expenses                          |    | 10,000           |
| Transfer agent and registrar fees and expenses      |    | 15,000           |
| Miscellaneous                                       |    | 191,476          |
| Total   | \$ | <u>1,630,000</u> |

**ITEM 14. Indemnification of Directors and Officers.**

Section 145 of the Delaware General Corporation Law permits a corporation to include in its charter documents, and in agreements between the corporation and its directors and officers, provisions expanding the scope of indemnification beyond that specifically provided by the current law.

Article VIII of our third amended and restated certificate of incorporation provides for the indemnification of directors to the fullest extent permissible under Delaware law. Our fourth amended and restated certification of incorporation to be filed upon completion of this offering will contain similar indemnification provisions.

Article IX of our second amended and restated bylaws provides for the indemnification of officers, directors or other agents acting on our behalf if such person acted in good faith and in a manner reasonably believed to be in and not opposed to our best interest and, with respect to any criminal action or proceeding, the indemnified party had no reason to believe his or her conduct was unlawful. Our third amended and restated bylaws to be filed upon completion of this offering will contain similar indemnification provisions.

Prior to the completion of the offering, the Registrant intends to enter into Indemnification Agreements with each of its current directors and officers to provide such directors and officers additional contractual assurances regarding the scope of the indemnification set forth in the Registrant's restated certificate of incorporation and amended and restated bylaws and to provide additional procedural protections. At present, there is no pending litigation or proceeding involving a director, officer or employee of the Registrant regarding which indemnification is sought. Reference is also made to Section 7 of the Underwriting Agreement, which provides for the indemnification of officers, directors and controlling persons of the Registrant against certain liabilities. The indemnification provision in the Registrant's restated and amended certificate of incorporation, amended and restated bylaws and the indemnification agreements to be entered into between the Registrant and each of its directors and officers may be sufficiently broad to permit indemnification of the Registrant's directors and officers for liabilities arising under the Securities Act.



The Registrant has directors' and officers' liability insurance for securities matters prior to the closing of this offering.

See also the undertakings set out in response to Item 17.

Reference is made to the following documents filed as exhibits to this Registration Statement regarding relevant indemnification provisions described above and elsewhere herein:

| <u>Exhibit Document</u>  | <u>Number</u> |
|--|---------------|
| Underwriting Agreement   | 1.1           |
| Registrant's Third Amended and Restated Certificate of Incorporation           | 3.1           |
| Registrant's Second Amended and Restated Bylaws                                | 3.3           |
| Second Amended and Restated Investors' Rights Agreement dated October 26, 2004 | 4.2           |
| Form of Indemnification Agreement  | 10.1          |

**ITEM 15. Recent Sales of Unregistered Securities.**

- On June 20, 2003, we sold 75,000 shares of our common stock at a price of \$0.46 per share to Dr. Robert Friedman, a former member of our board of directors, and 75,000 shares of our common stock at a price of \$0.46 per share to Breaux Castleman, a member of our board of directors, and the chairman of our board.
- On June 20, 2003, we issued an aggregate of 45,000 shares of our Series B preferred stock to the 149 Series B preferred stock investors who originally purchased our Series B preferred stock in 2000 in consideration of certain amendments to their investment agreements.
- On June 20, 2003, we issued a warrant to purchase up to 24,890 shares of our Series C preferred stock at an exercise price of \$2.26 per share to Koji Miyazaki, one of our Series C preferred stock investors.
- On June 20, 2003, we also issued a warrant to Dr. Marek Elbaum, a former member of our board of directors and former Chief Science and Technology Officer, to purchase up to 25,000 shares of our common stock at per share exercise price of \$13.00.
- From June 20, 2003 through October 26, 2004, we issued an aggregate of 5,414,779 shares of our Series C preferred stock to 73 accredited investors for an aggregate consideration of \$12,191,480.
- From June 20, 2003 through October 26, 2004, we issued warrants to purchase up to an aggregate of 2,610,643 shares of our common stock with an exercise price of \$13.00 per share to certain purchasers of our Series C preferred stock.
- On February 2, 2004, we issued a warrant to purchase up to 121,681 shares of our Series C preferred stock with an exercise price \$2.26 per share to Health Partners I, LLC.
- In May 2004, we issued 125,000 shares of our common stock at a per share purchase price of \$0.46 to accredited investors who loaned an aggregate of \$1,000,000 to the company, which loans were evidenced by convertible promissory notes, all of which converted into shares of our Series C preferred stock on October 26, 2004.
- On December 10, 2004, we issued a warrant to Allen & Company LLC to purchase up to 75,000 shares of our common stock at an exercise price of \$7.00 per share in consideration of Allen & Company's agreement to provide certain advisory services to us.
- From January 1, 2002 to May 15, 2005 we granted options to purchase 852,621 shares of our common stock to employees, directors and consultants under our 1996 Plan and 2003 Plan.

The sales of the above securities were deemed to be exempt from registration under the Securities Act in reliance on Section 4(2) of the Securities Act, or Regulation D promulgated thereunder, or Rule 701 promulgated under Section 3(b) of the Securities Act, as transactions by an issuer not involving

a public offering or transactions pursuant to compensatory benefit plans and contracts relating to compensation as provided under Rule 701. The recipients of securities in each of these transactions represented their intention to acquire the securities for investment only and not with view to or for sale in connection with any distribution thereof and appropriate legends were affixed to the share certificates and instruments issued in such transactions. The sales of these securities were made without general solicitation or advertising. All recipients had adequate access, through their relationship with the Registrant, to information about the Registrant.

**ITEM 16. Exhibits and Financial Statement Schedules.**

(a) The following exhibits are filed herewith:

| Number  | Exhibit Title   |
|---------|---|
| 1.1     | Form of Underwriting Agreement.   |
| 3.1**   | Third Amended and Restated Certificate of Incorporation.  |
| 3.2**   | Form of Amended and Restated Certificate of Incorporation of Registrant to be effective upon closing of the offering.   |
| 3.3**   | Second Amended and Restated Bylaws of the Registrant as currently in effect.  |
| 3.4     | Form of Amended and Restated Bylaws of the Registrant to be effective upon closing of the offering.   |
| 4.1     | Specimen Stock Certificate.   |
| 4.2**   | Second Amended and Restated Investor's Rights Agreement dated as of October 26, 2004 by and among the Registrant and the parties listed therein.                                    |
| 5.1     | Opinion of Dreier LLP.  |
| 10.1    | Form of Indemnification Agreement for directors and executive officers.   |
| 10.2**  | 1996 Stock Option Plan.   |
| 10.3**  | 2003 Stock Incentive Plan, as amended.  |
| 10.4††  | 2005 Stock Incentive Plan.  |
| 10.5**  | Employment Agreement dated as of January 5, 2004 between the Registrant and Joseph V. Gulfo.  |
| 10.6**  | Consulting Agreement dated as of May 31, 2005 between the Registrant and Marek Elbaum.  |
| 10.7**  | Lease Agreement dated as of December 16, 1998, by and between the Registrant and Bridge Street Properties LLC, for office space located at One Bridge Street, Irvington, New York.  |
| 10.8**  | First Amendment to the Lease Agreement dated as of May 17, 2001 by and between the Registrant and Bridge Street Properties LLC.   |
| 10.9**  | Second Amendment to the Lease Agreement dated as of June 19, 2003 by and between the Registrant and Bridge Street Properties LLC.   |
| 10.10** | Lease Agreement dated as of November 23, 2004, by and between the Registrant and Bridge Street Properties LLC, for office space located at 3 West Main Street, Irvington, New York. |
| 10.11** | Consulting Agreement dated as of June 1, 2005 between the Registrant and Gerald Wagner Consulting, LLC.   |
| 10.12** | Consulting Agreement dated as of June 20, 2003 between the Registrant and Breaux Castleman, as amended.   |
| 10.13** | Consulting Agreement dated as of June 1, 2005 between the Registrant and Robert Friedman, M.D.  |
| 10.14   | Task Order Agreement dated as of July 13, 2005 between the Registrant and Battelle Memorial Institute.  |
| 10.15** | Third Amendment dated as of June 6, 2005, by and between the Registrant and Bridge Street Properties LLC, for office space located at 1 Bridge Street, Irvington, New York.         |
| 14.1**  | Code of Business Conduct and Ethics.  |
| 23.1    | Consent of Eisner LLP, Independent Registered Public Accounting Firm.   |

| Number | Exhibit Title                                   |
|--------|---|
| 23.2   | Consent of Counsel (included in Exhibit 5.1).   |
| 24.1** | Power of Attorney.                              |
| 99.1   | Consent of Director Nominee (Martin D. Cleary). |

\*\* Previously filed.

†† This document has been refiled and replaces the version previously filed with the Registration Statement under the same exhibit number.

(b) Financial statement schedules are omitted because the information called for is not required or is shown either in the financial statements or the notes thereto.

**ITEM 17. Undertakings.**

The undersigned Registrant hereby undertakes to provide to the underwriters at the closing specified in the Underwriting Agreement certificates in such denominations and registered in such names as required by the Underwriters to permit prompt delivery to each purchaser.

Insofar as indemnification for liabilities arising under the Securities Act may be permitted to directors, officers and controlling persons of the Registrant pursuant to the provisions described under Item 14 above, or otherwise, the Registrant has been advised that in the opinion of the SEC such indemnification is against public policy as expressed in the Securities Act and is, therefore, unenforceable. In the event that a claim for indemnification against such liabilities (other than the payment by the Registrant of expenses incurred or paid by a director, officer or controlling person of the Registrant in the successful defense of any action, suit or proceeding) is asserted by such director, officer or controlling person in connection with the securities being registered, the Registrant will, unless in the opinion of its counsel the matter has been settled by controlling precedent, submit to a court of appropriate jurisdiction the question whether such indemnification by it is against public policy as expressed in the Securities Act and will be governed by the final adjudication of such issue.

The undersigned Registrant hereby undertakes that:

(1) For purposes of determining any liability under the Securities Act, the information omitted from the form of prospectus filed as part of this Registration Statement in reliance upon Rule 430A and contained in a form of prospectus filed by the Registrant pursuant to Rule 424(b)(1) or (4) or 497(h) under the Securities Act shall be deemed to be part of this Registration Statement as of the time it was declared effective.

(2) For the purpose of determining any liability under the Securities Act, each post-effective amendment that contains a form of prospectus shall be deemed to be a new registration statement relating to the securities offered therein, and the offering of such securities at that time shall be deemed to be the initial bona fide offering thereof.

## SIGNATURES

Pursuant to the requirements of the Securities Act, the Registrant has duly caused this Registration Statement to be signed on its behalf by the undersigned, thereunto duly authorized, in the City of New York, New York, on this 8<sup>th</sup> day of August, 2005.

ELECTRO-OPTICAL SCIENCES, INC.

By: /s/ JOSEPH V. GULFO

Joseph V. Gulfo  
President and Chief Executive Officer

Pursuant to the requirements of the Securities Act, this Registration Statement has been signed by the following persons in the capacities and on the date indicated.

| Name   | Title   | Date           |
|--|---|----------------|
| <b>Principal Executive Officer:</b>                                  |   |                |
| /s/ JOSEPH V. GULFO<br>Joseph V. Gulfo                               | President , Chief Executive Officer and Director    | August 8, 2005 |
| <b>Principal Financial Officer and Principal Accounting Officer:</b> |   |                |
| /s/ KAREN KRUMEICH<br>Karen Krumeich                                 | Vice President, Finance and Chief Financial Officer | August 8, 2005 |
| <b>Additional Directors:</b>   |   |                |
| *<br>Breux Castleman   | Director, Chairman of the Board of Directors        | August 8, 2005 |
| *<br>Sidney Braginsky  | Director  | August 8, 2005 |
| *<br>George C. Chryssis  | Director  | August 8, 2005 |
| *<br>Dan W. Lufkin   | Director  | August 8, 2005 |
| *<br>Gerald Wagner   | Director  | August 8, 2005 |

\*By: /s/ JOSEPH V. GULFO  
Joseph V. Gulfo  
*Attorney-in-fact*

## EXHIBIT INDEX

| Number  | Exhibit Title   |
|---------|---|
| 1.1     | Form of Underwriting Agreement.   |
| 3.1**   | Third Amended and Restated Certificate of Incorporation.  |
| 3.2**   | Form of Amended and Restated Certificate of Incorporation of Registrant to be effective upon closing of the offering.   |
| 3.3**   | Second Amended and Restated Bylaws of the Registrant as currently in effect.  |
| 3.4     | Form of Amended and Restated Bylaws of the Registrant to be effective upon closing of the offering.   |
| 4.1     | Specimen Stock Certificate.   |
| 4.2**   | Second Amended and Restated Investor's Rights Agreement dated as of October 26, 2004 by and among the Registrant and the parties listed therein.                                    |
| 5.1     | Opinion of Dreier LLP.  |
| 10.1    | Form of Indemnification Agreement for directors and executive officers.   |
| 10.2**  | 1996 Stock Option Plan.   |
| 10.3**  | 2003 Stock Incentive Plan, as amended.  |
| 10.4††  | 2005 Stock Incentive Plan.  |
| 10.5**  | Employment Agreement dated as of January 5, 2004 between the Registrant and Joseph V. Gulfo.  |
| 10.6**  | Consulting Agreement dated as of May 31, 2005 between the Registrant and Marek Elbaum.  |
| 10.7**  | Lease Agreement dated as of December 16, 1998, by and between the Registrant and Bridge Street Properties LLC, for office space located at One Bridge Street, Irvington, New York.  |
| 10.8**  | First Amendment to the Lease Agreement dated as of May 17, 2001 by and between the Registrant and Bridge Street Properties LLC.   |
| 10.9**  | Second Amendment to the Lease Agreement dated as of June 19, 2003 by and between the Registrant and Bridge Street Properties LLC.   |
| 10.10** | Lease Agreement dated as of November 23, 2004, by and between the Registrant and Bridge Street Properties LLC, for office space located at 3 West Main Street, Irvington, New York. |
| 10.11** | Consulting Agreement dated as of June 1, 2005 between the Registrant and Gerald Wagner Consulting, LLC.   |
| 10.12** | Consulting Agreement dated as of June 20, 2003 between the Registrant and Breaux Castleman, as amended.   |
| 10.13** | Consulting Agreement dated as of June 1, 2005 between the Registrant and Robert Friedman, M.D.  |
| 10.14   | Task Order Agreement dated as of July 13, 2005 between the Registrant and Battelle Memorial Institute.  |
| 10.15** | Third Amendment dated as of June 6, 2005, by and between the Registrant and Bridge Street Properties LLC, for office space located at 1 Bridge Street, Irvington, New York.         |
| 14.1**  | Code of Business Conduct and Ethics.  |
| 23.1    | Consent of Eisner LLP, Independent Registered Public Accounting Firm.   |
| 23.2    | Consent of Counsel (included in Exhibit 5.1).   |
| 24.1**  | Power of Attorney.  |
| 99.1    | Consent of Director Nominee (Martin D. Cleary).   |

\*\* Previously filed.

†† This document has been refiled and replaces the version previously filed with the Registration Statement under the same exhibit number.

\_\_\_\_\_ Shares of Common Stock

ELECTRO-OPTICAL SCIENCES, INC.

FORM OF UNDERWRITING AGREEMENT

\_\_\_\_\_, 2005

Ladenburg Thalmann & Co. Inc.  
A Representative of the Several Underwriters  
590 Madison Avenue  
New York, New York 10022

And

Stanford Group Company  
A Representative of the Several Underwriters  
201 South Biscayne Boulevard  
12th Floor  
Miami, Florida 33131

Ladies/Gentlemen:

Electro-Optical Sciences, Inc., a corporation organized and existing under the laws of the State of Delaware (the "Company"), proposes, subject to the terms and conditions stated herein, to issue and sell to the several underwriters named in Schedule I hereto (the "Underwriters") an aggregate of \_\_\_\_\_ shares (the "Firm Shares") of its common stock, par value \$.001 per share (the "Common Stock") and, for the sole purpose of covering over-allotments in connection with the sale of the Firm Shares, at the option of the Underwriters, up to an additional \_\_\_\_\_ shares (the "Additional Shares") of Common Stock. The Firm Shares and any Additional Shares purchased by the Underwriters are referred to herein as the "Shares." The Shares are more fully described in the Registration Statement and Prospectus referred to below. Ladenburg Thalmann & Co. Inc. ("Ladenburg") and Stanford Group Company ("Stanford Group") are acting as the co-lead managers (the "Co-Lead Managers") in connection with the offering and sale of the Shares contemplated herein (the "Offering").

1. Representations and Warranties of the Company. The Company represents and warrants to, and agrees with, each of the Underwriters that:

(a) The Company has filed with the Securities and Exchange Commission (the "Commission") a registration statement on Form S-1 (No. 333-\_\_\_\_\_), and amendments thereto, and related preliminary prospectuses for the registration under the Securities Act of 1933, as amended (the "Securities Act"), of the Shares which registration statement, as so amended (including post-effective amendments, if any), has been declared effective by the Commission and copies of which have heretofore been delivered to the

Underwriters. The registration statement, as amended at the time it became effective, including the prospectus, financial statements, schedules, exhibits and other information (if any) deemed to be part of the registration statement at the time of effectiveness pursuant to Rule 430A or 434(d) under the Securities Act, is hereinafter referred to as the "Registration Statement." If the Company has filed or is required pursuant to the terms hereof to file a registration statement pursuant to Rule 462(b) under the Securities Act registering additional shares of Common Stock (a "Rule 462(b) Registration Statement"), then, unless otherwise specified, any reference herein to the term "Registration Statement" shall be deemed to include such Rule 462(b) Registration Statement. Other than a Rule 462(b) Registration Statement, which, if filed, becomes effective upon filing, no other document with respect to the Registration Statement has heretofore been filed under the Securities Act with the Commission. All of the Shares have been registered under the Securities Act pursuant to the Registration Statement or, if any Rule 462(b) Registration Statement is filed, will be duly registered under the Securities Act with the filing of such Rule 462(b) Registration Statement. No stop order suspending the effectiveness of either the Registration Statement or the Rule 462(b) Registration Statement, if any, has been issued and no proceeding for that purpose has been initiated or, to the Company's knowledge, threatened by the Commission. The Company, if required by the Securities Act and the rules and regulations of the Commission (the "Rules and Regulations"), proposes to file the Prospectus with the Commission pursuant to Rule 424(b) under the Securities Act ("Rule 424(b)"). The final prospectus in the form included as part of the Registration Statement at the time the Registration Statement became effective and the prospectus supplement relating to the offering of the Shares, are collectively hereinafter referred to as the "Prospectus," except that if any revised prospectus or prospectus supplement shall be provided to the Underwriters by the Company for use in connection with the Offering which differs from the Prospectus (whether or not such revised prospectus or prospectus supplement is required to be filed by the Company pursuant to Rule 424(b)), the term "Prospectus" shall also refer to such revised prospectus or prospectus supplement, as the case may be, from and after the time it is first provided to the Underwriters for such use. Any preliminary prospectus or prospectus subject to completion included in the Registration Statement or filed with the Commission pursuant to Rule 424 under the Securities Act is hereafter called a "Preliminary Prospectus." All references in this Agreement to the Registration Statement, the Rule 462(b) Registration Statement, a Preliminary Prospectus and the Prospectus, or any amendments or supplements to any of the foregoing shall be deemed to include any copy thereof filed with the Commission pursuant to its Electronic Data Gathering, Analysis and Retrieval System ("EDGAR").

(b) At the time of the effectiveness of the Registration Statement or any Rule 462(b) Registration Statement or the effectiveness of any post-effective amendment to the Registration Statement, when the Prospectus is first filed with the Commission pursuant to Rule 424(b) or Rule 434 under the Securities Act ("Rule 434"), when any supplement to or amendment of the Prospectus is filed with the Commission and at the Closing Date and the Additional Closing Date, if any (as hereinafter respectively defined), the Registration Statement and the Prospectus and any amendments thereof and supplements thereto complied or will comply in all material respects with the applicable provisions of the Securities Act, the Exchange Act and the Rules and Regulations and did not and will not contain an untrue statement of a material fact and did not and will not omit to state any material fact required to be stated therein or necessary in order to make the statements therein (i) in the case of the Registration Statement, not misleading and (ii) in the case of the Prospectus or any related Preliminary Prospectus in

light of the circumstances under which they were made, not misleading. When any Preliminary Prospectus was first filed with the Commission (whether filed as part of the Registration Statement for the registration of the Shares or any amendment thereto or pursuant to Rule 424(a) under the Securities Act) and when any amendment thereof or supplement thereto was first filed with the Commission, such Preliminary Prospectus and any amendments thereof and supplements thereto complied in all material respects with the applicable provisions of the Securities Act, the Exchange Act and the Rules and Regulations and did not contain an untrue statement of a material fact and did not omit to state any material fact required to be stated therein or necessary in order to make the statements therein, in light of the circumstances under which they were made, not misleading. No representation and warranty is made in this subsection (b), however, with respect to any information contained in or omitted from the Registration Statement or the Prospectus or any related Preliminary Prospectus or any amendment thereof or supplement thereto in reliance upon and in conformity with information furnished in writing to the Company by or on behalf of any Underwriter through Ladenburg specifically for use therein. The parties acknowledge and agree that such information provided by or on behalf of any Underwriter consists solely of the material included under the caption "Underwriting" in the Prospectus and the last paragraph on the front cover page concerning the delivery of the Shares (the "Underwriters' Information").

(c) Eisner LLP ("Eisner"), who has certified certain of the financial statements of the Company that are included or incorporated by reference in the Registration Statement, are an independent public accounting firm as required by the Securities Act, the Exchange Act and the Rules and Regulations. Eisner has not, during the periods covered by the financial statements included in the Prospectus, provided to the Company any non-audit services, as such term is used in Section 10A(g) of the Exchange Act.

(d) Subsequent to the respective dates as of which information is given in the Registration Statement and the Prospectus, except as disclosed in the Registration Statement and the Prospectus, the Company has not declared, paid or made any dividends or other distributions of any kind on or in respect of its capital stock and there has been no material adverse change or any development involving a prospective material adverse change, whether or not arising from transactions in the ordinary course of business, in or affecting: (i) the business, condition (financial or otherwise), results of operations, stockholders' equity, properties or prospects of the Company, individually or taken as a whole (other than losses as disclosed in the Registration Statement and the Prospectus that will continue reduce stockholders equity); (ii) the long-term debt or capital stock of the Company; or (iii) the Offering or consummation of any of the other transactions contemplated by this Agreement, the Registration Statement or the Prospectus (a "Material Adverse Effect"). Since the date of the latest balance sheet presented, or incorporated by reference, in the Registration Statement and the Prospectus, the Company has not incurred or undertaken any liabilities or obligations, whether direct or indirect, liquidated or contingent, matured or unmatured, or entered into any transactions, including any acquisition or disposition of any business or asset, which are material to the Company, except for liabilities, obligations and transactions which are disclosed in the Registration Statement and the Prospectus.

(e) The authorized, issued and outstanding capital stock of the Company is as set forth in the Prospectus in the column headed "Actual" under the caption "Capitalization"



and, after giving effect to the Offering and the other transactions contemplated by this Agreement, the Registration Statement and the Prospectus, will be as set forth in the column headed "As Adjusted" under the caption "Capitalization," except for the shares of capital stock specifically excluded from such presentation as disclosed in the Registration Statement and the Prospectus. All of the issued and outstanding shares of capital stock of the Company are fully paid and non-assessable and have been duly and validly authorized and issued, in compliance with all applicable state, federal and foreign securities laws and not in violation of or subject to any preemptive or similar right that does or will entitle any person, upon the issuance or sale of any security, to acquire from the Company any Common Stock or other security of the Company or any security convertible into, or exercisable or exchangeable for, Common Stock or any other such security (any "Relevant Security"), except for such rights as may have been fully satisfied or waived prior to the effectiveness of the Registration Statement.

(f) The Shares have been duly and validly authorized and, when delivered in accordance with this Agreement, will be duly and validly issued, fully paid and non-assessable, will have been issued in compliance with all applicable state, federal and foreign securities laws and will not have been issued in violation of or subject to any preemptive or similar right that does or will entitle any person to acquire any Relevant Security from the Company upon issuance or sale of Shares in the Offering. The Common Stock and the Shares conform in all material respects to the descriptions thereof contained in the Registration Statement and the Prospectus. Except as disclosed in the Registration Statement and the Prospectus, the Company does not have outstanding warrants, options to purchase, or any preemptive rights or other rights to subscribe for or to purchase, or any contracts or commitments to issue or sell, any Relevant Security.

(g) Except as otherwise disclosed in the Registration Statement and the Prospectus, the Company holds no ownership or other interest, nominal or beneficial, direct or indirect, in any corporation, partnership, joint venture or other business entity. The Company does not have any subsidiaries (as defined in Rule 405 of the Rules and Regulations).

(h) The Company has been duly organized and validly exists as a corporation, partnership or limited liability company in good standing under the laws of its jurisdiction of organization. The Company has all requisite power and authority to carry on its business as it is currently being conducted and as described in the Prospectus, and to own, lease and operate its respective properties. The Company is duly qualified to do business and is in good standing as a foreign corporation, partnership or limited liability company in each jurisdiction in which the character or location of its properties (owned, leased or licensed) or the nature or conduct of its business makes such qualification necessary, except for those failures to be so qualified or in good standing which (individually and in the aggregate) could not reasonably be expected to have a material adverse effect on: (i) the business, condition (financial or otherwise), results of operations, stockholders' equity, properties or prospects of the Company, individually or taken as a whole; (ii) the long-term debt or capital stock of the Company; or (iii) the Offering or consummation of any of the other transactions contemplated by this Agreement, the Registration Statement or the Prospectus (any such effect being a "Material Adverse Effect").

(i) Except as disclosed in the Registration Statement and the Prospectus, the Company has all necessary consents, approvals, authorizations, orders, registrations, qualifications, licenses, filings and permits of, with and from all judicial, regulatory and other legal or governmental agencies and bodies and all third parties, foreign and domestic (collectively, the "Consents"), to own, lease and operate its properties and conduct its business as it is now being conducted and as disclosed in the Registration Statement and the Prospectus, and each such Consent is valid and in full force and effect, and the Company has not received notice of any investigation or proceedings which results in or, if decided adversely to the Company, could reasonably be expected to result in, the revocation of, or imposition of a materially burdensome restriction on, any Consent. The Company is in compliance with all applicable laws, rules, regulations, ordinances, directives, judgments, decrees and orders, foreign and domestic, except where failure to be in compliance could not reasonably be expected to have a Material Adverse Effect. No Consent contains a materially burdensome restriction not adequately disclosed in the Registration Statement and the Prospectus.

(j) The Company has full right, power and authority to execute and deliver this Agreement, to perform its obligations hereunder and to consummate the transactions contemplated by this Agreement, the Registration Statement and the Prospectus. This Agreement and the transactions contemplated by this Agreement, the Registration Statement and the Prospectus have been duly and validly authorized by the Company. This Agreement has been duly and validly executed and delivered by the Company and constitutes the legal, valid and binding obligation of the Company, enforceable against the Company in accordance with its terms, except as rights to indemnification hereunder may be limited by applicable law and enforceability may be limited by applicable bankruptcy, insolvency, reorganization, moratorium or similar laws affecting creditors' rights generally and except as enforceability may be subject to general principles of equity (regardless of whether such enforceability is considered in a proceeding in equity or at law).

(k) The execution, delivery, and performance of this Agreement and consummation of the transactions contemplated by this Agreement, the Registration Statement and the Prospectus do not and will not: (i) conflict with, require consent under or result in a breach of any of the terms and provisions of, or constitute a default (or an event which with notice or lapse of time, or both, would constitute a default) under, or result in the creation or imposition of any lien, charge or encumbrance upon any property or assets of the Company pursuant to, any indenture, mortgage, deed of trust, loan agreement or other agreement, instrument, franchise, license or permit to which the Company is a party or by which the Company or its properties, operations or assets may be bound; (ii) violate or conflict with any provision of the certificate or articles of incorporation, by-laws, certificate of formation, limited liability company agreement, partnership agreement or other organizational documents of the Company; or (iii) violate or conflict with any law, rule, regulation, ordinance, directive, judgment, decree or order of any judicial, regulatory or other legal or governmental agency or body, domestic or foreign, except (in the case of clauses (i) and (iii) above) as could not reasonably be expected to have a Material Adverse Effect.

(l) No Consent of, with or from any judicial, regulatory or other legal or governmental agency or body or any third party, foreign or domestic, is required for the execution, delivery and performance of this Agreement or consummation by the Company of the

transactions contemplated by this Agreement, the Registration Statement and the Prospectus, including the issuance, sale and delivery of the Shares to be issued, sold and delivered hereunder, except the registration under the Securities Act of the Shares, which has become effective, and such Consents as may be required under state securities or blue sky laws or the by-laws and rules of the National Association of Securities Dealers, Inc. (the "NASD") or NASD Regulation, Inc. ("NASDR") in connection with the purchase and distribution of the Shares by the Underwriters and to list the Shares on The NASDAQ National Market ("NASDAQ"), each of which has been obtained and is in full force and effect.

(m) Except as disclosed in the Registration Statement and the Prospectus, there is no judicial, regulatory, arbitral or other legal or governmental proceeding or other litigation or arbitration, domestic or foreign, pending to which the Company is a party or of which any property, operations or assets of the Company is the subject which, individually or in the aggregate, if determined adversely to the Company, could reasonably be expected to have a Material Adverse Effect; to the best of the Company's knowledge, no such proceeding, litigation or arbitration is threatened or contemplated; and the defense of all such proceedings, litigation and arbitration against or involving the Company could not reasonably be expected to have a Material Adverse Effect.

(n) The Company's use of proceeds from the Offering hereunder will not violate the Trading with the Enemy Act, as amended, or any of the foreign assets control regulations of the United States Treasury Department (31 CFR, Subtitle B, Chapter V, as amended) or any enabling legislation or executive order relating thereto, and the Company will not use such proceeds, directly or indirectly, for any payments to any governmental official or employee, political party, official of a political party, candidate for political office, or anyone else acting in an official capacity, in order to obtain, retain or direct business or obtain any improper advantage, in violation of the United States Foreign Corrupt Practices Act of 1977, as amended, to the extent that such Act applies to the Company.

(o) The financial statements and pro forma data, including the notes thereto, and the supporting schedules included or incorporated by reference in the Registration Statement and the Prospectus present fairly the financial position as of the dates indicated and the cash flows and results of operations for the periods specified of the Company; except as otherwise stated in the Registration Statement and the Prospectus, said financial statements have been prepared in conformity with United States generally accepted accounting principles applied on a consistent basis throughout the periods involved; and the supporting schedules included or incorporated by reference in the Registration Statement and the Prospectus present fairly the information required to be stated therein. No other financial statements or supporting schedules are required by the Rules and Regulations to be included in the Registration Statement. The other financial and statistical information derived from the financial statements or supporting schedules included or incorporated by reference in the Registration Statement and the Prospectus present fairly the information included therein and have been prepared on a basis consistent with that of the financial statements that are included or incorporated by reference in the Registration Statement and the Prospectus and the books and records of the respective entities presented therein.

(p) There are no pro forma or as adjusted financial statements which are required by the Rules and Regulations to be included or incorporated by reference in the Registration Statement and the Prospectus in accordance with Regulation S-X which have not been included as so required. The pro forma and as adjusted financial information included or incorporated by reference in the Registration Statement and the Prospectus has been properly compiled and prepared in accordance with the applicable requirements of the Securities Act, the Exchange Act and the Rules and Regulations and includes all adjustments and reconciliations necessary to present fairly in accordance with United States generally accepted accounting principles the pro forma and as adjusted financial position of the respective entity or entities presented therein at the respective dates indicated and their cash flows and the results of operations for the respective periods specified.

(q) The assumptions used in preparing the pro forma and as adjusted financial information included in the Registration Statement and the Prospectus provide a reasonable basis for presenting the significant effects directly attributable to the transactions or events described therein; the related adjustments made in the preparation of such pro forma and as adjusted financial information give appropriate effect to those assumptions; and such pro forma and as adjusted financial information reflect the proper application of those adjustments to the corresponding historical financial statement amounts.

(r) The statistical, industry-related and market-related data included in the Registration Statement and the Prospectus are based on or derived from sources which the Company reasonably and in good faith believes are reliable and accurate, and such data agree with the sources from which they are derived.

(s) The Company is subject to the reporting requirements of Section 13 or 15(d) of the Exchange Act and files reports with the Commission on the EDGAR System. The Common Stock is registered pursuant to Section 12(g) of the Exchange Act and the outstanding shares of Common Stock (other than the Shares) are listed for quotation on the NASDAQ (as defined in Section 11(b) below), the Shares have been approved for quotation on the NASDAQ upon issuance or sale and the Company has taken no action designed to, or likely to have the effect of, terminating the registration of the Common Stock under the Exchange Act or de-listing the Common Stock from the NASDAQ, nor has the Company received any notification that the Commission or the NASDAQ is contemplating terminating such registration or listing.

(t) The Company maintains a system of internal accounting and other controls sufficient to provide reasonable assurances that: (i) transactions are executed in accordance with management's general or specific authorizations; (ii) transactions are recorded as necessary to permit preparation of financial statements in conformity with United States generally accepted accounting principles and to maintain accountability for assets; (iii) access to assets is permitted only in accordance with management's general or specific authorization; and (iv) the recorded accounting for assets is compared with existing assets at reasonable intervals and appropriate action is taken with respect to any differences.

(u) The Company is in compliance in all material respects with the provisions of the Sarbanes-Oxley Act of 2002 (the "Sarbanes-Oxley Act") that are currently applicable to the Company and is actively taking steps to ensure that it will be in compliance

with other applicable provisions of the Sarbanes-Oxley Act upon the effectiveness of such provisions.

(v) The Company has established and maintains "disclosure controls and procedures" (as defined in Rules 13a-14(c) and 15d-14(c) of the Exchange Act); the Company's "disclosure controls and procedures" are reasonably designed to ensure that all information (both financial and non-financial) required to be disclosed by the Company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Rules and Regulations, and that all such information is accumulated and communicated to the Company's management as appropriate to allow timely decisions regarding required disclosure and to make the certifications of the Chief Executive Officer and Chief Financial Officer of the Company required under the Exchange Act with respect to such reports.

(w) Since the date of the filing of the Registration Statement, the Company's auditors and the audit committee of the board of directors of the Company (or persons fulfilling the equivalent function) have not been advised of: (i) any significant deficiencies in the design or operation of internal controls which could adversely affect the Company's ability to record, process, summarize and report financial data nor any material weaknesses in internal controls; or (ii) any fraud, whether or not material, that involves management or other employees who have a significant role in the Company's internal controls.

(x) Since the date of the filing of the Registration Statement, there have been no significant changes in internal controls or in other factors that could significantly affect internal controls, including any corrective actions with regard to significant deficiencies and material weaknesses.

(y) No event or circumstance has occurred or arisen since the date of the filing of the Registration Statement that could reasonably be expected to give rise to a requirement that the Company make additional disclosure on Form 8-K and has not been so disclosed.

(z) Neither the Company nor, to the Company's knowledge, any of its affiliates (within the meaning of Rule 144 under the Securities Act) has taken, directly or indirectly, any action which constitutes or is designed to cause or result in, or which could reasonably be expected to constitute, cause or result in, the stabilization or manipulation of the price of any security to facilitate the sale or resale of the Shares.

(aa) Neither Company nor, to the Company's knowledge, any of its affiliates has, prior to the date hereof, made any offer or sale of any securities which could be "integrated" for purposes of the Securities Act or the Rules and Regulations with the offer and sale of the Shares pursuant to the Registration Statement. Except as disclosed in the Registration Statement and the Prospectus, neither Company nor any of its affiliates has sold or issued any Relevant Security during the six-month period preceding the date of the Prospectus, including but not limited to any sales pursuant to Rule 144A or Regulation D or S under the Securities Act, other than shares of Common Stock issued pursuant to employee benefit plans, qualified stock

option plans or the employee compensation plans or pursuant to or in exchange for outstanding options, rights or warrants as described in the Registration Statement and the Prospectus.

(bb) Except as disclosed in the Registration Statement and the Prospectus, no holder of any Relevant Security has any rights to require registration of any Relevant Security as part or on account of, or otherwise in connection with, the offer and sale of the Shares contemplated hereby, and any such rights so disclosed have either been fully complied with by the Company or effectively waived by the holders thereof, and any such waivers remain in full force and effect, enforceable against the parties thereto.

(cc) The Company has complied to the Commission's satisfaction with all requests for additional or supplemental information.

(dd) The documents incorporated or deemed to be incorporated by reference in the Prospectus, at the time they were or hereafter are filed with the Commission, complied and will comply in all material respects with the requirements of the Securities Act, the Exchange Act and the Rules and Regulations, and, when read together with the other information in the Prospectus, do not contain an untrue statement of a material fact or omit to state a material fact required to be stated therein or necessary to make the statements therein, in the light of the circumstances under which they were made, not misleading.

(ee) The Company is not and, at all times up to and including consummation of the transactions contemplated by this Agreement, the Registration Statement and the Prospectus, and after giving effect to application of the net proceeds of the Offering, will not be, subject to registration as an "investment company" under the Investment Company Act of 1940, as amended, and is not and will not be an entity "controlled" by an "investment company" within the meaning of such act.

(ff) There are no contracts or other documents (including, without limitation, any voting agreement), which are required to be described in the Registration Statement and the Prospectus or filed as exhibits to the Registration Statement by the Securities Act, the Exchange Act or the Rules and Regulations and which have not been so described or filed.

(gg) No relationship, direct or indirect, exists between or among any of the Company or any affiliate of the Company, on the one hand, and any director, officer, stockholder, customer or supplier of the Company or any affiliate of the Company, on the other hand, which is required by the Securities Act, the Exchange Act or the Rules and Regulations to be described in the Registration Statement or the Prospectus which is not so described and described as required. There are no outstanding loans, advances (except normal advances for business expenses in the ordinary course of business) or guarantees of indebtedness by the Company to or for the benefit of any of the officers or directors of the Company or any of their respective family members, except as disclosed in the Registration Statement and the Prospectus. The Company has not, in violation of the Sarbanes-Oxley Act, directly or indirectly, extended or maintained credit, arranged for the extension of credit, or renewed or amended an extension of credit, in the form of a personal loan to or for any director or executive officer of the Company.

(hh) Except as disclosed in the Registration Statement and the Prospectus, there are no contracts, agreements or understandings between the Company and any person that would give rise to a valid claim against the Company or any Underwriter for a brokerage commission, finder's fee or other like payment in connection with the transactions contemplated by this Agreement, the Registration Statement and the Prospectus or, to the Company's knowledge, any arrangements, agreements, understandings, payments or issuance with respect to the Company or any of its officers, directors, shareholders, partners, employees or affiliates that may affect the Underwriters' compensation as determined by the NASD.

(ii) The Company owns or leases all such properties as are necessary to the conduct of its business as presently operated as described in the Registration Statement and the Prospectus. The Company has good and marketable title in fee simple to all real property and good and marketable title to all personal property owned by them, in each case free and clear of any lien, charge, mortgage, pledge, security interest, claim, equity, trust or other encumbrance, preferential arrangement, defect or restriction of any kind whatsoever (any "Lien") except such as are described in the Registration Statement and the Prospectus or such as do not (individually or in the aggregate) materially affect the value of such property or interfere with the use made or proposed to be made of such property by the Company; and any real property and buildings held under lease or sublease by the Company is held by it under valid, subsisting and enforceable leases with such exceptions as are not material to, and do not interfere with, the use made and proposed to be made of such property and buildings by the Company. The Company has not received any notice of any claim adverse to its ownership of any real or personal property or of any claim against the continued possession of any real property, whether owned or held under lease or sublease by the Company.

(jj) The Company: (i) owns or possesses adequate right to use all patents, patent applications, trademarks, service marks, trade names, trademark registrations, service mark registrations, copyrights, licenses, formulae, customer lists, and know-how and other intellectual property (including trade secrets and other unpatented and/or unpatentable proprietary or confidential information, systems or procedures, "Intellectual Property") necessary for the conduct of their respective businesses as now conducted and as described in the Registration Statement and Prospectus and (ii) have no reason to believe that the conduct of their respective businesses does or will conflict with, and have not received any notice of any claim of conflict with, any such right of others. To the best of the Company's knowledge, all material technical information developed by and belonging to the Company which has not been patented has been kept confidential. Except as disclosed in the Registration Statement and the Prospectus, the Company has not granted or assigned to any other person or entity any right to manufacture, have manufactured, assemble or sell the current products and services of the Company or those products and services described in the Registration Statement and Prospectus. To the knowledge of the Company and except as disclosed in the Registration Statement and the Prospectus, there is no infringement by third parties of any such Intellectual Property; there is no pending or, to the Company's knowledge, threatened action, suit, proceeding or claim by others challenging the Company's rights in or to any such Intellectual Property, and the Company is unaware of any facts which would form a reasonable basis for any such claim; and there is no pending or, to the Company's knowledge, threatened action, suit, proceeding or claim by others that the Company infringes or otherwise violates any patent, trademark, copyright, trade secret or other proprietary

rights of others, and the Company is unaware of any other fact which would form a reasonable basis for any such claim.

(kk) The Company maintains insurance in such amounts and covering such risks as the Company reasonably considers adequate for the conduct of its business and the value of its properties and as is customary for companies of a similar size engaged in similar businesses in similar industries, all of which insurance is in full force and effect, except where the failure to maintain such insurance could not reasonably be expected to have a Material Adverse Effect. There are no material claims by the Company under any such policy or instrument as to which any insurance company is denying liability or defending under a reservation of rights clause. The Company reasonably believes that it will be able to renew its existing insurance as and when such coverage expires or will be able to obtain replacement insurance adequate for the conduct of the business and the value of its properties and for similar coverages at a cost that would not have a Material Adverse Effect.

(ll) The Company has in effect insurance covering the Company, its directors, officers and the Underwriters for liabilities or losses arising in connection with this Offering, including, without limitation, liabilities or losses arising under the Securities Act, the Exchange Act, the Rules and Regulations and applicable foreign securities laws.

(mm) The Company has accurately prepared and timely filed all federal, state, foreign and other tax returns that are required to be filed by it and has paid or made provision for the payment of all taxes, assessments, governmental or other similar charges, including without limitation, all sales and use taxes and all taxes which the Company is obligated to withhold from amounts owing to employees, creditors and third parties, with respect to the periods covered by such tax returns (whether or not such amounts are shown as due on any tax return), except where the failure to file or pay could not reasonably be expected to have a Material Adverse Effect. No deficiency assessment with respect to a proposed adjustment of the Company's federal, state, local or foreign taxes is pending or, to the best of the Company's knowledge, threatened. The accruals and reserves on the books and records of the Company in respect of tax liabilities for any taxable period not finally determined are adequate to meet any assessments and related liabilities for any such period and, since date of most recent audited financial statements, the Company has not incurred any liability for taxes other than in the ordinary course of its business. There is no tax lien, whether imposed by any federal, state, foreign or other taxing authority, outstanding against the assets, properties or business of the Company.

(nn) No labor disturbance by the employees of the Company exists or, to the best of the Company's knowledge, is imminent and the Company is not aware of any existing or imminent labor disturbances by the employees of any of its principal suppliers, manufacturers, customers or contractors.

(oo) No "prohibited transaction" (as defined in either Section 406 of the Employee Retirement Income Security Act of 1974, as amended, including the regulations and published interpretations thereunder ("ERISA") or Section 4975 of the Internal Revenue Code of 1986, as amended from time to time (the "Code")), "accumulated funding deficiency" (as defined in Section 302 of ERISA) or other event of the kind described in Section 4043(b) of



ERISA (other than events with respect to which the 30-day notice requirement under Section 4043 of ERISA has been waived) has occurred with respect to any employee benefit plan; each employee benefit plan for which the Company would have any liability is in compliance in all material respects with applicable law, including (without limitation) ERISA and the Code; the Company has not incurred and does not expect to incur liability under Title IV of ERISA with respect to the termination of, or withdrawal from any "pension plan"; and each plan for which the Company would have any liability that is intended to be qualified under Section 401(a) of the Code is so qualified and nothing has occurred, whether by action or by failure to act, which could cause the loss of such qualification.

(pp) There has been no storage, generation, transportation, handling, treatment, disposal, discharge, emission or other release of any kind of toxic or other wastes or other hazardous substances by, due to, or caused by the Company (or, to the Company's knowledge, any other entity for whose acts or omissions the Company is or may be liable) upon any other property now or previously owned or leased by the Company, or upon any other property, which would be a violation of or give rise to any liability under any applicable law, rule, regulation, order, judgment, decree or permit relating to pollution or protection of human health and the environment ("Environmental Law"), except for violations and liabilities which, individually or in the aggregate, could not reasonably be expected to have a Material Adverse Effect. There has been no disposal discharge, emission or other release of any kind onto such property or into the environment surrounding such property of any toxic or other wastes or other hazardous substances with respect to which the Company has knowledge (without independent investigation or inquiry), except as could not, individually or in the aggregate, reasonably be expected to have a Material Adverse Effect. The Company has not agreed to assume, undertake or provide indemnification for any liability of any other person under any Environmental Law, including any obligation for cleanup or remedial action, except as could not, individually or in the aggregate, reasonably be expected to have a Material Adverse Effect. There is no pending or, to the best of the Company's knowledge, threatened administrative, regulatory or judicial action, claim or notice of noncompliance or violation, investigation or proceedings relating to any Environmental Law against the Company.

(qq) Neither the Company nor, to the Company's knowledge, any of its employees or agents has at any time during the last five years: (i) made any unlawful contribution to any candidate for foreign office, or failed to disclose fully any contribution in violation of law; or (ii) made any payment to any federal or state governmental officer or official, or other person charged with similar public or quasi-public duties, other than payments required or permitted by the laws of the United States of any jurisdiction thereof.

(rr) Neither the Company nor, to the knowledge of the Company, any director, officer, agent, employee or affiliate of the Company is currently subject to any U.S. sanctions administered by the Office of Foreign Assets Control of the U.S. Treasury Department ("OFAC"); and the Company will not directly or indirectly use the proceeds of the offering, or lend, contribute or otherwise make available such proceeds to any subsidiary, joint venture partner or other person or entity, for the purpose of financing the activities of any person currently subject to any U.S. sanctions administered by OFAC.

(ss) The Company is not: (i) in violation of its certificate or articles of incorporation, by-laws, certificate of formation, limited liability company agreement, partnership agreement or other organizational documents; (ii) in default under, and no event has occurred which, with notice or lapse of time or both, would constitute a default under or result in the creation or imposition of any lien, charge or encumbrance upon any of its property or assets pursuant to, any indenture, mortgage, deed of trust, loan agreement or other agreement or instrument to which it is a party or by which it is bound or to which any of its property or assets is subject; or (iii) in violation in any respect of any law, rule, regulation, ordinance, directive, judgment, decree or order of any judicial, regulatory or other legal or governmental agency or body, foreign or domestic, except (in the case clauses (ii) and (iii) above) violations or defaults that could not (individually or in the aggregate) reasonably be expected to have a Material Adverse Effect and except (in the case of clause (ii) alone) for any lien, charge or encumbrance disclosed in the Registration Statement and the Prospectus.

(tt) Except as set forth in the Registration Statement and the Prospectus, no action, suit or proceeding by or before any court or governmental agency, authority or body or any arbitrator, including, without limitation, the United States Food and Drug Administration (the "FDA"), involving the Company or its properties is pending or, to the knowledge of the Company, threatened that: (i) could materially impede the performance of this Agreement or the consummation of any of the transactions contemplated hereby; or (ii) could have a Material Adverse Effect.

(uu) The Company has not failed to file with applicable regulatory authorities (including, but not limited to, the FDA) any material statement, report, information or form required by any applicable law, regulation or order. No deficiencies have been asserted by any regulatory commission, agency or authority with respect to any such filings or submissions, except for any such failures to be in compliance or deficiencies which would not, individually and in the aggregate, have a Material Adverse Effect.

(vv) The studies, tests and preclinical and clinical trials conducted by or on behalf of the Company that are described in the Registration Statement and the Prospectus accurately describes the results of such studies, tests and trials in all material respects. Except as disclosed in the Registration Statement and the Prospectus, the Company has not received any notices or correspondence from the FDA or other governmental agency, foreign or domestic, requiring the termination, suspension or material modification of any preclinical or clinical trials conducted by, or on behalf, of the Company or in which the Company has participated.

(ww) The Company has established a compliance program (including a written compliance policy) to assist the Company and its directors, officers and employees in complying with applicable regulatory agency guidelines (including, without limitation, those regulations and guidelines published by FDA), and to provide compliance policies governing applicable areas for medical device companies.

Any certificate signed by or on behalf of the Company and delivered to the Representatives or to counsel for the Underwriters' shall be deemed to be a representation and warranty by the Company to each Underwriter as to the matters covered thereby.

## 2. Purchase, Sale and Delivery of the Shares.

(a) On the basis of the representations, warranties, covenants and agreements herein contained, but subject to the terms and conditions herein set forth, the Company agrees to sell to each Underwriter and each Underwriter, severally and not jointly, agrees to purchase from the Company, at a purchase price per share of \$\_\_\_\_\_, the number of Firm Shares set forth opposite their respective names on Schedule I hereto together with any additional number of Shares which such Underwriter may become obligated to purchase pursuant to the provisions of Section 9 hereof.

(b) Payment of the purchase price for, and delivery of the Firm Shares in either (i) the form of definitive certificates, issued in such names and in such denominations as Ladenburg may direct by notice in writing to the Company given at or prior to 12:00 Noon, New York time, on the second full business day preceding the Closing Date (as defined below) or (ii) in accordance with The Depository Trust Company's standard procedures that include the electronic delivery of capital shares, shall be made at the office of Greenberg Traurig, LLP, The Met Life Building, 200 Park Avenue, New York, New York 10166 ("Underwriters' Counsel"), or at such other place as shall be agreed upon by Ladenburg and the Company, at 10:00 A.M., New York City time, on the fifth, or such other time not later than ten business days after such date as shall be agreed upon by Ladenburg and the Company (such time and date of payment and delivery being herein called the "Closing Date").

Payment of the purchase price for the Firm Shares shall be made by wire transfer in same day funds to or as directed by the Company upon delivery of certificates for the Firm Shares to the Representatives through the facilities of The Depository Trust Company for the respective accounts of the several Underwriters. Certificates for the Firm Shares shall be registered in such name or names and shall be in such denominations as Ladenburg may request at least two business days before the Closing Date. The Company will permit Ladenburg to examine and package such certificates for delivery at least one full business day prior to the Closing Date.

(c) In addition, on the basis of the representations, warranties, covenants and agreements herein contained, but subject to the terms and conditions herein set forth, the Company hereby grants to the Underwriters, acting severally and not jointly, the option to purchase up to \_\_\_\_\_ Additional Shares at the same purchase price per share to be paid by the Underwriters for the Firm Shares as set forth in Section 2(a) above, for the sole purpose of covering over-allotments in the sale of Firm Shares by the Underwriters. This option may be exercised at any time and from time to time, in whole or in part on one or more occasions, on or before the forty-fifth (45th) day following the date of the Prospectus, by written notice from Ladenburg to the Company. Such notice shall set forth the aggregate number of Additional Shares as to which the option is being exercised and the date and time, as reasonably determined by Ladenburg, when the Additional Shares are to be delivered (any such date and time being herein sometimes referred to as the "Additional Closing Date"); provided, however, that no Additional Closing Date shall occur earlier than the Closing Date or earlier than the second full business day after the date on which the option shall have been exercised nor later than the eighth full business day after the date on which the option shall have been exercised (unless such time and date are postponed in accordance with the provisions of Section 9 hereof). Upon any

exercise of the option as to all or any portion of the Additional Shares, each Underwriter, acting severally and not jointly, agrees to purchase from the Company the number of Additional Shares that bears the same proportion of the total number of Additional Shares then being purchased as the number of Firm Shares set forth opposite the name of such Underwriter in Schedule I hereto (or such number increased as set forth in Section 9 hereof) bears to the total number of Firm Shares that the Underwriters have agreed to purchase hereunder, subject, however, to such adjustments to eliminate fractional shares as Ladenburg in its sole discretion shall make.

(d) Payment of the purchase price for, and delivery of the Additional Shares in either (i) the form of definitive certificates, issued in such names and in such denominations as Ladenburg may direct by notice in writing to the Company given at or prior to 12:00 Noon, New York time, on the second full business day preceding the Additional Closing Date or (ii) in accordance with The Depository Trust Company's standard procedures that include the electronic delivery of capital shares, shall be made at the office of Underwriters' Counsel, or at such other place as shall be agreed upon by Ladenburg and the Company, at 10:00 A.M., New York City time, on the Additional Closing Date (unless postponed in accordance with the provisions of Section 9 hereof), or such other time as shall be agreed upon by Ladenburg and the Company.

Payment of the purchase price for the Additional Shares shall be made by wire transfer in same day funds to or as directed by the Company upon delivery of certificates for the Additional Shares to the Representatives through the facilities of The Depository Trust Company for the respective accounts of the several Underwriters. Certificates for the Additional Shares shall be registered in such name or names and shall be in such denominations as Ladenburg may request at least two business days before the Additional Closing Date. The Company will permit Ladenburg to examine and package such certificates for delivery at least one full business day prior to the Additional Closing Date.

3. Offering. Upon authorization of the release of the Firm Shares by Ladenburg, the Underwriters propose to offer the Shares for sale to the public upon the terms and conditions set forth in the Prospectus.

4. Covenants of the Company. The Company covenants and agrees with the Underwriters that:

(a) The Registration Statement and any amendments thereto have been declared effective, and if Rule 430A is used or the filing of the Prospectus is otherwise required under Rule 424(b) or Rule 434, the Company will file the Prospectus (properly completed if Rule 430A has been used) pursuant to Rule 424(b) within the prescribed time period and will provide evidence satisfactory to Ladenburg of such timely filing. If the Company elects to rely on Rule 434, the Company will prepare and file a term sheet that complies with the requirements of Rule 434, and the Prospectus shall not be "materially different" (as such term is used in Rule 434) from the Prospectus included in the Registration Statement at the time it became effective.

The Company will notify you immediately (and, if requested by Ladenburg, will confirm such notice in writing): (i) when the Registration Statement and any amendments thereto become effective; (ii) of any request by the Commission for any amendment of or supplement to

the Registration Statement or the Prospectus or for any additional information; (iii) of the Company's intention to file or prepare any supplement or amendment to the Registration Statement or the Prospectus; (iv) of the mailing or the delivery to the Commission for filing of any amendment of or supplement to the Registration Statement or the Prospectus, including but not limited to Rule 462(b) under the Securities Act; (v) of the issuance by the Commission of any stop order suspending the effectiveness of the Registration Statement or any post-effective amendment thereto or of the initiation, or the threatening, of any proceedings therefor, it being understood that the Company shall make every reasonable effort to avoid the issuance of any such stop order; (vi) of the receipt of any comments from the Commission, and (vii) of the receipt by the Company of any notification with respect to the suspension of the qualification of the Shares for sale in any jurisdiction or the initiation or threatening of any proceeding for that purpose. If the Commission shall propose or enter a stop order at any time, the Company will make every reasonable effort to prevent the issuance of any such stop order and, if issued, to obtain the lifting of such order as soon as possible. The Company will not file any amendment to the Registration Statement or any amendment of or supplement to the Prospectus (including the prospectus required to be filed pursuant to Rule 424(b) or Rule 434) that differs from the prospectus on file at the time of the effectiveness of the Registration Statement to which Ladenburg shall object in writing after being timely furnished in advance a copy thereof. The Company will provide the Co-Lead Managers and Underwriters' Counsel with copies of all such amendments, filings and other documents a sufficient time prior to any filing or other publication thereof to permit the Co-Lead Managers a reasonable opportunity to review and comment thereon.

(b) The Company shall comply with the Securities Act and the Exchange Act to permit completion of the distribution as contemplated in this Agreement, the Registration Statement and the Prospectus. If at any time when a prospectus relating to the Shares is required to be delivered under the Securities Act or the Exchange Act in connection with the sales of Shares, any event shall have occurred as a result of which the Prospectus as then amended or supplemented would, in the judgment of the Underwriters or the Company, include an untrue statement of a material fact or omit to state any material fact required to be stated therein or necessary to make the statements therein, in the light of the circumstances existing at the time of delivery to the purchaser, not misleading, or if to comply with the Securities Act, the Exchange Act or the Rules and Regulations it shall be necessary at any time to amend or supplement the Prospectus or Registration Statement, the Company will notify you promptly and prepare and file with the Commission, subject to Section 4(a) hereof, an appropriate amendment or supplement (in form and substance reasonably satisfactory to Ladenburg) which will correct such statement or omission or which will effect such compliance and will use its commercially reasonable efforts to have any amendment to the Registration Statement declared effective as soon as possible.

(c) The Company will promptly deliver to each of you and Underwriters' Counsel a signed copy of the Registration Statement, as initially filed and all amendments thereto, including all consents and exhibits filed therewith, and will maintain in the Company's files manually signed copies of such documents for at least five years after the date of filing. The Company will promptly deliver to each of the Underwriters such number of copies of any Preliminary Prospectus, the Prospectus, the Registration Statement, and all amendments of and supplements to such documents, if any, and all documents incorporated by reference in the

Registration Statement and Prospectus or any amendment thereof or supplement thereto, and any documents as you may reasonably request. Prior to 10:00 A.M., New York time, on the business day next succeeding the date of this Agreement and from time to time thereafter, the Company will furnish the Underwriters with copies of the Prospectus in New York City in such quantities as you may reasonably request.

(d) The Company consents to the use and delivery of the Preliminary Prospectus by the Underwriters in accordance with Rule 430 and Section 5(b) of the Securities Act.

(e) The Company will use its commercially reasonable efforts, in cooperation with the Co-Lead Managers, at or prior to the time of effectiveness of the Registration Statement, to qualify the Shares for offering and sale under the securities laws relating to the offering or sale of the Shares of such jurisdictions, domestic or foreign, as the Co-Lead Managers may designate and to maintain such qualification in effect for so long as required for the distribution thereof; except that in no event shall the Company be obligated in connection therewith to qualify as a foreign corporation or to execute a general consent to service of process.

(f) The Company will make generally available to its security holders and to the Underwriters as soon as practicable, but in any event not later than twelve months after the effective date of the Registration Statement (as defined in Rule 158(c) under the Securities Act), an earnings statement of the Company (which need not be audited) complying with Section 11(a) of the Securities Act and the Rules and Regulations (including, at the option of the Company, Rule 158).

(g) During the period of two hundred seventy (270) days from the date of the Prospectus, without the prior written consent of Ladenburg the Company: (i) will not, directly or indirectly, issue, offer, sell, agree to issue, offer or sell, solicit offers to purchase, grant any call option, warrant or other right to purchase, purchase any put option or other right to sell, pledge, borrow or otherwise dispose of any Relevant Security, or make any announcement of any of the foregoing; (ii) will not establish or increase any "put equivalent position" or liquidate or decrease any "call equivalent position" (in each case within the meaning of Section 16 of the Exchange Act and the rules and regulations promulgated thereunder) with respect to any Relevant Security, and (iii) will not otherwise enter into any swap, derivative or other transaction or arrangement that transfers to another, in whole or in part, any economic consequence of ownership of a Relevant Security, whether or not such transaction is to be settled by delivery of Relevant Securities, other securities, cash or other consideration; and the Company will obtain an undertaking in substantially the form of Annex V hereto of each of its officers and directors and its stockholders listed on Schedule II attached hereto not to engage in any of the aforementioned transactions on their own behalf, other than the sale of Shares as contemplated by this Agreement and the Company's issuance of Common Stock upon (i) the conversion or exchange of convertible or exchangeable securities outstanding on the date hereof (including the Warrant Exchange as described in the Registration Statement and the Prospectus); (ii) the exercise of currently outstanding options; (iii) the exercise of currently outstanding warrants; and (iv) the grant and exercise of options under, or the issuance and sale of shares pursuant to, employee stock option plans in effect on the date hereof, each as described in the Registration Statement and the Prospectus. The Company will not, during such period, file a

registration statement under the Securities Act in connection with any transaction by the Company or any person that is prohibited pursuant to the foregoing, except for registration statements on Form S-8 relating to employee benefit plans or Form S-4 relating to corporate reorganizations or other transactions under Rule 145.

(h) During the period of five (5) years from the effective date of the Registration Statement, the Company will furnish to you copies of all reports or other communications (financial or other) furnished to security holders or from time to time published or publicly disseminated by the Company, and will deliver to you: (i) as soon as they are available, copies of any reports, financial statements and proxy or information statements furnished to or filed with the Commission or any national securities exchange on which any class of securities of the Company is listed; and (ii) such additional information concerning the business and financial condition of the Company as you may from time to time reasonably request (such financial information to be on a consolidated basis to the extent the accounts of the Company and any subsidiaries are consolidated in reports furnished to its security holders generally or to the Commission). For purposes of this Section 4(h), items filed by the Company with the Commission on EDGAR will be deemed to have been furnished to you on the date of such filing.

(i) The Company will apply the net proceeds from the sale of the Shares as set forth under the caption "Use of Proceeds" in the Prospectus.

(j) The Company shall cooperate with the Representatives and counsel for the Representatives to qualify or register the Shares for sale under (or obtain exemptions from the application of) the state securities or blue sky laws or other foreign laws of those jurisdictions designated by the Representatives, shall comply with such laws and shall continue such qualifications, registrations and exemptions in effect so long as required for the distribution of the Common Shares. The Company shall not be required to qualify as a foreign corporation or to take any action that would subject it to general service of process in any such jurisdiction where it is not presently qualified or where it would be subject to taxation as a foreign corporation. The Company will advise the Representatives promptly of the suspension of the qualification or registration of (or any such exemption relating to) the Shares for offering, sale or trading in any jurisdiction or any initiation or threat of any proceeding for any such purpose, and in the event of the issuance of any order suspending such qualification, registration or exemption, the Company shall use its commercially reasonable efforts to obtain the withdrawal thereof at the earliest possible moment.

(k) The Company shall engage and maintain, at its expense, an independent, qualified and experienced registrar and transfer agent for the Common Stock (it being understood and agreed that American Stock Transfer and Trust Company so qualifies).

(l) Prior to the Closing Date, the Company will furnish the Representatives as soon as they have been prepared by or are available to the Company, a copy of any unaudited interim financial statements of the Company for any period subsequent to the period covered by the most recent financial statements appearing in the Registration Statement and the Prospectus.

(m) Upon written request of any Underwriter, the Company shall furnish, or cause to be furnished, to such Underwriter an electronic version of the Company's trademarks, servicemarks and corporate logo for use on the website, if any, operated by such Underwriter for the purpose of facilitating the on-line offering of the Shares; (the "License"); provided, however, that the License shall be used solely for the purpose described above, is granted without any fee and may not be assigned or transferred.

(n) The Company will use its best efforts to list the Shares, subject to notice of issuance, for quotation on the NASDAQ.

(o) The Company, during the period when the Prospectus is required to be delivered under the Securities Act or the Exchange Act, will file all documents required to be filed with the Commission pursuant to the Securities Act, the Exchange Act and the Rules and Regulations within the time periods required thereby.

(p) The Company will use its commercially reasonable efforts to do and perform all things required to be done or performed under this Agreement by the Company prior to the Closing Date or the Additional Closing Date, as the case may be, and to satisfy all conditions precedent to the delivery of the Firm Shares and the Additional Shares.

(q) The Company will not take, and will cause its affiliates (within the meaning of Rule 144 under the Securities Act) not to take, directly or indirectly, any action which constitutes or is designed to cause or result in, or which could reasonably be expected to constitute, cause or result in, the stabilization or manipulation of the price of any security to facilitate the sale or resale of the Shares.

#### 5. Payment of Expenses.

(a) The Company agrees to pay all reasonable and accountable out-of-pocket costs, fees and expenses incurred in connection with the performance of its obligations hereunder up to a maximum of \$100,000 less any deposits previously paid by the Company to Ladenburg and the lodging and transportation expenses, if any, of any Underwriter incurred in connection with the road show and paid by the Company (the "Expense Cap"), including without limitation (i) all expenses incident to the issuance and delivery of the Shares (including all printing and engraving costs); (ii) all fees and expenses of the registrar and transfer agent of the Common Stock; (iii) all necessary issue, transfer and other stamp taxes in connection with the issuance and sale of the Shares to the several Underwriters; (iv) all reasonable and accountable out-of-pocket fees and expenses of the Company's counsel, independent public or certified public accountants and other advisors; (v) all reasonable and accountable out-of-pocket costs and expenses incurred in connection with the preparation, printing, filing, shipping and distribution of the Registration Statement (including financial statements, exhibits, schedules, consents and certificates of experts), each preliminary prospectus and the Prospectus, and all amendments and supplements thereto, and this Agreement; (vi) all filing fees, reasonable and accountable attorneys' fees and expenses incurred by the Company or the Representatives in connection with qualifying or registering (or obtaining exemptions from the qualification or registration of) all or any part of the Shares for offer and sale under the state securities or blue sky laws and preparing and printing a "Blue Sky Survey" or memorandum, and any supplements thereto, advising the



Underwriters of such qualifications, registrations and exemptions; (vii) the filing fees incident to, and the reasonable and accountable out-of-pocket fees and expenses of counsel for the Representatives in connection with, the NASD's review and approval of the Underwriters' participation in the offering and distribution of the Common Shares; (viii) the fees and expenses associated with including the Shares on the NASDAQ; (ix) all other fees, costs and expenses as set forth in Item 13 of Part II of the Registration Statement; (x) the costs and expenses of the Company relating to investor presentations on any "road show" undertaken in connection with the marketing of the Shares, including without limitation, expenses associated with the production of road show slides and graphics, fees and expenses of any consultants engaged by the Company or the Representative in connection with the road show presentations and the lodging and transportation expenses of officers of and consultants to the Company incurred in connection with the road show (but excluding the lodging and expenses of the Representatives incurred in connection with the road show); (xi) a nonaccountable expense allowance payable to the Representatives equal to one percent (1%) of the public offering price of the Firm Shares payable on the Closing Date, and (xii) all reasonable and accountable out-of-pocket expenses of the Representatives in connection with due diligence meetings with the investment community. Except as otherwise provided herein, the Underwriters shall pay their own expenses, including the fees and disbursements of their counsel, stock transfer taxes on the resale of any Shares by them and any advertising expenses connected with any offers they make.

(b) On the Closing Date, the Company shall sell to the Representatives for an aggregate of \$\_\_\_\_, the Underwriters' Warrant entitling the Underwriters to purchase up to an aggregate of \_\_\_\_\_ shares of the Company's Common Stock, at an exercise price of \$\_\_\_\_\_ (subject to adjustment as set forth therein), which shall first become exercisable one year after the Effective Date and shall remain exercisable for a period of four (4) years thereafter. The Underwriters' Warrant shall be subject to certain transfer restrictions and shall be in substantially the form annexed as Annex VI hereto.

6. Conditions of Underwriters' Obligations. The obligations of the Underwriters to purchase and pay for the Firm Shares and the Additional Shares, as provided herein, shall be subject to the accuracy of the representations and warranties of the Company herein contained, as of the date hereof and as of the Closing Date (for purposes of this Section 6 "Closing Date" shall refer to the Closing Date for the Firm Shares and any Additional Closing Date, if different, for the Additional Shares), to the absence from any certificates, opinions, written statements or letters furnished to you or to Underwriters' Counsel pursuant to this Section 6 of any material misstatement or omission, to the performance by the Company of its obligations hereunder, and to each of the following additional conditions:

(a) The Registration Statement shall have become effective and all necessary regulatory or stock exchange approvals shall have been received not later than 5:30 P.M., New York time, on the date of this Agreement, or at such later time and date as shall have been consented to in writing by Ladenburg; if the Company shall have elected to rely upon Rule 430A or Rule 434 under the Securities Act, the Prospectus shall have been filed with the Commission in a timely fashion in accordance with Section 4(a) hereof and a form of the Prospectus containing information relating to the description of the Shares and the method of distribution and similar matters shall have been filed with the Commission pursuant to Rule 424(b) within the applicable time period; and, at or prior to the Closing Date no stop order

suspending the effectiveness of the Registration Statement or any post-effective amendment thereof shall have been issued and no proceedings therefor shall have been initiated or threatened by the Commission.

(b) At the Closing Date you shall have received the written opinion of Dreier LLP, counsel for the Company, and William R. Bronner, Esq., General Counsel of the Company, dated the Closing Date addressed to the Underwriters substantially in the forms annexed as Annexes I and II hereto.

(c) The Company shall have requested and caused: (i) Wilmer Cutler Pickering Hale & Dorr, LLP, special regulatory counsel for the Company, to have furnished to the Underwriters its opinion, dated the Closing Date and addressed to the Underwriters, substantially in the form annexed as Annex III hereto; and (ii) Rodney Hodgson, registered patent agent for the Company, to have furnished to the Underwriters a certificate, dated the Closing Date, substantially in the form annexed as Annex IV hereto.

(d) All proceedings taken in connection with the sale of the Firm Shares and the Additional Shares as herein contemplated shall be reasonably satisfactory in form and substance to Ladenburg and to Underwriters' Counsel, and the Underwriters shall have received from Underwriters' Counsel a favorable written opinion, dated as of the Closing Date, with respect to the issuance and sale of the Shares, the Registration Statement and the Prospectus and such other related matters as Ladenburg may require, and the Company shall have furnished to Underwriters' Counsel such documents as they may reasonably request for the purpose of enabling them to pass upon such matters.

(e) At the Closing Date you shall have received a certificate of the Chief Executive Officer and Chief Financial Officer of the Company, dated the Closing Date to the effect that: (i) the condition set forth in subsection (a) of this Section 6 has been satisfied; (ii) as of the date hereof and as of the Closing Date, the representations and warranties of the Company set forth in Section 1 hereof are accurate; (iii) as of the Closing Date all agreements, conditions and obligations of the Company to be performed or complied with hereunder on or prior thereto have been duly performed or complied with; (iv) the Company has not sustained any material loss or interference with their respective businesses or properties from fire, flood, hurricane, accident or other calamity, whether or not covered by insurance, or from any labor dispute or any legal or governmental proceeding; (v) no stop order suspending the effectiveness of the Registration Statement or any post-effective amendment thereof has been issued and no proceedings therefor have been initiated or threatened by the Commission; (vi) there are no pro forma or as adjusted financial statements that are required to be included in the Registration Statement and the Prospectus pursuant to the Rules and Regulations that have not been included as required; and (vii) subsequent to the respective dates as of which information is given in the Registration Statement and the Prospectus there has not been any material adverse change or any development involving a prospective material adverse change, whether or not arising from transactions in the ordinary course of business, in or affecting: (X) the business, condition (financial or otherwise), results of operations, stockholders' equity, properties or prospects of the Company, individually or taken as a whole; (Y) the long-term debt or capital stock of the Company; or (Z) the Offering or consummation of any of the other transactions contemplated by this Agreement, the Registration Statement and the Prospectus.

(f) At the time this Agreement is executed and at the Closing Date, you shall have received a comfort letter, from Eisner, independent public accountants for the Company, dated as of the date of this Agreement and as of the Closing Date addressed to the Underwriters and in form and substance satisfactory to the Underwriters and Underwriters' Counsel.

(g) Subsequent to the execution and delivery of this Agreement or, if earlier, the dates as of which information is given in the Registration Statement (exclusive of any amendment thereof) and the Prospectus (exclusive of any supplement thereto), there shall not have been any change in the capital stock or long-term debt of the Company or any change or development involving a change, whether or not arising from transactions in the ordinary course of business, in the business, condition (financial or otherwise), results of operations, stockholders' equity, properties or prospects of the Company, including but not limited to the occurrence of any fire, flood, storm, explosion, accident or other calamity at any of the properties owned or leased by the Company, the effect of which, in any such case described above, is, in the reasonable judgment of Ladenburg, so material and adverse as to make it impracticable or inadvisable to proceed with the Offering on the terms and in the manner contemplated in the Prospectus (exclusive of any supplement).

(h) On the Closing Date, the Representatives shall have received the written certificates executed by the Secretary of the Company, dated as of the Closing Date, in the form and substance reasonably satisfactory to the Representatives, certifying as to: (i) the incumbency and the signatures of those officers of the Company executing this Agreement and such other certificates or documents contemplated under this Agreement; (ii) the Certificate of Incorporation and Bylaws of the Company; and (iii) the resolutions of the Board of Directors of the Company authorizing the execution and delivery of this Agreement and such other certificates or documents contemplated under this Agreement, a copy of such resolutions to be attached to said certificate.

(i) You shall have received a duly executed lock-up agreement from each person who is a director or officer of the Company and each shareholder listed on Schedule II hereto, in each case substantially in the form annexed as Annex V hereto.

(j) At the Closing Date, the Shares shall have been approved for quotation, upon notice of issuance, on the NASDAQ.

(k) At the Closing Date, the NASD shall have confirmed that it has not raised any objection with respect to the fairness and reasonableness of the underwriting terms and arrangements.

(l) No action shall have been taken and no statute, rule, regulation or order shall have been enacted, adopted or issued by any federal, state or foreign governmental or regulatory authority that would, as of the Closing Date, prevent the issuance or sale of the Shares; and no injunction or order of any federal, state or foreign court shall have been issued that would, as of the Closing Date, prevent the issuance or sale of the Shares.

(m) The Company shall have furnished the Underwriters and Underwriters' Counsel with such other certificates, opinions or other documents as they may have reasonably requested.

If any of the conditions specified in this Section 6 shall not have been fulfilled when and as required by this Agreement, or if any of the certificates, opinions, written statements or letters furnished to you or to Underwriters' Counsel pursuant to this Section 6 shall not be satisfactory in form and substance to Ladenburg and to Underwriters' Counsel, all obligations of the Underwriters hereunder may be cancelled by Ladenburg at, or at any time prior to, the Closing Date and the obligations of the Underwriters to purchase the Additional Shares may be cancelled by Ladenburg at, or at any time prior to, the Additional Closing Date. Notice of such cancellation shall be given to the Company in writing, or by telephone. Any such telephone notice shall be confirmed promptly thereafter in writing.

#### 7. Indemnification.

(a) The Company shall indemnify and hold harmless each Underwriter and each person, if any, who controls any Underwriter within the meaning of Section 15 of the Securities Act or Section 20 of the Exchange Act, against any and all losses, liabilities, claims, damages and expenses whatsoever as incurred (including but not limited to reasonable attorneys' fees and any and all other reasonable expenses whatsoever incurred in investigating, preparing or defending against any litigation, commenced or threatened, or any claim whatsoever, and any and all amounts paid in settlement of any claim or litigation), joint or several, to which they or any of them may become subject under the Securities Act, the Exchange Act or otherwise, insofar as such losses, liabilities, claims, damages or expenses (or actions in respect thereof) directly arise out of or are directly based upon: (i) any untrue statement or alleged untrue statement of a material fact contained in (A) the Registration Statement, as originally filed or any amendment thereof, or any related Preliminary Prospectus or the Prospectus, or in any supplement thereto or amendment thereof; or (B) in any written materials or information provided to investors by, or with the approval of, the Company in connection with the marketing of the offering of the Shares, including any road show or investor presentations made to investors by the Company (whether in person or electronically) ("Marketing Materials"); or (ii) the omission or alleged omission to state in the Registration Statement, as originally filed or any amendment thereof, or any related Preliminary Prospectus or the Prospectus, or in any supplement thereto or amendment thereof, or in any Marketing Materials, a material fact required to be stated therein or necessary to make the statements therein not misleading; provided, however, that the Company will not be liable in any such case to the extent but only to the extent that (i) any such loss, liability, claim, damage or expense arises out of or is based upon any untrue statement or alleged untrue statement or omission or alleged omission made in the Registration Statement, as originally filed or any amendment thereof, or any related Preliminary Prospectus or the Prospectus, or in any supplement thereto or amendment thereof, in reliance upon and in conformity with written information furnished to the Company by or on behalf of any Underwriter through Ladenburg expressly for use therein and (ii) a court of competent jurisdiction shall have determined by a final judgment that such loss, liability, claim, damage or expense resulted from any such acts or failures to act undertaken or omitted to be taken by such Underwriter, other than any action or failure to act undertaken at the written request or with the prior written consent of the Company and such action or failure to act is performed in accordance

with such request or within the scope of such consent, through its gross negligence, bad faith or willful misconduct. The parties agree that such information provided by or on behalf of any Underwriter through Ladenburg consists solely of the material referred to in the last sentence of Section 1(b) hereof. This indemnity agreement will be in addition to any liability which the Company may otherwise have, including but not limited to other liability under this Agreement. The foregoing indemnity agreement with respect to any Preliminary Prospectus shall not inure to the benefit of any Underwriter who failed to deliver a Prospectus (as then amended or supplemented, provided by the Company to such Underwriter in the requisite quantity and on a timely basis to permit proper delivery on or prior to the Closing Date) to the person asserting any losses, liabilities, claims, damages or expenses caused by any untrue statement or alleged untrue statement of a material fact contained in any Preliminary Prospectus, or caused by any omission or alleged omission to state therein a material fact required to be stated therein or necessary to make the statements therein not misleading, if (i) such Prospectus is true and correct in all material respects, (ii) such Prospectus was required by law to be delivered at or prior to the written confirmation of sale to such person and (iii) such loss, liability, claim, damage or expense resulted from failure to deliver such Prospectus.

(b) Each Underwriter, severally and not jointly, shall indemnify and hold harmless the Company, each of the directors of the Company, each of the officers of the Company who shall have signed the Registration Statement, and each other person, if any, who controls the Company within the meaning of Section 15 of the Securities Act or Section 20 of the Exchange Act, against any losses, liabilities, claims, damages and expenses whatsoever as incurred (including but not limited to reasonable attorneys' fees and any and all other reasonable expenses whatsoever incurred in investigating, preparing or defending against any litigation, commenced or threatened, or any claim whatsoever, and any and all amounts paid in settlement of any claim or litigation), joint or several, to which they or any of them may become subject under the Securities Act, the Exchange Act or otherwise, insofar as such losses, liabilities, claims, damages or expenses (or actions in respect thereof) directly arise out of or are directly based upon any untrue statement or alleged untrue statement of a material fact contained in the Registration Statement, as originally filed or any amendment thereof, or any related Preliminary Prospectus or the Prospectus, or in any amendment thereof or supplement thereto, or directly arise out of or are directly based upon the omission or alleged omission to state therein a material fact required to be stated therein or necessary to make the statements therein not misleading, in each case to the extent, but only to the extent, that any such loss, liability, claim, damage or expense arises out of or is based upon any such untrue statement or alleged untrue statement or omission or alleged omission made therein in reliance upon and in conformity with information furnished in writing to the Company by or on behalf of any Underwriter through Ladenburg specifically for use therein; provided, however, that in no case shall any Underwriter be liable or responsible for any amount in excess of the underwriting discount applicable to the Shares to be purchased by such Underwriter hereunder. The parties agree that such information provided by or on behalf of any Underwriter through Ladenburg consists solely of the material referred to in the last sentence of Section 1(b) hereof.

(c) Promptly after receipt by an indemnified party under subsection (a) or (b) above of notice of any claims or the commencement of any action, such indemnified party shall, if a claim in respect thereof is to be made against the indemnifying party under such subsection, notify each party against whom indemnification is to be sought in writing of the

claim or the commencement thereof (but the failure so to notify an indemnifying party shall not relieve the indemnifying party from any liability which it may have under this Section 7, except to the extent that it is prejudiced as a result thereof). Each indemnified party, as a condition to the indemnity agreements contained in subsection (a) or (b) above, shall use all reasonable efforts to cooperate with the indemnifying party in the defense of such claim or action. In case any such claim or action is brought against any indemnified party, and it notifies an indemnifying party of the commencement thereof, the indemnifying party will be entitled to participate, at its own expense in the defense of such action, and to the extent it may elect by written notice delivered to the indemnified party promptly after receiving the aforesaid notice from such indemnified party, to assume the defense thereof with counsel reasonably satisfactory to such indemnified party; provided however, that counsel to the indemnifying party shall not (except with the written consent of the indemnified party) also be counsel to the indemnified party. Notwithstanding the foregoing, the indemnified party or parties shall have the right to employ its or their own counsel in any such case, but the fees and expenses of such counsel shall be at the expense of such indemnified party or parties unless (i) the employment of such counsel shall have been authorized in writing by one of the indemnifying parties in connection with the defense of such action; (ii) the indemnifying parties shall not have employed counsel to have charge of the defense of such action within a reasonable time after notice of commencement of the action; (iii) the indemnifying party does not diligently defend the action after the assumption of the defense; or (iv) such indemnified party or parties shall have reasonably concluded (based on advice of counsel) that there may be defenses available to it or them which are different from or additional to those available to one or all of the indemnifying parties (in which case the indemnifying parties shall not have the right to direct the defense of such action on behalf of the indemnified party or parties), in any of which events such fees and expenses shall be borne by the indemnifying parties (it being understood, however, that the Company shall not be liable for the expenses of more than one separate law firm for the Underwriters or controlling persons in any one action or series of related actions in the same jurisdiction). No indemnifying party shall, without the prior written consent of the indemnified parties, effect any settlement or compromise of, or consent to the entry of judgment with respect to, any pending or threatened claim, investigation, action or proceeding in respect of which indemnity or contribution may be or could have been sought by an indemnified party under this Section 7 or Section 8 hereof (whether or not the indemnified party is an actual or potential party thereto), unless (x) such settlement, compromise or judgment (A) includes an unconditional release of the indemnified party from all liability arising out of such claim, investigation, action or proceeding and (B) does not include a statement as to or an admission of fault, culpability or any failure to act, by or on behalf of the indemnified party, and (y) the indemnifying party confirms in writing its indemnification obligations hereunder with respect to such settlement, compromise or judgment.

8. Contribution. In order to provide for contribution in circumstances in which the indemnification provided for in Section 7 hereof is for any reason held to be unavailable from any indemnifying party or is insufficient to hold harmless a party indemnified thereunder, the Company and the Underwriters shall contribute to the aggregate losses, claims, damages, liabilities and expenses of the nature contemplated by such indemnification provision (including any reasonable investigation, legal and other expenses incurred in connection with, and any amount paid in settlement of, any action, suit or proceeding or any claims asserted, but after deducting in the case of losses, claims, damages, liabilities and expenses suffered by the Company, any contribution received by the Company from persons, other than the Underwriters,

who may also be liable for contribution, including persons who control the Company within the meaning of Section 15 of the Securities Act or Section 20 of the Exchange Act, officers of the Company who signed the Registration Statement and directors of the Company) as incurred to which the Company and one or more of the Underwriters may be subject, in such proportions as is appropriate to reflect the relative benefits received by the Company and the Underwriters from the Offering or, if such allocation is not permitted by applicable law, in such proportions as are appropriate to reflect not only the relative benefits referred to above but also the relative fault of the Company and the Underwriters in connection with the statements or omissions which resulted in such losses, claims, damages, liabilities or expenses, as well as any other relevant equitable considerations. The relative benefits received by the Company and the Underwriters shall be deemed to be in the same proportion as (x) the total proceeds from the Offering (net of underwriting discounts and commissions but before deducting expenses) received by the Company bears to (y) the underwriting discount or commissions received by the Underwriters, in each case as set forth in the table on the cover page of the Prospectus. The relative fault of each of the Company and of the Underwriters shall be determined by reference to, among other things, whether the untrue or alleged untrue statement of a material fact or the omission or alleged omission to state a material fact relates to information supplied by the Company or the Underwriters and the parties' relative intent, knowledge, access to information and opportunity to correct or prevent such statement or omission. The Company and the Underwriters agree that it would not be just and equitable if contribution pursuant to this Section 8 were determined by pro rata allocation (even if the Underwriters were treated as one entity for such purpose) or by any other method of allocation which does not take account of the equitable considerations referred to above in this Section. The aggregate amount of losses, liabilities, claims, damages and expenses incurred by an indemnified party and referred to above in this Section 8 shall be deemed to include any legal or other expenses reasonably incurred by such indemnified party in investigating, preparing or defending against any litigation, or any investigation or proceeding by any judicial, regulatory or other legal or governmental agency or body, commenced or threatened, or any claim whatsoever based upon any such untrue or alleged untrue statement or omission or alleged omission. Notwithstanding the provisions of this Section 8; (i) no Underwriter shall be required to contribute any amount in excess of the discounts and commissions applicable to the Shares underwritten by it and distributed to the public and (ii) no person guilty of fraudulent misrepresentation (within the meaning of Section 11(f) of the Securities Act) shall be entitled to contribution from any person who was not guilty of such fraudulent misrepresentation. For purposes of this Section 8, each person, if any, who controls an Underwriter within the meaning of Section 15 of the Securities Act or Section 20 of the Exchange Act shall have the same rights to contribution as such Underwriter, and each person, if any, who controls the Company within the meaning of Section 15 of the Securities Act or Section 20 of the Exchange Act, each officer of the Company who shall have signed the Registration Statement and each director of the Company shall have the same rights to contribution as the Company, subject in each case to clauses (i) and (ii) of the immediately preceding sentence. Any party entitled to contribution will, promptly after receipt of notice of commencement of any action, suit or proceeding against such party in respect of which a claim for contribution may be made against another party or parties, notify each party or parties from whom contribution may be sought, but the omission to so notify such party or parties shall not relieve the party or parties from whom contribution may be sought from any obligation it or they may have under this Section 8 or otherwise, except to the extent such failure prejudiced such

party. The obligations of the Underwriters to contribute pursuant to this Section 8 are several in proportion to the respective number of Shares to be purchased by each of the Underwriters hereunder and not joint.

#### 9. Underwriter Default.

(a) If any Underwriter or Underwriters shall default in its or their obligation to purchase Firm Shares or Additional Shares hereunder, and if the Firm Shares or Additional Shares with respect to which such default relates (the "Default Shares") do not (after giving effect to arrangements, if any, made by Ladenburg pursuant to subsection (b) below) exceed in the aggregate 10% of the number of Firm Shares or Additional Shares, each non-defaulting Underwriter, acting severally and not jointly, agrees to purchase from the Company that number of Default Shares that bears the same proportion of the total number of Default Shares then being purchased as the number of Firm Shares set forth opposite the name of such Underwriter in Schedule I hereto bears to the aggregate number of Firm Shares set forth opposite the names of the non-defaulting Underwriters, subject, however, to such adjustments to eliminate fractional shares as Ladenburg in its sole discretion shall make.

(b) In the event that the aggregate number of Default Shares exceeds 10% of the number of Firm Shares or Additional Shares, as the case may be, Ladenburg may in its discretion arrange for itself or for another party or parties (including any non-defaulting Underwriter or Underwriters who so agree) to purchase the Default Shares on the terms contained herein. In the event that within five calendar days after such a default Ladenburg does not arrange for the purchase of the Default Shares as provided in this Section 9, this Agreement or, in the case of a default with respect to the Additional Shares, the obligations of the Underwriters to purchase and of the Company to sell the Additional Shares shall thereupon terminate, without liability on the part of the Company with respect thereto (except in each case as provided in Sections 5, 7, 8 and 10) or the Underwriters, but nothing in this Agreement shall relieve a defaulting Underwriter or Underwriters of its or their liability, if any, to the other Underwriters and the Company for damages occasioned by its or their default hereunder.

(c) In the event that any Default Shares are to be purchased by the non-defaulting Underwriters, or are to be purchased by another party or parties as aforesaid, Ladenburg or the Company shall have the right to postpone the Closing Date or Additional Closing Date, as the case may be for a period, not exceeding five business days, in order to effect whatever changes may thereby be made necessary in the Registration Statement or the Prospectus or in any other documents and arrangements, and the Company agrees to file promptly any amendment or supplement to the Registration Statement or the Prospectus which, in the opinion of Underwriters' Counsel, may thereby be made necessary or advisable. The term "Underwriter" as used in this Agreement shall include any party substituted under this Section 9 with like effect as if it had originally been a party to this Agreement with respect to such Firm Shares and Additional Shares.

10. Survival of Representations and Agreements. All representations and warranties, covenants and agreements of the Underwriters and the Company contained in this Agreement or in certificates of officers of the Company submitted pursuant hereto, including the agreements contained in Section 5, the indemnity agreements contained in Section 7 and the



contribution agreements contained in Section 8, shall remain operative and in full force and effect regardless of any investigation made by or on behalf of any Underwriter or any controlling person thereof or by or on behalf of the Company, any of its officers and directors or any controlling person thereof, and shall survive delivery of and payment for the Shares to and by the Underwriters. The representations contained in Section 1 and the agreements contained in Sections 5, 7, 8, 10, 11, 12 and 14 hereof shall survive any termination of this Agreement, including termination pursuant to Section 9 or 11 hereof.

#### 11. Effective Date of Agreement; Termination.

(a) This Agreement shall become effective upon the execution of this Agreement. Notwithstanding any termination of this Agreement, the provisions of this Section 11 and of Sections 1, 5, 7, 8 and 12 through 19, inclusive, shall remain in full force and effect at all times after the execution hereof.

(b) Ladenburg shall have the right to terminate this Agreement at any time prior to the Closing Date or to terminate the obligations of the Underwriters to purchase the Additional Shares at any time prior to the Additional Closing Date, as the case may be, if: (i) any domestic or international event or act or occurrence has materially disrupted, or in the reasonable opinion of Ladenburg will in the immediate future materially disrupt, the market for the Company's securities or securities in general; or (ii) trading on NASDAQ shall have been suspended or been made subject to material limitations, or minimum or maximum prices for trading shall have been fixed, or maximum ranges for prices for securities shall have been required, on the NASDAQ or by order of the Commission or any other governmental authority having jurisdiction; or (iii) a banking moratorium has been declared by the State of New York or any federal authority or if any material disruption in commercial banking or securities settlement or clearance services shall have occurred; (iv) in the reasonable judgment of Ladenburg a Material Adverse Effect has occurred since the date of the Prospectus; or (v) (A) there shall have occurred any outbreak or escalation of hostilities or acts of terrorism involving the United States or there is a declaration of a national emergency or war by the United States or (B) there shall have been any other calamity or crisis or any change in political, financial or economic conditions if the effect of any such event in (A) or (B), in the reasonable judgment of Ladenburg, makes it impracticable or inadvisable to proceed with the offering, sale and delivery of the Firm Shares or the Additional Shares, as the case may be, on the terms and in the manner contemplated by the Prospectus.

(c) Any notice of termination pursuant to this Section 11 shall be in writing and delivered pursuant to Section 12 hereof.

(d) If this Agreement shall be terminated pursuant to any of the provisions hereof (other than pursuant to (i) notification by Ladenburg as provided in Section 11(a) hereof or (ii) Section 9(b) hereof), or if the sale of the Shares provided for herein is not consummated because any condition to the obligations of the Underwriters set forth herein is not satisfied or because of any refusal, inability or failure on the part of the Company to perform any agreement herein or comply with any provision hereof, the Company will, subject to demand by Ladenburg, reimburse the Underwriters for all reasonable and accountable out-of-pocket

expenses (including the reasonable and accountable fees and expenses of their counsel), incurred by the Underwriters in connection herewith up to the Fee Cap.

12. Notices. All communications hereunder, except as may be otherwise specifically provided herein, shall be in writing, and:

(a) if sent to any Underwriter, shall be mailed, delivered, or faxed and confirmed in writing, to such Underwriter c/o Ladenburg Thalmann & Co. Inc., 590 Madison Avenue, New York, New York 10022, Attention: Jonathan Burklund, Managing Director, with a copy to Underwriter's Counsel (which shall not constitute notice hereunder) at Greenberg Traurig, P.A. 401 East Las Olas Boulevard, Suite 2000, Fort Lauderdale, Florida 33301, Attention: David C. Peck, Esq.; or

(b) if sent to the Company, shall be mailed, delivered, or faxed and confirmed in writing to the Company and its counsel (which notice to such counsel shall not constitute notice hereunder) at the addresses set forth in the Registration Statement, Attention: Joseph V. Gulfo, M.D., President and Chief Executive Officer, and Valerie A. Price, Esq.;

provided, however, that any notice to an Underwriter pursuant to Section 7 shall be delivered or sent by mail or facsimile transmission to such Underwriter at its address set forth in its acceptance facsimile to Ladenburg, which address will be supplied to any other party hereto by Ladenburg upon request. Any such notices and other communications shall take effect at the time of receipt thereof. Any change of address for receipt of communications hereunder by any party shall be made by giving written notice in accordance with this Section 12 to the other parties.

13. Parties. This Agreement shall inure solely to the benefit of, and shall be binding upon, the Underwriters and the Company and the controlling persons, directors, officers, employees and agents referred to in Sections 7 and 8 hereof, and their respective successors and assigns, and no other person shall have or be construed to have any legal or equitable right, remedy or claim under or in respect of or by virtue of this Agreement or any provision herein contained. This Agreement and all conditions and provisions hereof are intended to be for the sole and exclusive benefit of the parties hereto and said controlling persons and their respective successors, officers, directors, heirs and legal representatives, and it is not for the benefit of any other person, firm or corporation. The term "successors and assigns" shall not include a purchaser, in its capacity as such, of Shares from any of the Underwriters.

14. Governing Law and Jurisdiction; Waiver of Jury Trial. THIS AGREEMENT SHALL BE GOVERNED BY AND CONSTRUED IN ACCORDANCE WITH THE LAWS OF THE STATE OF NEW YORK FOR CONTRACTS MADE AND TO BE FULLY PERFORMED IN SUCH STATE WITHOUT REGARD TO PRINCIPLES OF CONFLICTS OF LAW. The Company and each of the Underwriters irrevocably (a) submits to the jurisdiction of any court of the State of New York or the United State District Court for the Southern District of the State of New York for the purpose of any suit, action, or other proceeding arising out of this Agreement, or any of the agreements or transactions contemplated by this Agreement, the Registration Statement and the Prospectus (each, a "Proceeding"); (b) agrees that all claims in respect of any Proceeding may be heard and determined in any such court; (c) waives, to the fullest extent permitted by law, any immunity from jurisdiction of any

such court or from any legal process therein; (d) agrees not to commence any Proceeding other than in such courts, and (e) waives, to the fullest extent permitted by law, any claim that such Proceeding is brought in an inconvenient forum. THE COMPANY (ON BEHALF OF ITSELF AND, TO THE FULLEST EXTENT PERMITTED BY LAW, ON BEHALF OF ITS RESPECTIVE EQUITY HOLDERS AND CREDITORS) HEREBY WAIVES ANY RIGHT IT MAY HAVE TO A TRIAL BY JURY IN RESPECT OF ANY CLAIM BASED UPON, ARISING OUT OF OR IN CONNECTION WITH THIS AGREEMENT AND THE TRANSACTIONS CONTEMPLATED BY THIS AGREEMENT, THE REGISTRATION STATEMENT AND THE PROSPECTUS.

15. Severability. The invalidity or unenforceability of any Section, paragraph or provision of this Agreement shall not affect the validity or enforceability of any other Section, paragraph or provision hereof. If any Section, paragraph or provision of this Agreement is for any reason determined to be invalid or unenforceable, there shall be deemed to be made such minor changes (and only such minor changes) as are necessary to make it valid and enforceable.

16. General Provisions. This Agreement constitutes the entire agreement of the parties to this Agreement and supersedes all prior written or oral and all contemporaneous oral agreements, understandings and negotiations with respect to the subject matter hereof (including, without limitation, that certain agreement between the Company and Ladenburg dated April 12, 2005). This Agreement may not be amended or modified unless in writing signed by all of the parties hereto, and no condition herein (express or implied) may be waived unless waived in writing by each party whom the condition is meant to benefit.

17. Counterparts. This Agreement may be executed in any number of counterparts, each of which shall be deemed to be an original, but all such counterparts shall together constitute one and the same instrument. Delivery of a signed counterpart of this Agreement by facsimile transmission shall constitute valid and sufficient delivery thereof.

18. Headings. The headings herein are inserted for convenience of reference only and are not intended to be part of, or to affect the meaning or interpretation of, this Agreement.

19. Time is of the Essence. Time shall be of the essence of this Agreement. As used herein, the term "business day" shall mean any day when the Commission's office in Washington, D.C. is open for business.

[REMAINDER OF PAGE INTENTIONALLY LEFT BLANK]

If the foregoing correctly sets forth your understanding, please so indicate in the space provided below for that purpose, whereupon this letter shall constitute a binding agreement among us.

Very truly yours,

ELECTRO-OPTICAL SCIENCES, INC.

By:

-----  
Name:  
Title:

Accepted as of the date first above written on behalf of themselves and the other Underwriters named in Schedule I hereto

LADENBURG THALMANN & CO. INC.

By:

-----  
Name:  
Title:

STANFORD GROUP COMPANY

By:

-----  
Name:  
Title:

SCHEDULE I

| Underwriter<br>-----                                    | Total Number of Firm<br>Shares to be Purchased<br>----- | Number of Additional<br>Shares to be Purchased if<br>Option is Fully Exercised<br>----- |
|---|---|---|
| Ladenburg Thalmann & Co. Inc.<br>Stanford Group Company |   |   |
|   | Total.....<br>-----                                     | -----   |

SCHEDULE II

1. Allen & Company Incorporated
2. Allen & Company LLC
3. Arcadian Venture Partners, LP
4. Margaret L. Bishop Trust (Dan W. Lufkin, trustee)
5. Sidney Braginsky
6. Patricia Siders Brilliant
7. Stanley Brilliant
8. William R. Bronner
9. Caremi Partners Ltd. (beneficial holder, Donald Sussman)
10. Breaux Castleman
11. George C. Chryssis
12. Martin D. Cleary
13. Eric S. Dobkin
14. Double D Venture Fund, LLC
15. Marek Elbaum
16. Abigail Lufkin Living Trust (Dan W. Lufkin, trustee)
17. Alison Lufkin Living Trust (Dan W. Lufkin, trustee)
18. Dan W. Lufkin & Associates
19. Elise G.B. Lufkin Living Trust (Dan W. Lufkin, trustee)
20. Michael Greenebaum
21. Joseph V. Gulfo, M.D.
22. Dina Gutkowicz-Krusin
23. Adam Jacobs
24. Jon Klippel
25. Karen Krumeich
26. George Lind
27. Dan W. Lufkin
28. Theodore Shultz
29. Gerald Wagner, Ph.D.

ANNEX I

Form of Opinion of Company Counsel

1. The Company has been duly organized and validly exists as a corporation in good standing under the laws of its jurisdiction of incorporation, with full power and authority to own its properties and conduct its business as described in the Registration Statement and the Prospectus.

2. The Company has an authorized capitalization as set forth in the Registration Statement and the Prospectus. All of the issued shares of capital stock of the Company have been duly and validly authorized and issued, are fully paid and non-assessable and are not in violation of or subject to any preemptive or, to the knowledge of such counsel, similar rights that entitle or will entitle any person to acquire any Shares from the Company upon issuance or sale thereof. The Shares and the Underwriters' Warrant to be delivered on the Closing Date and the Additional Closing Date, if any, have been duly and validly authorized and, when delivered in accordance with the Underwriting Agreement, will be duly and validly issued, fully paid and non-assessable and will not have been issued in violation of or subject to preemptive or, to the knowledge of such counsel, similar rights that entitle or will entitle any person to acquire any Shares from the Company upon issuance or sale thereof, and the shares of Common Stock for which the Underwriters' Warrant is exercisable at the initial exercise price has been duly authorized and, when issued and delivered in the manner contemplated by the Underwriting Agreement, will be duly and validly issued, fully paid and non-assessable and will not have been issued in violation of or subject to preemptive or, to the knowledge of such counsel, similar rights that entitle or will entitle any person to acquire any Shares from the Company upon issuance or sale thereof. The Common Stock, the Firm Shares, the Additional Shares and the Underwriters' Warrant conform to the descriptions thereof contained in the Registration Statement and the Prospectus.

3. The Common Stock currently outstanding is listed, and the Shares and shares of Common Stock for which the Underwriters' warrant is exercisable are duly authorized for listing on the NASDAQ National Market.

4. The Underwriting Agreement has been duly and validly authorized, executed and delivered by the Company and constitutes the legal, valid and binding obligation of the Company, enforceable in accordance with its terms, except as enforceability may be limited by applicable bankruptcy, insolvency, reorganization, moratorium or similar laws affecting creditors' rights generally and except as enforceability may be subject to general principles of equity (regardless of whether such enforceability is considered in a proceeding in equity or at law).

5. To the knowledge of such counsel and other than as set forth in the Prospectus, there are no judicial, regulatory or other legal or governmental proceedings pending to which the Company is a party or of which any property of the Company is the subject which, if determined adversely to the Company, would individually or in the aggregate have a Material Adverse Effect; and, to the knowledge of such counsel, no such proceedings are threatened or contemplated.

6. The execution, delivery, and performance of the Underwriting Agreement and consummation of the transactions contemplated by Underwriting Agreement, the Registration Statement and the Prospectus do not and will not (A) conflict with or result in a breach of any of the terms and provisions of, or constitute a default (or an event which with notice or lapse of time, or both, would constitute a default) under, or result in the creation or imposition of any lien, charge or encumbrance upon any property or assets of the Company pursuant to, any indenture, mortgage, deed of trust, loan agreement or any other agreement, instrument, franchise, license or permit known to such counsel to which the Company is a party or by which any of the Company or its properties or assets may be bound or (B) violate or conflict with any provision of the certificate of incorporation or by-laws of the Company, or, to the knowledge, after due inquiry, of such counsel, any judgment, decree, order, statute, rule or regulation of any court or any judicial, regulatory or other legal or governmental agency or body.

7. No consent, approval, authorization, order, registration, filing, qualification, license or permit of or with any court or any judicial, regulatory or other legal or governmental agency or body is required for the execution, delivery and performance of this Agreement or consummation of the transactions contemplated by the Underwriting Agreement, the Registration Statement and the Prospectus, except for (1) such as may be required under state securities or blue sky laws in connection with the purchase and distribution of the Shares by the Underwriters (as to which such counsel need express no opinion); (2) such as have been made or obtained under the Securities Act and (3) such as are required by the NASD.

8. The Registration Statement and the Prospectus and any amendments thereof or supplements thereto (other than the financial statements and schedules and other financial data included or incorporated by reference therein, as to which no opinion need be rendered) comply as to form in all material respects with the requirements of the Securities Act, the Exchange Act and the Rules and Regulations. The documents filed under the Exchange Act and incorporated by reference in the Registration Statement and the Prospectus or any amendment thereof or supplement thereto (other than the financial statements and schedules and other financial data included or incorporated by reference therein, as to which no opinion need be rendered) when they became effective or were filed with the Commission, as the case may be, complied as to form in all material respects with the Securities Act or the Exchange Act, as applicable, and the Rules and Regulations.

9. The statements under the captions "\_\_\_\_\_", "\_\_\_\_\_", "\_\_\_\_\_", "\_\_\_\_\_", "\_\_\_\_\_", "\_\_\_\_\_", "Description of Capital Stock" and "Underwriting" in the Prospectus and Items 14 and 15 of Part II of the Registration Statement, insofar as such statements constitute a summary of the legal matters, documents or proceedings referred to therein, fairly present the information called for with respect to such legal matters, documents and proceedings.

10. The Company is not and, after giving effect to the offering and sale of the Shares and the application of the proceeds thereof as described in the Registration Statement and the Prospectus, will not be, an "investment company" as such term is defined in the Investment Company Act of 1940, as amended.

11. The Registration Statement is effective under the Securities Act, and, to the knowledge, after due inquiry, of such counsel, no stop order suspending the effectiveness of



the Registration Statement or any post-effective amendment thereof has been issued and no proceedings therefor have been initiated or threatened by the Commission and all filings required by Rule 424(b) and Rule 430A under the Securities Act have been made.

12. The Company has full right, power and authority to execute and deliver this Agreement, the Shares and the Underwriters' Warrant and to perform its obligations hereunder, and all corporate action required to be taken for the due and proper authorization, execution and delivery of this Agreement, the Shares and the Underwriters' Warrant and consummation of the transactions contemplated by Underwriting Agreement, the Registration Statement and the Prospectus and as described in the Registration Statement and the Prospectus have been duly and validly taken.

13. To the knowledge, after due inquiry, of such counsel, no contract or agreement is required to be filed as an exhibit to the Registration Statement that is not so filed.

14. The Company is not in violation of its respective charter or by-laws and, to the knowledge of such counsel after due inquiry, the Company is not in default in the performance of any obligation, agreement, covenant or condition contained in any indenture, loan agreement, mortgage, lease or other agreement or instrument that is material to the Company, individually or taken as a whole, to which the Company is a party or by which the Company or its property is bound.

15. The Company has not violated any environmental law, any provisions of the Employee Retirement Income Security Act of 1974, as amended, or any provisions of the Foreign Corrupt Practices Act, or the rules and regulations promulgated thereunder, except for such violations which, singly or in the aggregate, would not have a Material Adverse Effect.

16. The Company has such authorizations of, and has made all filings with and notices to, all governmental or regulatory authorities and self-regulatory organizations and all courts and other tribunals, including, without limitation, under any applicable environmental laws, as are necessary to own, lease, license and operate its respective properties and to conduct its business, except where the failure to have any such authorization or to make any such filing or notice would not, singly or in the aggregate, have a Material Adverse Effect; each such authorization is valid and in full force and effect and the Company is in compliance with all the terms and conditions thereof and with the rules and regulations of the authorities and governing bodies having jurisdiction with respect thereto; and no event has occurred (including, without limitation, the receipt of any notice from any authority or governing body) which allows or, after notice or lapse of time or both, would allow, revocation, suspension or termination of any such authorization or results or, after notice or lapse of time or both, would result in any other impairment of the rights of the holder of any such authorization; and such authorizations contain no restrictions that are burdensome to the Company; except where such failure to be valid and in full force and effect or to be in compliance, the occurrence of any such event or the presence of any such restriction would not, singly or in the aggregate, have a Material Adverse Effect.

17. Except as set forth in the Prospectus, no action, suit or proceeding by or before any court or governmental agency, authority or body or any arbitrator, including, without limitation, the United States Food and Drug Administration (the "FDA"), involving the Company or its or its properties is pending or, to the knowledge of such counsel, threatened that (i)

could have a material adverse effect on the performance of the Underwriting Agreement or the consummation of any of the transactions contemplated hereby or (ii) could have a Material Adverse Effect.

18. Except as set forth in the Prospectus, (A) the Company possesses all permits, licenses, provider numbers, certificates, approvals, consents, orders, certifications and other authorizations (collectively, "Governmental Licenses") issued by, and have made all declarations and filings with, the appropriate Federal, state, local or foreign regulatory agencies or bodies, including without limitation, the FDA, necessary to conduct the business now operated by the Company except where the failure to possess such Governmental Licenses or to make such declarations and filings would not result in a Material Adverse Effect; the Company is in compliance with the terms and conditions of all such Governmental Licenses, except where the failure so to comply would not, individually and in the aggregate, have a Material Adverse Effect; all of the Governmental Licenses are valid and in full force and effect, except when the invalidity of such Governmental Licenses or the failure of such Governmental Licenses to be in full force and effect would not have a Material Adverse Effect; and (B) the Company has not received any notice of proceedings relating to the revocation or modification of any such Governmental Licenses which, individually or in the aggregate, if the subject of an unfavorable decision, ruling or finding, would result in a Material Adverse Effect.

19. The Company owns or possesses all U.S. patents and patent applications listed on Schedule A hereto (collectively, the "Intellectual Property"). All such Intellectual Property is in Good Standing, Valid, and Enforceable.

20. Based on our review of certain third party rights made known to us and written certificates from the Company's registered patent agent and its Director of Intellectual Property, which certificates are listed on Schedule B hereto, we have no knowledge of any valid United States or foreign patent that is or would be infringed by the activities of the Company in the manufacture, use or sale of any existing product as currently manufactured, used, or sold, the technologies currently employed by the Company, or its current method of use in any existing product, each as described in the Prospectus.

21. The Company patent applications have been properly prepared and filed, and are being diligently pursued by the Company and the inventions described in the Company patent applications are owned by, or are licensed to the Company.

22. Except as disclosed in the Prospectus, we have no knowledge of any basis for a right or claim by any party or individual in any of the inventions, patents or patent applications listed on Schedule A hereto, except for such right or claim, which if the subject of an unfavorable decision, ruling or finding, would not have a Material Adverse Effect, and to the knowledge of such counsel, the Company's patent applications discloses patentable subject matter.

23. The Company's Intellectual Property licenses are in full force and effect, no default or threatened default exists under such licenses and, to our knowledge, no basis exists for the same.

24. We know of no legal or governmental proceedings that are pending or, to our knowledge, that are threatened, relating to any Intellectual Property, except (A) as disclosed

in the Prospectus or (B) which, individually or in the aggregate, if the subject of an unfavorable decision, ruling or finding, would not have a Material Adverse Effect.

In addition, such opinion shall also contain a statement that such counsel has participated in conferences with officers and representatives of the Company, representatives of the independent public accountants for the Company and the Underwriters at which the contents and the Prospectus and related matters were discussed and, no facts have come to the attention of such counsel which would lead such counsel to believe that either the Registration Statement, at the time it became effective (including the information deemed to be part of the Registration Statement at the time of effectiveness pursuant to Rule 430A(b) or Rule 434, if applicable), or any amendment thereof made prior to the Closing Date, as of the date of such amendment, contained or incorporated by reference any untrue statement of a material fact or omitted to state any material fact required to be stated therein or necessary to make the statements therein not misleading or that the Prospectus (including the documents incorporated by reference therein), as of its date (or any amendment thereof or supplement thereto made prior to the Closing Date as of the date of such amendment or supplement) and as of the Closing Date, contained or contains an untrue statement of a material fact or omitted or omits to state any material fact required to be stated therein or necessary to make the statements therein, in light of the circumstances under which they were made, not misleading (it being understood that such counsel need express no belief or opinion with respect to the financial statements and schedules and other financial data included or incorporated by reference therein).

ANNEX II

Form of Opinion of General Counsel to the Company

1. The Company is duly qualified as a foreign corporation to transact business and is in good standing in each jurisdiction in which such qualification is required, whether by reason of the ownership or leasing of property or the conduct of business, except where the failure to so qualify or to be in good standing would not result in a Material Adverse Effect.

2. The statements contained or incorporated by reference in the Prospectus under the headings "\_\_\_\_\_", "\_\_\_\_\_", "\_\_\_\_\_", insofar as such statements purport to summarize legal matters, agreements, documents or proceedings discussed therein, are accurate and fair summaries of such legal matters, agreements, documents and proceedings.

3. No consent, approval, authorization, filing with or order of any court or governmental agency or body is required in connection with the sale of the Shares or the Underwriters' Warrant as contemplated by the Underwriting Agreement, except as may be required under the securities and blue sky laws in connection with the purchase and distribution of the Shares by the Underwriter in the manner contemplated by the Underwriting Agreement and the Prospectus.

4. The sale of the Shares and the Underwriters' Warrant as contemplated by the Underwriting Agreement will not conflict with, result in a breach or violation of or imposition of any lien, charge or encumbrance upon any property or assets of the Company pursuant to; (i) the charter or by-laws; (ii) the terms of any indenture or other agreement, obligation, condition, covenant or instrument known to me to which the Company is a party or bound or to which its or their property is subject or (iii) any statute, law, rule, regulation, judgment, order or decree known to me to be applicable to the Company of any court, regulatory body, administrative agency, governmental body, arbitratory or other authority having jurisdiction over the Company or any of its properties, except, in the case of each of (ii) and (iii) above, for any such conflict, breach, violation or imposition that would have a Material Adverse Effect.

5. Except as set forth in the Prospectus, no action, suit or proceeding by or before any court or governmental agency, authority or body or any arbitrator, including, without limitation, the United States Food and Drug Administration (the "FDA"), involving the Company or its properties is pending or, to my knowledge, threatened that (i) could have a material adverse effect on the performance of the Underwriting Agreement or the consummation of any of the transactions contemplated hereby or (ii) could have a Material Adverse Effect.

6. Except as set forth in the Prospectus, (A) the Company possesses all permits, licenses, provider numbers, certificates, approvals, consents, orders, certifications and other authorizations (collectively, "Governmental Licenses") issued by, and have made all declarations and filings with, the appropriate Federal, state, local or foreign regulatory agencies or bodies, including without limitation, the FDA, necessary to conduct the business now operated

by the Company except where the failure to possess such Governmental Licenses or to make such declarations and filings would not result in a Material Adverse Effect; the Company is in compliance with the terms and conditions of all such Governmental Licenses, except where the failure so to comply would not, individually and in the aggregate, have a Material Adverse Effect; all of the Governmental Licenses are valid and in full force and effect, except when the invalidity of such Governmental Licenses or the failure of such Governmental Licenses to be in full force and effect would not have a Material Adverse Effect; and (B) the Company has not received any notice of proceedings relating to the revocation or modification of any such Governmental Licenses which, individually or in the aggregate, if the subject of an unfavorable decision, ruling or finding, would result in a Material Adverse Effect.

7. There is no franchise, contract or other document of a character required to be described in the Registration Statement or Prospectus, or to be filed as an exhibit thereto, which is not described or filed as required.

8. The documents incorporated by reference in the Registration Statement and the Prospectus, when they became effective or were filed with the Commission, as the case may be, appeared on their face to be appropriately responsive in all material respects to the requirements of the Securities Act or the Exchange Act, as applicable, and the Rules and Regulations, except that in each case, I do not express an opinion as to the financial statement schedules or other financial data included in the Registration Statement or the Prospectus or excluded therefrom and I do not assume any responsibility for the accuracy, completeness or fairness of the statements contained therein.

9. The Company owns, has rights under, licenses or has other rights to use, on commercially reasonable terms, all intellectual property necessary for the conduct of their businesses as now conducted; and other than as described in the Prospectus, the Company has not received any notice of infringement of or conflict with asserted rights of others with respect to any intellectual property, which infringement or conflict, individually or in the aggregate, if the subject of an unfavorable decision, ruling or finding would result in a Material Adverse Effect.

10. The Company owns or possesses all U.S. patents and patent applications listed on Schedule A hereto (collectively, the "Intellectual Property"). All such Intellectual Property is in good standing, valid, and enforceable.

11. Based on my review of certain third party rights made known to me and written certificates from the Company's registered patent agent and its Director of Intellectual Property, which certificates are listed on Schedule B hereto, I have no knowledge of any valid United States or foreign patent that is or would be infringed by the activities of the Company in the manufacture, use or sale of any existing product as currently manufactured, used, or sold, the technologies currently employed by the Company, or its current method of use in any existing product, each as described in the Prospectus.

12 The Company's patent applications have been properly prepared and filed, and are being diligently pursued by the Company, and the inventions described in the Company patent applications are owned by the Company.

13 All of the Company's Intellectual Property licenses are in full force and effect, no default or threatened default exists under such licenses and, to my knowledge, no basis exists for the same.

14 I know of no legal or governmental proceedings that are pending or, to my knowledge, that are threatened, relating to any Intellectual Property, except (A) as disclosed in the Prospectus or (B) which, individually or in the aggregate, if the subject of an unfavorable decision, ruling or finding, could not have a Material Adverse Effect.

15 Except as disclosed in the Prospectus, I have no knowledge of any basis for a right or claim by any party or individual in any of the inventions, patents or patent applications listed on Schedule A hereto, except for such right or claim, which if the subject of an unfavorable decision, ruling or finding, would not have a Material Adverse Effect, and to my knowledge, each of the Company's patent applications discloses patentable subject matter.

16. The execution and delivery of the Underwriting Agreement and the consummation of the sale of the Shares and Underwriters' Warrant does not conflict with or result in a breach of any terms or provisions of, or constitute a default under, the Company's certificate of incorporation or by-laws and any agreement or instrument to which the Company is a party or by which the Company may be bound, and will not conflict with or result in a breach or violation of any statute or any order, rule or regulation known to me and applicable to the transactions contemplated by the Underwriting Agreement.

17. No facts have come to my attention that have led me to believe that the Registration Statement, at the time it became effective, contained an untrue statement of a material fact or omitted to state any material fact required to be stated therein or necessary to make the statements therein not misleading or that the Prospectus, as of its date and as of the date hereof, contained or contains an untrue statement of a material fact or omitted or omits to state any material fact necessary to make the statements therein, in light of the circumstances under which they were made, not misleading, except that I express no belief with respect to the financial statements, financial statement schedules and other financial data included therein or excluded therefrom or the exhibits to the Registration Statement.

ANNEX III

Form of Opinion of Regulatory Counsel

1. The Company has obtained such licenses, permits, approvals, and authorizations required by the United States Food and Drug Administration ("FDA") that are necessary for the conduct of the business of the Company as it is currently conducted and described in the Prospectus and to our knowledge such authorizations are in effect.

2. To our knowledge except as disclosed in the Prospectus, we are not aware of any lawsuit or regulatory proceeding, pending or threatened, brought by or before the FDA, in which the Company is or would be the defendant or respondent, nor are we aware of any adverse judgment, decree, or order currently in effect that has been issued by the FDA against the Company.

3. No facts have come to our attention that have led us to believe that the Regulatory Disclosure in the Registration Statement, at the time the Registration Statement became effective, contained an untrue statement of a material fact or omitted to state any material fact required to be stated therein or necessary to make the statements therein not misleading or that the Regulatory Disclosure in the Prospectus, as of the date of the Prospectus and as of the date hereof, contained or contains an untrue statement of a material fact or omitted or omits to state any material fact necessary to make the statements therein, in light of the circumstances under which they were made, not misleading.

ANNEX IV

Form of Certificate of Registered Patent Agent

1. To my knowledge, the Company owns or possesses all Intellectual Property currently employed by it in connection with the business now operated by it except where the failure to own or possess or otherwise be able to acquire such Intellectual Property could not, individually or in the aggregate, have a Material Adverse Effect.

2. Based upon a review of the third party rights made known to me and discussions with scientific personnel of the Company, I am not aware of any valid United States or foreign patent that is or would be infringed by the activities of the Company in the manufacture, use or sale of any existing or presently proposed product, the technologies employed by the Company or the method of its use in any existing or presently proposed product, each as described in the Prospectus and as such are related to the foregoing technology and products.

3. I have reviewed the Company's patent applications which are identified in the Patent Schedule included with this letter, and in my opinion the Company's patent applications have been properly prepared and filed, and are being diligently pursued by the Company, and the inventions described in the Company's patent applications are owned by, have been assigned to or are licensed to the Company.

4. To my knowledge except as disclosed in the Prospectus, no party or individual has any right or claim in any of the inventions, patents or patent applications listed in the Patent Schedule and to my knowledge each of the Company's patent applications discloses patentable subject matter.

5. To our knowledge, the Company is not infringing or otherwise violating any Intellectual Property of others, unless otherwise disclosed in the Prospectus. To my knowledge, except as disclosed in the Prospectus, the Company has not received any notice of infringement of or conflict with asserted rights of others with respect to any Intellectual Property.

6. All of the Company's Intellectual Property licenses are in full force and effect, no default or threatened default exists under such licenses and, to my knowledge, no basis exists for the same.

7. I know of no legal or governmental proceedings that are pending or, to my knowledge, that are threatened, relating to any Intellectual Property, except (A) as disclosed in the Prospectus or (B) which, individually or in the aggregate, if the subject of an unfavorable decision, ruling or finding, could not have a Material Adverse Effect.

8. No facts have come to my attention that have led me to believe that the Intellectual Property Disclosure in the Registration Statement, at the time the Registration Statement became effective, contained an untrue statement of a material fact or omitted to state any material fact required to be stated therein or necessary to make the statements therein not



misleading or that the Intellectual Property Disclosure in the Prospectus, as of the date of the Prospectus and as of the date hereof, contained or contains an untrue statement of a material fact or omitted or omits to state any material fact necessary to make the statements therein, in light of the circumstances under which they were made, not misleading.

ANNEX V

Form of Lock-Up Agreement

[Date]

Ladenburg Thalmann & Co. Inc.  
A Representative of the Several Underwriters  
590 Madison Avenue  
New York, New York 10022

And

Stanford Group Company  
A Representative of the Several Underwriters  
201 South Biscayne Boulevard  
12th Floor  
Miami, Florida 33131

Electro-Optical Sciences, Inc. Lock-Up Agreement

Ladies and Gentlemen:

This letter agreement (this "Agreement") relates to the proposed public offering (the "Offering") by Electro-Optical Sciences, Inc., a Delaware corporation (the "Company"), of its common stock, \$.001 par value (the "Stock").

In order to induce you and the other underwriters for which you act as representatives (the "Underwriters") to underwrite the Offering, the undersigned hereby agrees that, without the prior written consent of Ladenburg Thalmann & Co. Inc. ("Ladenburg"), during the period from the date hereof until two hundred seventy (270) days from the date of the final prospectus for the Offering (the "Lock-Up Period"), the undersigned (a) will not, directly or indirectly, offer, sell, agree to offer or sell, solicit offers to purchase, grant any call option or purchase any put option with respect to, pledge, borrow or otherwise dispose of any Relevant Security (as defined below), and (b) will not establish or increase any "put equivalent position" or liquidate or decrease any "call equivalent position" with respect to any Relevant Security (in each case within the meaning of Section 16 of the Securities Exchange Act of 1934, as amended, and the rules and regulations promulgated thereunder), or otherwise enter into any swap, derivative or other transaction or arrangement that transfers to another, in whole or in part, any economic consequence of ownership of a Relevant Security, whether or not such transaction is to be settled by delivery of Relevant Securities, other securities, cash or other consideration. As used herein "Relevant Security" means the Stock, any other equity security of the Company or any of its subsidiaries and any security convertible into, or exercisable or exchangeable for, any Stock or other such equity security.

The undersigned hereby authorizes the Company during the Lock-Up Period to cause any transfer agent for the Relevant Securities to decline to transfer, and to note stop transfer

restrictions on the stock register and other records relating to, Relevant Securities for which the undersigned is the record holder and, in the case of Relevant Securities for which the undersigned is the beneficial but not the record holder, agrees during the Lock-Up Period to cause the record holder to cause the relevant transfer agent to decline to transfer, and to note stop transfer restrictions on the stock register and other records relating to, such Relevant Securities. The undersigned hereby further agrees that, without the prior written consent of Ladenburg, during the Lock-up Period the undersigned (x) will not file or participate in the filing with the Securities and Exchange Commission of any registration statement, or circulate or participate in the circulation of any preliminary or final prospectus or other disclosure document with respect to any proposed offering or sale of a Relevant Security and (y) will not exercise any rights the undersigned may have to require registration with the Securities and Exchange Commission of any proposed offering or sale of a Relevant Security.

The undersigned hereby represents and warrants that the undersigned has full power and authority to enter into this Agreement and that this Agreement constitutes the legal, valid and binding obligation of the undersigned, enforceable in accordance with its terms. Upon request, the undersigned will execute any additional documents necessary in connection with enforcement hereof. Any obligations of the undersigned shall be binding upon the successors and assigns of the undersigned from the date first above written.

This Agreement shall be governed by and construed in accordance with the laws of the State of New York. Delivery of a signed copy of this letter by facsimile transmission shall be effective as delivery of the original hereof.

Very truly yours,

By: \_\_\_\_\_

Print Name: \_\_\_\_\_

ANNEX VI

FORM OF UNDERWRITERS' WARRANT AGREEMENT

WARRANT AGREEMENT dated as of , 2005 between Electro-Optical Sciences, Inc., a Delaware corporation (the "Company"), and the Underwriters listed on Appendix 1 (hereinafter referred to as the "Underwriters").

WITNESSETH:

WHEREAS, the Company proposes to issue to the Underwriters warrants (the "Warrants") to purchase up to an aggregate of \_\_\_\_\_ (as such number may be adjusted from time to time pursuant to Article 7 of this Warrant Agreement) shares (the "Shares") of common stock, \$.001 par value per share (the "Common Stock"), of the Company; and

WHEREAS, the Underwriters have agreed, pursuant to the underwriting agreement (the "Underwriting Agreement") dated , 2005 between the Underwriters and the Company, to act as Underwriters in connection with the Company's proposed public offering (the "Public Offering") of \_\_\_\_\_ shares of Common Stock (the "Public Shares") at an initial public offering price of \$[ ] per Public Share; and

WHEREAS, the Warrants issued pursuant to this Agreement are being issued by the Company to the Underwriters or to their designees who are officers or partners of the respective Underwriter (collectively, the "Designees"), in consideration for, and as part of the Underwriter's compensation in connection with, the Underwriters acting as Underwriters pursuant to the Underwriting Agreement;

NOW, THEREFORE, in consideration of the premises, the payment by the Underwriters to the Company of the aggregate amount of \_\_\_\_\_ dollars (\$\_\_\_\_.00), the agreements herein set forth and other good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, the parties hereto agree as follows:

1. Grant. The Underwriters and/or the Designees are hereby granted the right to purchase, up to an aggregate of \_\_\_\_\_ fully-paid and non-assessable Shares at an initial exercise price, as more particularly described on Appendix 1 (subject to adjustment as provided in Article 6 hereof) of \$[ ] per Share at any time from \_\_\_\_\_, 2006 until 5:00 P.M., New York City time, on \_\_\_\_\_, 2010 (the "Underlying Share Warrant Term"). Except as provided in Article 12 hereof, the Shares are in all respects identical to the Public Shares being sold to the public pursuant to the terms and provisions of the Underwriting Agreement.

2. Exercise of Warrant.

2.1. Cash Exercise. The Warrants initially are exercisable at a price of \$[\_\_\_\_\_] per Share purchased, payable in cash or by check to the order of the

Company, or any combination thereof, subject to adjustment as provided in Article 7 hereof. Upon surrender of the Warrant Certificate(s) with the annexed Form of Election to Purchase duly executed, together with payment of the Exercise Price (as hereinafter defined) for the Shares, at the Company's principal office in New York (currently located at 3 West Main Street, Suite 201, Irvington, New York 10533), the registered holder of a Warrant Certificate ("Holder" or "Holders") shall be entitled to receive a certificate or certificates for the Shares so purchased. The purchase rights represented by the Warrant Certificate are exercisable at the option of the Holder hereof, in whole or in part. In the case of the purchase of less than all of the Shares purchasable under any Warrant Certificate, the Company shall cancel said Warrant Certificate upon the surrender thereof and shall execute and deliver a new Warrant Certificate of like tenor for the balance of the Shares.

2.2. Cashless Exercise. At any time during the Warrant Exercise Term, the Holder may, at the Holder's option, exchange, in whole or in part, the Warrants represented by such Holder's Warrant Certificate which are exercisable for the purchase of Shares, into the number of Shares determined in accordance with this Section 2.2 (a "Warrant Exchange"), by surrendering such Warrant Certificate at the principal office of the Company or at the office of its transfer agent, accompanied by a notice stating such Holder's intent to effect such exchange, the number of Warrants to be so exchanged and the date on which the Holder requests that such Warrant Exchange occur (the "Notice of Exchange"). The Warrant Exchange shall take place on the date specified in the Notice of Exchange or, if later, the date the Notice of Exchange is received by the Company (the "Exchange Date"). Certificates for the Shares issuable upon such Warrant Exchange and, if applicable, a new Warrant Certificate of like tenor representing the Warrants which were subject to the surrendered Warrant Certificate and not included in the Warrant Exchange, shall be issued as of the Exchange Date and delivered to the Holder within three (3) days following the Exchange Date. In connection with any Warrant Exchange, the Holder shall be entitled to subscribe for and acquire (i) the number of Shares (rounded to the next highest integer) which would, but for such Warrant Exchange, then be issuable pursuant to the provisions of Section 2.1 above upon the exercise of the Warrants specified by the Holder in its Notice of Exchange (the "Total Share Number") less (ii) the number of Shares equal to the quotient obtained by dividing (a) the product of the Total Share Number and the existing Exercise Price per Share (as hereinafter defined) by (b) the Market Price (as hereinafter defined) of a Public Share on the day preceding the Warrant Exchange. "Market Price" at any date shall be deemed to be the last reported sale price, or, in case no such reported sales takes place on such day, the average of the last reported sale prices for the last three (3) trading days, in either case as officially reported by the principal securities exchange on which the Common Stock is listed or admitted to trading or as reported in the NASDAQ National Market System, or, if the Common Stock is not listed or admitted to trading on any national securities exchange or quoted on the NASDAQ National Market System, the closing bid price as furnished by (i) the

National Association of Securities Dealers, Inc. through NASDAQ or (ii) the OTC Bulletin Board or successor trading market.

3. Issuance of Certificates. Upon the exercise of the Warrants, the issuance of certificates for the Shares purchased shall be made no later than three (3) business days thereafter without charge to the Holder thereof including, without limitation, any tax which may be payable in respect of the issuance thereof, and such certificates shall (subject to the provisions of Article 4 hereof) be issued in the name of, or in such names as may be directed by, the Holder thereof; provided, however, that the Company shall not be required to pay any transfer tax which may be payable in respect of any transfer involved in the issuance and delivery of any such certificates in a name other than that of the Holder and the Company shall not be required to issue or deliver such certificates unless or until the person or persons requesting the issuance thereof shall have paid to the Company the amount of such tax or shall have established to the satisfaction of the Company that such tax has been paid.

The certificates representing the Shares shall be executed on behalf of the Company by the manual or facsimile signature of the present or any future Chief Executive Officer or President of the Company under its corporate seal (if any) reproduced thereon, attested to by the manual or facsimile signature of the present or any future Secretary or Assistant Secretary of the Company. Warrant Certificates shall be dated the date of execution by the Company upon initial issuance, division, exchange, substitution or transfer.

Upon exercise, in part or in whole, of the Warrants, certificates representing the Shares purchased, (the "Warrant Securities"), shall bear a legend substantially similar to the following:

"The securities represented by this certificate and the other securities issuable upon exercise thereof have not been registered for purposes of public distribution under the Securities Act of 1933, as amended (the "Act"), and may not be offered or sold except (i) pursuant to an effective registration statement under the Act, (ii) to the extent applicable, pursuant to Rule 144 under the Act (or any similar rule under such Act relating to the disposition of securities), or (iii) upon the delivery by the holder to the Company of an opinion of counsel, reasonably satisfactory to counsel to the Company, stating that an exemption from registration under such Act is available."

4. Restriction on Transfer of Warrants. The Holder of a Warrant Certificate, by the Holder's acceptance thereof, covenants and agrees that the Warrants are being acquired as an investment and not with a view to the distribution thereof, and that the Warrants may not be sold during the Public Offering, or sold, transferred, assigned, pledged or hypothecated, or be the subject of any hedging, short sale, derivative, put or call transaction that would result in the effective economic disposition of the Warrants for

a period of one (1) year from \_\_\_\_\_, 2005, except to the Underwriters or the Designees, provided that any portion of the warrant so transferred shall remain subject to the above restriction for the remainder of the restriction period.

5. Price.

5.1. Initial and Adjusted Exercise Price. The initial exercise price of each Warrant shall be \$[ ] per Share. The adjusted exercise price per Share shall be the prices which shall result from time to time from any and all adjustments of the initial exercise price per Share in accordance with the provisions of Article 7 hereof.

5.2. Exercise Price. The term "Exercise Price" herein shall mean the initial exercise price or the adjusted exercise price, depending upon the context.

6. Registration Rights.

6.1. Registration Under the Securities Act of 1933. None of the Warrants or the Shares have been registered for purposes of public distribution under the Securities Act of 1933, as amended (the "Act").

6.2. Registrable Securities. As used herein the term "Registrable Security" means each of the Warrants, the Shares, and any shares of Common Stock issued upon any stock split or stock dividend in respect of such Shares; provided, however, that with respect to any particular Registrable Security, such security shall cease to be a Registrable Security when, as of the date of determination, (i) it has been effectively registered under the Act and disposed of pursuant thereto, (ii) registration under the Act is no longer required for subsequent public distribution of such security under Rule 144(k) promulgated under the Act or otherwise, or (iii) it has ceased to be outstanding. The term "Registrable Securities" means any and/or all of the securities falling within the foregoing definition of a "Registrable Security." In the event of any merger, reorganization, consolidation, recapitalization or other change in corporate structure affecting the Common Stock, such adjustment shall be made in the definition of "Registrable Security" as is appropriate in order to prevent any dilution or enlargement of the rights granted pursuant to this Article 6.

6.3. Piggyback Registration. If, within seven (7) years following the effective date of the Public Offering, the Company proposes to prepare and file one or more post-effective amendments to the registration statement filed in connection with the Public Offering or any new registration statement or post-effective amendments thereto covering equity or debt securities of the Company, or any such securities of the Company held by its shareholders (in any such case, other than in connection with a merger, acquisition or pursuant to Form S-8 or successor form) (for purposes of this Article 6, collectively, the "Registration Statement"), it will give written notice of its intention to do so by certified mail,

return receipt requested ("Notice"), at least thirty (30) business days prior to the filing of each such Registration Statement, to all Holders of the Registrable Securities. Upon the written request of such a Holder (a "Requesting Holder"), made within twenty (20) business days after receipt by the Holder of the Notice, that the Company include any of the Requesting Holder's Registrable Securities in the proposed Registration Statement, the Company shall, as to each such Requesting Holder, use its best efforts to effect the registration under the Act of the Registrable Securities which it has been so requested to register ("Piggyback Registration"), at the Company's sole cost and expense and at no cost or expense to the Requesting Holders (except as provided in Section 6.5(b) hereof).

Notwithstanding the provisions of this Section 6.3, the Company shall have the right at any time after it shall have given written notice pursuant to this Section 6.3 (irrespective of whether any written request for inclusion of Registrable Securities shall have already been made) to elect not to file any such proposed Registration Statement, or to withdraw the same after the filing but prior to the effective date thereof.

#### 6.4. Demand Registration.

(a) At any time within five (5) years following the effective date of the Public Offering, any "Majority Holder" (as such term is defined in Section 6.4(c) below) of the Registrable Securities shall have the right (which right is in addition to the piggyback registration rights provided for under Section 6.3 hereof), exercisable by written notice to the Company (the "Demand Registration Request"), to have the Company prepare and file with the Securities and Exchange Commission (the "Commission") on one occasion, at the sole expense of the Company (except as provided in Section 6.5(b) hereof), a Registration Statement and such other documents, including a prospectus, as may be necessary (in the opinion of both counsel for the Company and counsel for such Majority Holder) in order to comply with the provisions of the Act, so as to permit a public offering and sale of the Registrable Securities by the Holders thereof. The Company shall use its best efforts to cause the Registration Statement to become effective under the Act, so as to permit a public offering and sale of the Registrable Securities by the Holders thereof. Once effective, the Company will use its best efforts to maintain the effectiveness of the Registration Statement until the earlier of (i) the date that all of the Registrable Securities have been sold or (ii) the date the Holders thereof receive an opinion of counsel to the Company that all of the Registrable Securities may be freely traded without registration under the Act, under Rule 144(k) promulgated under the Act or otherwise.

(b) The Company covenants and agrees to give written notice of any Demand Registration Request to all Holders of the Registrable Securities within ten (10) business days from the date of the Company's



receipt of any such Demand Registration Request. After receiving notice from the Company as provided in this Section 6.4(b), holders of Registrable Securities may request the Company to include their Registrable Securities in the Registration Statement to be filed pursuant to Section 6.4(a) hereof by notifying the Company of their decision to have such securities included within ten (10) days of their receipt of the Company's notice.

(c) The term "Majority Holder" as used in Section 6.4 hereof shall mean any Holder or any combination of Holders of Registrable Securities, if included in such Holders' Registrable Securities, that hold an aggregate number of shares of Common Stock (including Shares already issued, Shares issuable pursuant to the exercise of outstanding Warrants) as would constitute a majority of the aggregate number of shares of Common Stock outstanding (including Shares already issued and Shares issuable pursuant to the exercise of outstanding Warrants) that are Registrable Securities.

6.5. Covenants of the Company With Respect to Registration. The Company covenants and agrees as follows:

(a) In connection with any registration under Section 6.4 hereof, the Company shall file the Registration Statement as expeditiously as possible, but in any event no later than twenty (20) days following receipt of any demand therefor, shall use its best efforts to have any such Registration Statement declared effective at the earliest possible time, and shall furnish each Holder of Registrable Securities such number of prospectuses as shall reasonably be requested.

(b) The Company shall pay all costs, fees and expenses (other than underwriting fees, discounts and nonaccountable expense allowance applicable to the Registrable Securities and fees and expenses of counsel retained by the Holders of Registrable Securities) in connection with all Registration Statements filed pursuant to Sections 6.3 and 6.4(a) hereof including, without limitation, the Company's legal and accounting fees, printing expenses, and blue sky fees and expenses.

(c) The Company will take all necessary action which may be required in qualifying or registering the Registrable Securities included in the Registration Statement for offering and sale under the securities or blue sky laws of such states as are reasonably requested by the Holders of such securities.

(d) The Company shall indemnify any Holder of the Registrable Securities to be sold pursuant to any Registration Statement and any underwriter or person deemed to be an underwriter under the Act

and each person, if any, who controls such Holder or underwriter or person deemed to be an underwriter within the meaning of Section 15 of the Act or Section 20(a) of the Securities Exchange Act of 1934, as amended ("Exchange Act"), against all loss, claim, damage, expense or liability (including all expenses reasonably incurred in investigating, preparing or defending against any claim whatsoever) to which any of them may become subject under the Act, the Exchange Act or otherwise, arising from such registration statement to the same extent and with the same effect as the provisions pursuant to which the Company has agreed to indemnify the Underwriters as set forth in Section 7 of the Underwriting Agreement and to provide for just and equitable contribution as set forth in Section 8 of the Underwriting Agreement.

(e) Any Holder of Registrable Securities to be sold pursuant to a registration statement, and such Holder's successors and assigns, shall severally, and not jointly, indemnify, the Company, its officers and directors and each person, if any, who controls the Company within the meaning of Section 15 of the Act or Section 20(a) of the Exchange Act, against all loss, claim, damage or expense or liability (including all expenses reasonably incurred in investigating, preparing or defending against any claim whatsoever) to which they may become subject under the Act, the Exchange Act or otherwise, arising from information furnished by or on behalf of such Holder, or such Holder's successors or assigns, for specific inclusion in such Registration Statement to the same extent and with the same effect as the provisions pursuant to which the Underwriters have agreed to indemnify the Company as set forth in Section 7 of the Underwriting Agreement and to provide for just and equitable contribution as set forth in Section 8 of the Underwriting Agreement.

(f) Nothing contained in this Agreement shall be construed as requiring any Holder to exercise the Warrants held by such Holder prior to the initial filing of any registration statement or the effectiveness thereof.

(g) The Company shall not permit the inclusion of any securities other than the Registrable Securities to be included in any Registration Statement filed pursuant to Section 6.4 hereof, without the prior written consent of the Majority Holders, which consent shall not be unreasonably withheld.

(h) The Company shall promptly deliver copies of all correspondence between the Commission and the Company, its counsel or its auditors and all memoranda relating to discussions with the Commission or its staff with respect to the Registration Statement to each Holder of Registrable Securities included for registration in such Registration Statement pursuant to Section 6.3 hereof or Section 6.4

hereof requesting such correspondence and memoranda and to the managing underwriter, if any, of the offering in connection with which such Holder's Registrable Securities are being registered and shall permit each Holder of Registrable Securities and such underwriter to do such reasonable investigation, upon reasonable advance notice, with respect to information contained in or omitted from the Registration Statement as it deems reasonably necessary to comply with applicable securities laws or rules of the National Association of Securities Dealers, Inc. Such investigation shall include access to books, records and properties and opportunities to discuss the business of the Company with its officers and independent auditors, all to such reasonable extent and at such reasonable times and as often as any such Holder of Registrable Securities or underwriter shall reasonably request.

7. Adjustments of Exercise Price and Number of Securities. The following adjustments apply to the Exercise Price of the Warrants with respect to the Shares and the number of Shares purchasable upon exercise of the Warrants.

7.1. Computation of Adjusted Price. In case the Company shall at any time after the date hereof pay a dividend in shares of Common Stock or make a distribution in shares of Common Stock, then upon such dividend or distribution, the Exercise Price in effect immediately prior to such dividend or distribution shall forthwith be reduced to a price determined by dividing:

(a) an amount equal to the total number of shares of Common Stock outstanding immediately prior to such dividend or distribution multiplied by the Exercise Price in effect immediately prior to such dividend or distribution, by

(b) the total number of shares of Common Stock outstanding immediately after such issuance or sale.

For the purposes of any computation to be made in accordance with the provisions of this Section 7.1, the Common Stock issuable by way of dividend or other distribution on any stock of the Company shall be deemed to have been issued immediately after the opening of business on the date following the date fixed for the determination of stockholders entitled to receive such dividend or other distribution.

7.2. Subdivision and Combination. In case the Company shall at any time subdivide or combine the outstanding shares of Common Stock, the Exercise Price shall forthwith be proportionately decreased in the case of subdivision or increased in the case of combination.

7.3. Adjustment in Number of Securities. Upon each adjustment of the Exercise Price pursuant to the provisions of this Article 7, the number of Shares

issuable upon the exercise of each Warrant shall be adjusted to the nearest full number by multiplying a number equal to the Exercise Price in effect immediately prior to such adjustment by the number of Shares issuable upon exercise of the Warrants immediately prior to such adjustment and dividing the product so obtained by the adjusted Exercise Price.

7.4. Reclassification, Consolidation, Merger, etc. In case of any reclassification or change of the outstanding shares of Common Stock (other than a change in par value to no par value, or from no par value to par value, or as a result of a subdivision or combination), or in the case of any consolidation of the Company with, or merger of the Company into, another corporation (other than a consolidation or merger in which the Company is the surviving corporation and which does not result in any reclassification or change of the outstanding shares of Common Stock, except a change as a result of a subdivision or combination of such shares or a change in par value, as aforesaid), or in the case of a sale or conveyance to another corporation of all or substantially all of the assets of the Company, the Holders shall thereafter have the right to purchase the kind and number of shares of stock and other securities and property receivable upon such reclassification, change, consolidation, merger, sale or conveyance as if the Holders were the owners of the Shares immediately prior to any such events, at a price equal to the product of (x) the number of shares of Common Stock issuable upon exercise of the Holders' Warrants and (y) the exercise prices for the Warrants in effect immediately prior to the record date for such reclassification, change, consolidation, merger, sale or conveyance as if such Holders had exercised the Warrants.

7.5. Determination of Outstanding Common Shares. The number of Common Shares at any one time outstanding shall include the aggregate number of shares issued and the aggregate number of shares issuable upon the exercise of options, rights, warrants and upon the conversion or exchange of convertible or exchangeable securities.

7.6. Dividends and Other Distributions with Respect to Outstanding Securities. In the event that the Company shall at any time prior to the exercise of all Warrants make any distribution of its assets to holders of its Common Stock as a liquidating or a partial liquidating dividend, then the Holder of Warrants who exercises its Warrants after the record date for the determination of those Holders of Common Stock entitled to such distribution of assets as a liquidating or partial liquidating dividend shall be entitled to receive for the Warrant Price per Warrant, in addition to each share of Common Stock, the amount of such distribution (or, at the option of the Company, a sum equal to the value of any such assets at the time of such distribution as determined by the Board of Directors of the Company in good faith) which would have been payable to such Holder had he been the Holder of record of the Common Stock receivable upon exercise of his Warrant on the record date for the determination of those entitled to such distribution. At the time of any such dividend or distribution, the Company shall make

appropriate reserves to ensure the timely performance of the provisions of this Subsection 7.6.

8. Exchange and Replacement of Warrant Certificates. Each Warrant Certificate is exchangeable without expense, upon the surrender thereof by the registered Holder at the principal executive office of the Company, for a new Warrant Certificate of like tenor and date representing in the aggregate the right to purchase the same number of securities in such denominations as shall be designated by the Holder thereof at the time of such surrender.

Upon receipt by the Company of evidence reasonably satisfactory to it of the loss, theft, destruction or mutilation of any Warrant Certificate, and, in case of loss, theft or destruction, of indemnity or security reasonably satisfactory to it, and reimbursement to the Company of all reasonable expenses incidental thereto, and upon surrender and cancellation of the Warrant Certificate, if mutilated, the Company will make and deliver a new Warrant Certificate of like tenor, in lieu thereof.

9. Elimination of Fractional Interests. The Company shall not be required to issue certificates representing fractions of Shares upon the exercise of the Warrants, nor shall it be required to issue scrip or pay cash in lieu of fractional interests, it being the intent of the parties that all fractional interests shall be eliminated by rounding any fraction up to the nearest whole number of Shares.

10. Reservation and Listing of Securities. The Company shall at all times reserve and keep available out of its authorized shares of Common Stock, solely for the purpose of issuance upon the exercise of the Warrants, such number of shares of Common Stock as shall be issuable upon the exercise thereof. The Company covenants and agrees that, upon exercise of the Warrants and payment of the Exercise Price therefor, all Shares issuable upon such exercise shall be duly and validly issued, fully paid, non-assessable and not subject to the preemptive rights of any shareholder. As long as the Warrants shall be outstanding, the Company shall use its best efforts to cause all shares of Common Stock issuable upon the exercise of the Warrants to be listed on the NASDAQ National Market, or any successor trading market on which the Common Stock may be listed and/or quoted.

11. Notices to Warrant Holders. Nothing contained in this Agreement shall be construed as conferring upon the Holder or Holders the right to vote or to consent or to receive notice as a shareholder in respect of any meetings of shareholders for the election of directors or any other matter, or as having any rights whatsoever as a shareholder of the Company. If, however, at any time prior to the expiration of the Warrants and their exercise, any of the following events shall occur:

(a) the Company shall take a record of the holders of its shares of Common Stock for the purpose of entitling them to receive a dividend or distribution payable otherwise than in cash, or a cash dividend or distribution payable otherwise than out of current or retained earnings, as

indicated by the accounting treatment of such dividend or distribution on the books of the Company; or

(b) the Company shall offer to all the holders of its Common Stock any additional shares of capital stock of the Company or securities convertible into or exchangeable for shares of capital stock of the Company, or any option, right or warrant to subscribe therefor; or

(c) a dissolution, liquidation or winding up of the Company (other than in connection with a consolidation or merger) or a sale of all or substantially all of its property, assets and business as an entirety shall be proposed; or

(d) reclassification or change of the outstanding shares of Common Stock (other than a change in par value to no par value, or from no par value to par value, or as a result of a subdivision or combination), consolidation of the Company with, or merger of the Company into, another corporation (other than a consolidation or merger in which the Company is the surviving corporation and which does not result in any reclassification or change of the outstanding shares of Common Stock, except a change as a result of a subdivision or combination of such shares or a change in par value, as aforesaid), or a sale or conveyance to another corporation of the property of the Company as an entirety is proposed; or

(e) the Company or an affiliate of the Company shall propose to issue any rights to subscribe for shares of Common Stock or any other securities of the Company or of such affiliate to all the shareholders of the Company;

then, in any one or more of said events, the Company shall give written notice to the Holder or Holders of such event at least fifteen (15) days prior to the date fixed as a record date or the date of closing the transfer books for the determination of the shareholders entitled to such dividend, distribution, convertible or exchangeable securities or subscription rights, options or warrants, or entitled to vote on such proposed dissolution, liquidation, winding up or sale. Such notice shall specify such record date or the date of closing the transfer books, as the case may be. Failure to give such notice or any defect therein shall not affect the validity of any action taken in connection with the declaration or payment of any such dividend or distribution, or the issuance of any convertible or exchangeable securities or subscription rights, options or warrants, or any proposed dissolution, liquidation, winding up or sale.

12. Notices. All notices, requests, consents and other communications hereunder shall be in writing and shall be deemed to have been duly made when delivered, or mailed by registered or certified mail, return receipt requested:

(a) if to a registered Holder of the Warrants, to the address of such Holder as shown on the books of the Company; or

(b) if to the Company, to the address set forth in Section 2.1 of this Agreement or to such other address as the Company may designate by notice to the Holders.

13. Supplements and Amendments. The Company and the Representative (as defined in the Underwriting Agreement) may from time to time supplement or amend this Agreement without the approval of any Holders of the Warrants and/or Warrant Securities in order to cure any ambiguity, to correct or supplement any provision contained herein which may be defective or inconsistent with any provisions herein, or to make any other provisions in regard to matters or questions arising hereunder which the Company and the Representative may deem necessary or desirable and which the Company and the Representative deem not to adversely affect the interests of the Holders of Warrant Certificates.

14. Successors. All the covenants and provisions of this Agreement by or for the benefit of the Company and the Holders inure to the benefit of their respective successors and assigns hereunder.

15. Termination. This Agreement shall terminate at the close of business on August , 2010. Notwithstanding the foregoing, this Agreement will terminate on any earlier date when all Warrants have been exercised and all Warrant Securities have been resold to the public; provided, however, that the provisions of Section 6 shall survive any termination pursuant to this Section 15.

16. Governing Law. This Agreement and each Warrant Certificate issued hereunder shall be deemed to be a contract made under the laws of the State of New York and for all purposes shall be construed in accordance with the laws of said State, other than its conflicts of laws provisions.

17. Benefits of This Agreement. Nothing in this Agreement shall be construed to give to any person or corporation other than the Company and the Underwriter and any other registered Holder or Holders of the Warrant Certificates or Warrant Securities any legal or equitable right, remedy or claim under this Agreement; and this Agreement shall be for the sole and exclusive benefit of the Company and the Underwriter and any other Holder or Holders of the Warrant Certificates or Warrant Securities.

18. Counterparts. This Agreement may be executed in any number of counterparts and each of such counterparts shall for all purposes be deemed to be an original, and such counterparts shall together constitute but one and the same instrument.

[REMAINDER OF PAGE INTENTIONALLY LEFT BLANK]

IN WITNESS WHEREOF, the parties hereto have caused this Agreement to be duly executed, as of the day and year first above written.

ELECTRO-OPTICAL SCIENCES, INC.

By:

-----

Name:

Title:

LADENBURG THALMANN & CO. INC.

By:

-----

Name:

Title:

AND

STANFORD GROUP COMPANY

By:

-----

Name:

Title:

Acting on behalf of itself and as the  
Representatives of the several Underwriters



APPENDIX 1

UNDERWRITERS' SHARES

Ladenburg Thalmann & Co. Inc.

Stanford Group Company

Total :

16

EXHIBIT A

THE WARRANTS REPRESENTED BY THIS CERTIFICATE AND THE OTHER SECURITIES ISSUABLE UPON EXERCISE THEREOF HAVE NOT BEEN REGISTERED UNDER THE SECURITIES ACT OF 1933, AS AMENDED (THE "ACT"), AND MAY NOT BE OFFERED OR SOLD EXCEPT (i) PURSUANT TO AN EFFECTIVE REGISTRATION STATEMENT UNDER THE ACT, (ii) TO THE EXTENT APPLICABLE, PURSUANT TO RULE 144 UNDER THE ACT (OR ANY SIMILAR RULE UNDER SUCH ACT RELATING TO THE DISPOSITION OF SECURITIES), OR (iii) UPON THE DELIVERY BY THE HOLDER TO THE COMPANY OF AN OPINION OF COUNSEL, REASONABLY SATISFACTORY TO COUNSEL FOR THE COMPANY, STATING THAT AN EXEMPTION FROM REGISTRATION UNDER THE ACT IS AVAILABLE. THE TRANSFER OR EXCHANGE OF THE WARRANTS REPRESENTED BY THIS CERTIFICATE IS RESTRICTED IN ACCORDANCE WITH THE WARRANT AGREEMENT REFERRED TO HEREIN. EXERCISABLE ON OR BEFORE 5:00 P.M., NEW YORK CITY TIME, \_\_\_\_\_, 2010

No. W- \_\_\_\_\_ Warrants

WARRANT CERTIFICATE

This Warrant Certificate certifies that \_\_\_\_\_ or his, her or its registered assigns, is the registered holder of \_\_\_\_\_ Warrants to purchase, at any time from \_\_\_\_\_, 2006 until 5:00 P.M. New York City time on \_\_\_\_\_, 2010 ("Expiration Date"), up to \_\_\_\_\_ fully-paid and non-assessable shares (the "Shares") of the common stock, \$.001 par value per share (the "Common Stock"), of Electro-Optical Sciences, Inc., a New York corporation (the "Company"), at an initial exercise price, subject to adjustment in certain events (the "Exercise Price"), of \$ per Share, upon surrender of this Warrant Certificate and payment of the Exercise Price at an office or agency of the Company, but subject to the conditions set forth herein and in the warrant agreement dated as of \_\_\_\_\_, 2005 between the Company and Ladenburg Thalmann & Co. Inc. and Stanford Group Company (the "Warrant Agreement"). Payment of the Exercise Price may be made in cash or by check payable to the order of the Company, or any combination thereof.

No Warrant may be exercised after 5:00 P.M., New York City time, on the Expiration Date, at which time all Warrants evidenced hereby, unless exercised prior thereto, shall thereafter be void.

The Warrants evidenced by this Warrant Certificate are part of a duly authorized issue of Warrants issued pursuant to the Warrant Agreement, which Warrant Agreement is hereby incorporated by reference in and made a part of this instrument and is hereby

referred to for a description of the rights, limitation of rights, obligations, duties and immunities thereunder of the Company and the holders (the words "holders" or "holder" means the registered holders or registered holder) of the Warrants.

The Warrant Agreement provides that upon the occurrence of certain events, the Exercise Price and the type and/or number of the Company's securities issuable thereupon may, subject to certain conditions, be adjusted. In such event, the Company will, at the request of the holder, issue a new Warrant Certificate evidencing the adjustment in the Exercise Price and the number and/or type of securities issuable upon the exercise of the Warrants; provided, however, that the failure of the Company to issue such new Warrant Certificates shall not in any way change, alter, or otherwise impair, the rights of the holder as set forth in the Warrant Agreement.

Upon due presentment for registration of transfer of this Warrant Certificate at an office or agency of the Company, a new Warrant Certificate or Warrant Certificates of like tenor and evidencing in the aggregate a like number of Warrants shall be issued to the transferee(s) in exchange for this Warrant Certificate, subject to the limitations provided herein and in the Warrant Agreement, without any charge except for any tax, or other governmental charge imposed in connection therewith.

Upon the exercise of less than all of the Warrants evidenced by this Certificate, the Company shall forthwith issue to the holder hereof a new Warrant Certificate representing such number of unexercised Warrants.

The Company may deem and treat the registered holder(s) hereof as the absolute owner(s) of this Warrant Certificate (notwithstanding any notation of ownership or other writing hereon made by anyone), for the purpose of any exercise hereof, and of any distribution to the holder(s) hereof, and for all other purposes, and the Company shall not be affected by any notice to the contrary.

All terms used in this Warrant Certificate which are defined in the Warrant Agreement shall have the meanings assigned to them in the Warrant Agreement.

IN WITNESS WHEREOF, the Company has caused this Warrant Certificate to be duly executed.

Dated:           , 2005

ELECTRO-OPTICAL SCIENCES, INC.

By: \_\_\_\_\_

Name:

Title:

[FORM OF ELECTION TO PURCHASE]

The undersigned hereby irrevocably elects to exercise the right, represented by this Warrant Certificate, to purchase \_\_\_\_\_ Shares of Common Stock and herewith tenders in payment for such securities, cash or check payable to the order of Electro-Optical Sciences, Inc. in the amount of \$ \_\_\_\_\_, all in accordance with the terms hereof. The undersigned requests that a certificate for such securities be registered in the name of \_\_\_\_\_, whose address is \_\_\_\_\_, and that such Certificate be delivered to \_\_\_\_\_, whose address is \_\_\_\_\_.

Dated: \_\_\_\_\_ Signature: \_\_\_\_\_

(Signature must conform in all respects to the name of holder as specified on the face of the Warrant Certificate or with the name of the assignee appearing in the assignment form, if any.)

-----  
(Insert Social Security or Tax Identification Number of Holder)

[FORM OF ASSIGNMENT]

(To be executed by the registered holder if such holder desires to transfer the Warrant Certificate.)

FOR VALUE RECEIVED, \_\_\_\_\_ hereby sells, assigns and transfers unto \_\_\_\_\_ (Please print name, address and social security or tax identification number of assignee) this Warrant Certificate, together with all right, title and interest therein, and does hereby irrevocably constitute and appoint \_\_\_\_\_, Attorney, to transfer the within Warrant Certificate on the books of the within-named Company, with full power of substitution.

Dated: \_\_\_\_\_ Signature: \_\_\_\_\_

(Signature must conform in all respects to the name of holder as specified on the face of the Warrant Certificate or with the name of the assignee appearing in the assignment form, if any.)

-----  
(Insert Social Security or Tax Identification Number of Holder)

[CASHLESS EXERCISE FORM]

(To be executed upon exercise of Warrant pursuant to Section 2.2)

To: ELECTRO-OPTICAL SCIENCES, INC.

The undersigned hereby irrevocably elects a cashless exercise of the right to purchase represented by the attached Warrant Certificate for, and to purchase thereunder, Shares, as provided for in Section 2.2 therein.

Please issue a certificate or certificates for such Shares in the name of:

Name:

-----

(Please print name)

Address:

-----

and deliver such certificate or certificates to (if different from above):

Name:

-----

(Please print name)

Address:

-----

Dated:

Signature:

-----

-----  
(Insert Social Security or Tax Identification Number of Holder)

NOTE: The above signature should correspond exactly with the name on the first page of this Warrant Certificate or with the name of the assignee appearing in the assignment form, if any.

And if said number of shares shall not be all the shares purchasable under the attached Warrant Certificate, a new Warrant Certificate is to be issued in the name of the undersigned for the remaining balance of the shares purchasable thereunder.

THIRD AMENDED AND RESTATED  
BYLAWS  
OF  
ELECTRO-OPTICAL SCIENCES, INC.  
(A DELAWARE CORPORATION)  
AS ADOPTED \_\_\_\_\_, 2005



## ARTICLE I

### STOCKHOLDERS

SECTION 1.1. ANNUAL MEETINGS. An annual meeting of stockholders shall be held for the election of directors at such date and time as the Board of Directors shall each year fix. The meeting may be held either at a place, within or without the State of Delaware, or by means of remote communication as the Board of Directors in its sole discretion may determine. Any other proper business may be transacted at the annual meeting.

SECTION 1.2. SPECIAL MEETINGS. Special meetings of stockholders for any purpose or purposes may be called at any time by the Board of Directors, and shall be called upon the request of the Chairperson of the Board of Directors, the Chief Executive Officer, or by a majority of the members of the Board of Directors. Special meetings may not be called by any other person or persons.

SECTION 1.3. NOTICE OF MEETINGS. Notice of all meetings of stockholders shall be given in writing or by electronic transmission in the manner provided by law (including, without limitation, as set forth in Section 7.1(b) of these Bylaws) stating the date, time and place, if any, of the meeting and, in the case of a special meeting, the purpose or purposes for which the meeting is called. Unless otherwise required by applicable law or the Certificate of Incorporation of the Corporation, such notice shall be given not less than ten (10) nor more than sixty (60) days before the date of the meeting to each stockholder of record entitled to vote at such meeting.

SECTION 1.4. ADJOURNMENTS. The chairperson shall have the power to adjourn the meeting to another time, date and place (if any). Any meeting of stockholders may adjourn from time to time, and notice need not be given of any such adjourned meeting if the time, date and place (if any) thereof are announced at the meeting at which the adjournment is taken; provided, however, that if the adjournment is for more than thirty (30) days, or if after the adjournment a new record date is fixed for the adjourned meeting, then a notice of the adjourned meeting shall be given to each stockholder of record entitled to vote at the meeting. At the adjourned meeting the Corporation may transact any business that might have been transacted at the original meeting. The Board of Directors may postpone or reschedule any previously scheduled special or annual meeting of stockholders, in which case notice shall be provided to the stockholders of the new date, time and place, if any, of the meeting as provided in Section 1.3 above.

SECTION 1.5. QUORUM. At each meeting of stockholders the holders of a majority of the shares of stock entitled to vote at the meeting, present in person or represented by proxy, shall constitute a quorum for the transaction of business, unless otherwise required by applicable law. If a quorum shall fail to attend any meeting, the chairperson of the meeting may adjourn the meeting. Shares of the Corporation's stock belonging to the Corporation (or to another corporation, if a majority of the shares entitled to vote in the election of directors of such other corporation are held, directly or indirectly, by the

Corporation) shall neither be entitled to vote nor be counted for quorum purposes; provided, however, that the foregoing shall not limit the right of the Corporation or any other corporation to vote any shares of the Corporation's stock held by it in a fiduciary capacity and to count such shares for purposes of determining a quorum.

SECTION 1.6. ORGANIZATION. Meetings of stockholders shall be presided over by such person as the Board of Directors may designate, or, in the absence of such a person, the Chairperson of the Board of Directors, or, in the absence of such person, the President of the Corporation, or, in the absence of such person, such person as may be chosen by the holders of a majority of the shares entitled to vote who are present, in person or by proxy, at the meeting. Such person shall be chairperson of the meeting and, subject to Section 1.11 hereof, shall determine the order of business and the procedure at the meeting, including such regulation of the manner of voting and the conduct of discussion as seems to him or her to be in order. The Secretary of the Corporation shall act as secretary of the meeting, but in such person's absence the chairperson of the meeting may appoint any person to act as secretary of the meeting.

SECTION 1.7. VOTING; PROXIES. Unless otherwise provided by law or the Certificate of Incorporation of the Corporation, and subject to the provisions of Section 1.8 of these Bylaws, each stockholder shall be entitled to one (1) vote for each share of stock held by such stockholder. Each stockholder entitled to vote at a meeting of stockholders may authorize another person or persons to act for such stockholder by proxy. Such a proxy may be prepared, transmitted and delivered in any manner permitted by applicable law. Directors shall be elected by a plurality of the votes of the shares present in person or represented by proxy at the meeting and entitled to vote on the election of directors. Unless otherwise provided by applicable law, the Certificate of Incorporation of the Corporation or these Bylaws, every matter other than the election of directors shall be decided by the affirmative vote of the holders of a majority of the shares of stock entitled to vote thereon that are present in person or represented by proxy at the meeting and are voted for or against the matter.

SECTION 1.8. FIXING DATE FOR DETERMINATION OF STOCKHOLDERS OF RECORD. In order that the Corporation may determine the stockholders entitled to notice of or to vote at any meeting of stockholders or any adjournment thereof, or entitled to receive payment of any dividend or other distribution or allotment of any rights, or entitled to exercise any rights in respect of any change, conversion or exchange of stock or for the purpose of any other lawful action, the Board of Directors may fix, in advance, a record date, which shall not precede the date upon which the resolution fixing the record date is adopted by the Board of Directors and which shall not be more than sixty (60) nor less than ten (10) days before the date of such meeting, nor more than sixty (60) days prior to any other action. If no record date is fixed by the Board of Directors, then the record date shall be as provided by applicable law. A determination of stockholders of record entitled to notice of or to vote at a meeting of stockholders shall apply to any adjournment of the meeting; provided, however, that the Board of Directors may fix a new record date for the adjourned meeting.

SECTION 1.9. LIST OF STOCKHOLDERS ENTITLED TO VOTE. A complete list of stockholders entitled to vote at any meeting of stockholders, arranged in alphabetical order and showing the address of each stockholder and the number of shares registered in the name of each stockholder, shall be open to the examination of any stockholder, for any purpose germane to the meeting, during ordinary business hours, for a period of at least ten (10) days prior to the meeting, either on a reasonably accessible electronic network as permitted by law (provided that the information required to gain access to the list is provided with the notice of the meeting) or during ordinary business hours at the principal place of business of the Corporation. If the meeting is held at a place, the list shall also be produced and kept at the time and place of the meeting during the whole time thereof and may be inspected by any stockholder who is present at the meeting. If the meeting is held solely by means of remote communication, then the list shall be open to the examination of any stockholder during the whole time of the meeting on a reasonably accessible electronic network, and the information required to access the list shall be provided with the notice of the meeting.

SECTION 1.10. INSPECTORS OF ELECTIONS.

(a) Applicability. Unless otherwise provided in the Certificate of Incorporation of the Corporation or required by the Delaware General Corporation Law, the following provisions of this Section 1.10 shall apply only if and when the Corporation has a class of voting stock that is: (i) listed on a national securities exchange; (ii) authorized for quotation on an automated interdealer quotation system of a registered national securities association; or (iii) held of record by more than 2,000 stockholders; in all other cases, observance of the provisions of this Section 1.10 shall be optional, and at the discretion of the Corporation.

(b) Appointment. The Corporation shall, in advance of any meeting of stockholders, appoint one or more inspectors of election to act at the meeting and make a written report thereof. The Corporation may designate one or more persons as alternate inspectors to replace any inspector who fails to act. If no inspector or alternate is able to act at a meeting of stockholders, the person presiding at the meeting shall appoint one or more inspectors to act at the meeting.

(c) Inspector's Oath. Each inspector of election, before entering upon the discharge of his duties, shall take and sign an oath faithfully to execute the duties of inspector with strict impartiality and according to the best of such inspector's ability.

(d) Duties of Inspectors. At a meeting of stockholders, the inspectors of election shall (i) ascertain the number of shares outstanding and the voting power of each share, (ii) determine the shares represented at a meeting and the validity of proxies and ballots, (iii) count all votes and ballots, (iv) determine and retain for a reasonable period of time a record of the disposition of any challenges made

to any determination by the inspectors, and (v) certify their determination of the number of shares represented at the meeting, and their count of all votes and ballots. The inspectors may appoint or retain other persons or entities to assist the inspectors in the performance of the duties of the inspectors.

(e) Opening and Closing of Polls. The date and time of the opening and the closing of the polls for each matter upon which the stockholders will vote at a meeting shall be announced by the chairperson of the meeting. No ballot, proxies or votes, nor any revocations thereof or changes thereto, shall be accepted by the inspectors after the closing of the polls unless the Court of Chancery upon application by a stockholder shall determine otherwise.

(f) Determinations. In determining the validity and counting of proxies and ballots, the inspectors shall be limited to an examination of the proxies, any envelopes submitted with those proxies, any information provided in connection with proxies in accordance with Section 211(e) or Section 212(c)(2) of the Delaware General Corporation Law, or any information provided pursuant to Section 211(a)(2)(B)(i) or (iii) of the Delaware General Corporation Law ballots and the regular books and records of the Corporation, except that the inspectors may consider other reliable information for the limited purpose of reconciling proxies and ballots submitted by or on behalf of banks, brokers, their nominees or similar persons which represent more votes than the holder of a proxy is authorized by the record owner to cast or more votes than the stockholder holds of record. If the inspectors consider other reliable information for the limited purpose permitted herein, the inspectors at the time they make their certification of their determinations pursuant to this Section 1.10 shall specify the precise information considered by them, including the person or persons from whom they obtained the information, when the information was obtained, the means by which the information was obtained and the basis for the inspectors' belief that such information is accurate and reliable.

#### SECTION 1.11. NOTICE OF STOCKHOLDER BUSINESS; NOMINATIONS.

(a) Annual Meeting of Stockholders.

(i) Nominations of persons for election to the Board of Directors and the proposal of business to be considered by the stockholders shall be made at an annual meeting of stockholders (A) pursuant to the Corporation's notice of such meeting, (B) by or at the direction of the Board of Directors or (C) by any stockholder of the Corporation who was a stockholder of record at the time of giving of the notice provided for in this Section 1.11, who is entitled to vote at such meeting and who complies with the notice procedures set forth in this Section 1.11.

(ii) For nominations or other business to be properly brought before an annual meeting by a stockholder pursuant to clause (C) of subparagraph

(a)(i) of this Section 1.11, the stockholder must have given timely notice thereof in writing to the Secretary of the Corporation, such other business must otherwise be a proper matter for stockholder action, and if the stockholder, or the beneficial owner on whose behalf any such proposal or nomination is made, has provided the Corporation with a Solicitation Notice, as that term is defined below, such stockholder or beneficial owner must, in the case of a proposal, have delivered a proxy statement and form of proxy to holders of at least the percentage of the Corporation's voting shares required under applicable law to carry any such proposal, or, in the case of a nomination or nominations, have delivered a proxy statement and form of proxy to holders of a percentage of the Corporation's voting shares reasonably believed by such stockholder or beneficial holder to be sufficient to elect the nominee or nominees proposed to be nominated by such stockholder, and must, in either case, have included in such materials the Solicitation Notice and (4) if no Solicitation Notice relating thereto has been timely provided pursuant to this section, the stockholder or beneficial owner proposing such business or nomination must not have solicited a number of proxies sufficient to have required the delivery of such a Solicitation Notice under this section. To be timely, a stockholder's notice must be delivered to the Secretary at the principal executive offices of the Corporation not later than the close of business on the ninetieth (90th) day nor earlier than the close of business on the one hundred and twentieth (120th) day prior to the first anniversary of the preceding year's annual meeting (except in the case of the 2006 annual meeting, for which such notice shall be timely if delivered in the same time period as if such meeting were a special meeting governed by subparagraph (b) of this Section 1.11); provided, however, that in the event that the date of the annual meeting is more than thirty (30) days before or more than sixty (60) days after such anniversary date, notice by the stockholder to be timely must be so delivered not earlier than the close of business on the one hundred and twentieth (120th) day prior to such annual meeting and not later than the close of business on the later of the ninetieth (90th) day prior to such annual meeting or the close of business on the tenth (10th) day following the day on which public announcement of the date of such meeting is first made by the Corporation. Such stockholder's notice shall set forth: (a) as to each person whom the stockholder proposes to nominate for election or reelection as a director all information relating to such person that is required to be disclosed in solicitations of proxies for election of directors, or is otherwise required, in each case pursuant to Regulation 14A under the Securities Exchange Act of 1934, as amended (the "EXCHANGE ACT"), including such person's written consent to being named in the proxy statement as a nominee and to serving as a director if elected; (b) as to any other business that the stockholder proposes to bring before the meeting, a brief description of the business desired to be brought before the meeting, the reasons for conducting such business at the meeting and any material interest in such business of such stockholder

and the beneficial owner, if any, on whose behalf the proposal is made; (c) as to the stockholder giving the notice and the beneficial owner, if any, on whose behalf the nomination or proposal is made (1) the name and address of such stockholder, as they appear on the Corporation's books, and of such beneficial owner, and (2) the class and number of shares of the Corporation that are owned beneficially and held of record by such stockholder and such beneficial owner and (d) whether either such stockholder or beneficial owner intends to deliver a proxy statement and form of proxy to holders of, in the case of a proposal, at least the percentage of the Corporation's voting shares required under applicable law to carry the proposal or, in the case of a nomination or nominations, a sufficient number of holders of the Corporation's voting shares to elect such nominee or nominees (an affirmative statement of such intent, a "Solicitation Notice").

(iii) Notwithstanding anything in the second sentence of subparagraph (a)(ii) of this Section 1.11 to the contrary, in the event that the number of directors to be elected to the Board of Directors of the Corporation is increased and there is no public announcement by the Corporation naming all of the nominees for director or specifying the size of the increased board of directors at least seventy-five (75) days prior to the first anniversary of the preceding year's annual meeting (or, if the annual meeting is held more than thirty (30) days before or sixty (60) days after such anniversary date, at least seventy-five (75) days prior to such annual meeting), a stockholder's notice required by this Section 1.11 shall also be considered timely, but only with respect to nominees for any new positions created by such increase, if it shall be delivered to the Secretary of the Corporation at the principal executive office of the Corporation not later than the close of business on the tenth (10th) day following the day on which such public announcement is first made by the Corporation.

(b) Special Meetings of Stockholders. Only such business shall be conducted at a special meeting of stockholders as shall have been brought before the meeting pursuant to the Corporation's notice of such meeting. Nominations of persons for election to the Board of Directors may be made at a special meeting of stockholders at which directors are to be elected pursuant to the Corporation's notice of such meeting (i) by or at the direction of the Board of Directors or (ii) provided that the Board of Directors has determined that directors shall be elected at such meeting, by any stockholder of the Corporation who is a stockholder of record at the time of giving of notice of the special meeting, who shall be entitled to vote at the meeting and who complies with the notice procedures set forth in this Section 1.11. In the event the Corporation calls a special meeting of stockholders for the purpose of electing one or more directors to the Board of Directors, any such stockholder may nominate a person or persons (as the case may be), for election to such position(s) as specified in the Corporation's notice of meeting, if the stockholder's notice required by

subparagraph (a)(ii) of this Section 1.11 shall be delivered to the Secretary of the Corporation at the principal executive offices of the Corporation not earlier than the one hundred fifth (105th) day prior to such special meeting and not later than the close of business on the later of the seventy-fifth (75th) day prior to such special meeting or the tenth (10th) day following the day on which public announcement is first made of the date of the special meeting and of the nominees proposed by the Board of Directors to be elected at such meeting.

(c) General.

(i) Only such persons who are nominated in accordance with the procedures set forth in this Section 1.11 shall be eligible to serve as directors and only such business shall be conducted at a meeting of stockholders as shall have been brought before the meeting in accordance with the procedures set forth in this Section 1.11. Except as otherwise provided by law or these Bylaws, the chairperson of the meeting shall have the power and duty to determine whether a nomination or any business proposed to be brought before the meeting was made or proposed, as the case may be, in accordance with the procedures set forth in this Section 1.11 and, if any proposed nomination or business is not in compliance herewith, to declare that such defective proposal or nomination shall be disregarded.

(ii) For purposes of this Section 1.11, the term "PUBLIC ANNOUNCEMENT" shall mean disclosure in a press release reported by the Dow Jones News Service, Associated Press or comparable national news service or in a document publicly filed by the Corporation with the Securities and Exchange Commission pursuant to section 13, 14 or 15(d) of the Exchange Act.

(iii) Notwithstanding the foregoing provisions of this Section 1.11, a stockholder shall also comply with all applicable requirements of the Exchange Act and the rules and regulations thereunder with respect to the matters set forth herein. Nothing in this Section 1.11 shall be deemed to affect any rights of stockholders to request inclusion of proposals in the Corporation's proxy statement pursuant to Rule 14a-8 under the Exchange Act.

#### SECTION 1.12. STOCKHOLDER ACTION BY WRITTEN CONSENT WITHOUT A MEETING.

Subject to the rights of the holders of the shares of any series of Preferred Stock or any other class of stock or series thereof having a preference over the Common Stock as to dividends or upon liquidation, any action required or permitted to be taken by the stockholders of the corporation must be effected at a duly called annual or special

meeting of stockholders of the corporation and may not be effected by any consent in writing by such stockholders.

## ARTICLE II

### BOARD OF DIRECTORS

SECTION 2.1. NUMBER; QUALIFICATIONS. The Board of Directors shall consist of one or more members. The initial number of authorized directors shall be nine (9), and thereafter shall be fixed from time to time by resolution of the Board of Directors. No decrease in the authorized number of directors constituting the Board of Directors shall shorten the term of any incumbent director. Directors need not be stockholders of the Corporation.

SECTION 2.2. ELECTION; RESIGNATION; REMOVAL; VACANCIES. Each director, including a director elected to fill a vacancy, shall hold office until the expiration of the term for which elected and until such director's successor is elected and qualified or until such director's earlier death, resignation or removal. Directors need not be stockholders unless so required by the certificate of incorporation or these bylaws. The certificate of incorporation or these bylaws may prescribe other qualifications for directors. Any director may resign at any time upon notice to the Corporation given in writing or by electronic transmission. Subject to the rights of the holders of any series of Preferred Stock, no director may be removed except for cause by the holders of a majority of the voting power of the shares then entitled to vote at an election of directors. Subject to the rights of the holders of any series of Preferred Stock, any vacancy occurring in the Board of Directors for any cause, and any newly created directorship resulting from any increase in the authorized number of directors, shall, unless as otherwise provided by law, be filled only by the affirmative vote of a majority of the directors then in office, although less than a quorum, or by a sole remaining director. In the event of any increase or decrease in the authorized number of directors, (i) each director then serving as such shall nevertheless continue as a director of the class of which he is a member and (ii) the newly created or eliminated directorships resulting from such increase or decrease shall be apportioned by the Board of Directors among the three classes of directors so as to ensure that no one class has more than one director more than any other class. To the fullest extent permitted by law and to the extent possible, consistent with the foregoing rule, any newly created directorships shall be added to those classes whose terms of office are to expire at the latest dates following such allocation, and any newly eliminated directorships shall be subtracted from those classes whose terms of office are to expire at the earliest dates following such allocation, unless otherwise provided from time to time by resolution adopted by the Board of Directors.

SECTION 2.3. REGULAR MEETINGS. Regular meetings of the Board of Directors may be held at such places, within or without the State of Delaware, and at such times as the Board of Directors may from time to time determine. Notice of regular meetings need not be given if the date, times and places thereof are fixed by resolution of the Board of Directors.



SECTION 2.4. SPECIAL MEETINGS. Special meetings of the Board of Directors may be called by the Chairperson of the Board of Directors, the Chief Executive Officer or a majority of the members of the Board of Directors then in office and may be held at any time, date or place, within or without the State of Delaware, as the person or persons calling the meeting shall fix. Notice of the time, date and place of such meeting shall be given, orally, in writing or by electronic transmission (including electronic mail), by the person or persons calling the meeting to all directors at least four (4) days before the meeting if the notice is mailed, or at least twenty-four (24) hours before the meeting if such notice is given by telephone, hand delivery, telegram, telex, mailgram, facsimile, electronic mail or other means of electronic transmission. Unless otherwise indicated in the notice, any and all business may be transacted at a special meeting.

SECTION 2.5. REMOTE MEETINGS PERMITTED. Members of the Board of Directors, or any committee of the Board, may participate in a meeting of the Board or such committee by means of conference telephone or other communications equipment by means of which all persons participating in the meeting can hear each other, and participation in a meeting pursuant to conference telephone or other communications equipment shall constitute presence in person at such meeting.

SECTION 2.6. QUORUM; VOTE REQUIRED FOR ACTION. At all meetings of the Board of Directors a majority of the total number of authorized directors shall constitute a quorum for the transaction of business. Except as otherwise provided herein or in the Certificate of Incorporation of the Corporation, or required by law, the vote of a majority of the directors present at a meeting at which a quorum is present shall be the act of the Board of Directors.

SECTION 2.7. ORGANIZATION. Meetings of the Board of Directors shall be presided over by the Chairperson of the Board of Directors, or in such person's absence by the Chief Executive Officer, or in such person's absence by a chairperson chosen at the meeting. The Secretary shall act as secretary of the meeting, but in such person's absence the chairperson of the meeting may appoint any person to act as secretary of the meeting.

SECTION 2.8. WRITTEN ACTION BY DIRECTORS. Any action required or permitted to be taken at any meeting of the Board of Directors, or of any committee thereof, may be taken without a meeting if all members of the Board or such committee, as the case may be, consent thereto in writing or by electronic transmission, and the writing or writings or electronic transmission or transmissions are filed with the minutes of proceedings of the Board or committee, respectively. Such filing shall be in paper form if the minutes are maintained in paper form and shall be in electronic form if the minutes are maintained in electronic form.

SECTION 2.9. POWERS. The Board of Directors may, except as otherwise required by law or the Certificate of Incorporation of the Corporation, exercise all such powers and do all such acts and things as may be exercised or done by the Corporation.

SECTION 2.10. COMPENSATION OF DIRECTORS. Directors, as such, may receive, pursuant to a resolution of the Board of Directors, fees and other compensation for their services as directors, including without limitation their services as members of committees of the Board of Directors.

### ARTICLE III

#### COMMITTEES

SECTION 3.1. COMMITTEES. The Board of Directors may designate one or more committees, each committee to consist of one or more of the directors of the Corporation. The Board of Directors may designate one or more directors as alternate members of any committee, who may replace any absent or disqualified member at any meeting of the committee. In the absence or disqualification of a member of the committee, the member or members thereof present at any meeting of such committee who are not disqualified from voting, whether or not such member or members constitute a quorum, may unanimously appoint another member of the Board of Directors to act at the meeting in place of any such absent or disqualified member. Any such committee, to the extent provided in a resolution of the Board of Directors, shall have and may exercise all the powers and authority of the Board of Directors in the management of the business and affairs of the Corporation and may authorize the seal of the Corporation to be affixed to all papers that may require it; but no such committee shall have the power or authority in reference to the following matters: (i) approving or adopting, or recommending to the stockholders, any action or matter expressly required by the Delaware General Corporation Law to be submitted to stockholders for approval or (ii) adopting, amending or repealing any bylaw of the Corporation.

SECTION 3.2. COMMITTEE RULES. Unless the Board of Directors otherwise provides, each committee designated by the Board of Directors may make, alter and repeal rules for the conduct of its business. In the absence of such rules each committee shall conduct its business in the same manner as the Board of Directors conducts its business pursuant to Article II of these Bylaws.

Adequate provision shall be made for notice to members of all meetings, and all matters shall be determined by a majority vote of the members present. Action may be taken by any committee without a meeting if all members thereof consent thereto in writing or by electronic transmission, and the writing or writings or electronic transmission or transmissions are filed with the minutes of the proceedings of such committee. Such filing shall be in paper form if the minutes are maintained in paper form and shall be in electronic form if the minutes are maintained in electronic form.

### ARTICLE IV

#### OFFICERS

SECTION 4.1. GENERALLY. The officers of the Corporation shall consist of a Chief Executive Officer and/or a President, one or more Vice Presidents, a Secretary, a Treasurer and such other officers, including a Chairperson of the Board of Directors and/or Chief Financial Officer, as may from time to time be appointed by the Board of Directors. All officers shall be elected by the Board of Directors. Each officer shall hold office until such person's successor is elected and qualified or until such person's earlier resignation or removal. Any number of offices may be held by the same person. Any officer may resign at any time upon written notice to the Corporation. Any vacancy occurring in any office of the Corporation by death, resignation, removal or otherwise may be filled by the Board of Directors.

SECTION 4.2. CHIEF EXECUTIVE OFFICER. Subject to the control of the Board of Directors and such supervisory powers, if any, as may be given by the Board of Directors, the powers and duties of the Chief Executive Officer of the Corporation are:

(a) To act as the general manager and, subject to the control of the Board of Directors, to have general supervision, direction and control of the business and affairs of the Corporation;

(b) To preside at all meetings of the stockholders;

(c) To call meetings of the stockholders to be held at such times and, subject to the limitations prescribed by law or by these Bylaws, at such places as he or she shall deem proper; and

(d) To affix the signature of the Corporation to all deeds, conveyances, mortgages, guarantees, leases, obligations, bonds, certificates and other papers and instruments in writing which have been authorized by the Board of Directors or which, in the judgment of the Chief Executive Officer, should be executed on behalf of the Corporation; to sign certificates for shares of stock of the Corporation; and, subject to the direction of the Board of Directors, to have general charge of the property of the Corporation and to supervise and control all officers, agents and employees of the Corporation.

The President shall be the Chief Executive Officer of the Corporation unless the Board of Directors shall designate another officer to be the Chief Executive Officer. If there is no President, and the Board of Directors has not designated any other officer to be the Chief Executive Officer, then the Chairperson of the Board of Directors shall be the Chief Executive Officer.

SECTION 4.3. CHAIRPERSON OF THE BOARD. The Chairperson of the Board of Directors shall have the power to preside at all meetings of the Board of Directors and shall have such other powers and duties as provided in these Bylaws and as the Board of Directors may from time to time prescribe.

SECTION 4.4. PRESIDENT. The President shall be the Chief Executive Officer of the Corporation unless the Board of Directors shall have designated another officer as the Chief Executive Officer of the Corporation. Subject to the provisions of these Bylaws and to the direction of the Board of Directors, and subject to the supervisory powers of the Chief Executive Officer (if the Chief Executive Officer is an officer other than the President), and subject to such supervisory powers and authority as may be given by the Board of Directors to the Chairperson of the Board of Directors, and/or to any other officer, the President shall have the responsibility for the general management the control of the business and affairs of the Corporation and the general supervision and direction of all of the officers, employees and agents of the Corporation (other than the Chief Executive Officer, if the Chief Executive Officer is an officer other than the President) and shall perform all duties and have all powers that are commonly incident to the office of President or that are delegated to the President by the Board of Directors.

SECTION 4.5. VICE PRESIDENT. Each Vice President shall have all such powers and duties as are commonly incident to the office of Vice President, or that are delegated to him or her by the Board of Directors or the Chief Executive Officer. A Vice President may be designated by the Board to perform the duties and exercise the powers of the Chief Executive Officer in the event of the Chief Executive Officer's absence or disability.

SECTION 4.6. CHIEF FINANCIAL OFFICER. The Chief Financial Officer shall be the Treasurer of the Corporation unless the Board of Directors shall have designated another officer as the Treasurer of the Corporation. Subject to the direction of the Board of Directors and the Chief Executive Officer, the Chief Financial Officer shall perform all duties and have all powers that are commonly incident to the office of Chief Financial Officer.

SECTION 4.7. TREASURER. The Treasurer shall have custody of all monies and securities of the Corporation. The Treasurer shall make such disbursements of the funds of the Corporation as are authorized and shall render from time to time an account of all such transactions. The Treasurer shall also perform such other duties and have such other powers as are commonly incident to the office of Treasurer, or as the Board of Directors or the Chief Executive Officer may from time to time prescribe.

SECTION 4.8. SECRETARY. The Secretary shall issue or cause to be issued all authorized notices for, and shall keep, or cause to be kept, minutes of all meetings of the stockholders and the Board of Directors. The Secretary shall have charge of the corporate minute books and similar records and shall perform such other duties and have such other powers as are commonly incident to the office of Secretary, or as the Board of Directors or the Chief Executive Officer may from time to time prescribe.

SECTION 4.9. DELEGATION OF AUTHORITY. The Board of Directors may from time to time delegate the powers or duties of any officer to any other officers or agents, notwithstanding any provision hereof.

SECTION 4.10. REMOVAL. Any officer of the Corporation shall serve at the pleasure of the Board of Directors and may be removed at any time, with or without cause, by the Board of Directors. Such removal shall be without prejudice to the contractual rights of such officer, if any, with the Corporation.

## ARTICLE V

### STOCK

SECTION 5.1. CERTIFICATES. Every holder of stock shall be entitled to have a certificate signed by or in the name of the Corporation by the Chairperson or Vice-Chairperson of the Board of Directors, or the President or a Vice President, and by the Treasurer or an Assistant Treasurer, or the Secretary or an Assistant Secretary, of the Corporation, certifying the number of shares owned by such stockholder in the Corporation. Any or all of the signatures on the certificate may be a facsimile.

SECTION 5.2. LOST, STOLEN OR DESTROYED STOCK CERTIFICATES; ISSUANCE OF NEW CERTIFICATES. The Corporation may issue a new certificate of stock in the place of any certificate previously issued by it, alleged to have been lost, stolen or destroyed, and the Corporation may require the owner of the lost, stolen or destroyed certificate, or such owner's legal representative, to agree to indemnify the Corporation and/or to give the Corporation a bond sufficient to indemnify it, against any claim that may be made against it on account of the alleged loss, theft or destruction of any such certificate or the issuance of such new certificate.

SECTION 5.3. OTHER REGULATIONS. The issue, transfer, conversion and registration of stock certificates shall be governed by such other regulations as the Board of Directors may establish.

## ARTICLE VI

### INDEMNIFICATION

SECTION 6.1. INDEMNIFICATION OF OFFICERS AND DIRECTORS. Each person who was or is made a party to, or is threatened to be made a party to, or is involved in any action, suit or proceeding, whether civil, criminal, administrative or investigative (a "PROCEEDING"), by reason of the fact that such person (or a person of whom such person is the legal representative), is or was a director or officer of the Corporation or is or was serving at the request of the Corporation as a director or officer of another corporation, or of a partnership, joint venture, trust or other enterprise, including service with respect to employee benefit plans, shall be indemnified and held harmless by the Corporation to the fullest extent permitted by the Delaware General Corporation Law, against all expenses, liability and loss (including attorneys' fees, judgments, fines, ERISA excise taxes and penalties and amounts paid or to be paid in settlement) reasonably incurred or suffered by such person in connection therewith, provided such person acted in good faith and in a manner which the person reasonably believed to be in or not opposed to the best interests

of the Corporation, and, with respect to any criminal action or proceeding, had no reasonable cause to believe the person's conduct was unlawful. Such indemnification shall continue as to a person who has ceased to be a director or officer and shall inure to the benefit of such person's heirs, executors and administrators. Notwithstanding the foregoing, the Corporation shall indemnify any such person seeking indemnity in connection with a Proceeding (or part thereof) initiated by such person only if such Proceeding (or part thereof) was authorized by the Board of Directors of the Corporation, or if such indemnification is authorized by an agreement approved by the Board of Directors.

SECTION 6.2. ADVANCE OF EXPENSES. The Corporation shall pay all expenses (including attorneys' fees) incurred by such a director or officer in defending any such Proceeding as they are incurred in advance of its final disposition; provided, however, that if the Delaware General Corporation Law then so requires, the payment of such expenses incurred by such a director or officer in advance of the final disposition of such Proceeding shall be made only upon delivery to the Corporation of an undertaking, by or on behalf of such director or officer, to repay all amounts so advanced if it should be determined ultimately that such director or officer is not entitled to be indemnified under this Article VI or otherwise; and provided, further, that the Corporation shall not be required to advance any expenses to a person against whom the Corporation directly brings a claim, in a Proceeding, alleging that such person has breached such person's duty of loyalty to the Corporation, committed an act or omission not in good faith or that involves intentional misconduct or a knowing violation of law, or derived an improper personal benefit from a transaction.

SECTION 6.3. NON-EXCLUSIVITY OF RIGHTS. The rights conferred on any person in this Article VI shall not be exclusive of any other right that such person may have or hereafter acquire under any statute, provision of the Certificate of Incorporation of the Corporation, Bylaw, agreement, vote or consent of stockholders or disinterested directors, or otherwise. Additionally, nothing in this Article VI shall limit the ability of the Corporation, in its discretion, to indemnify or advance expenses to persons whom the Corporation is not obligated to indemnify or advance expenses pursuant to this Article VI.

SECTION 6.4. INDEMNIFICATION CONTRACTS. The Board of Directors is authorized to cause the Corporation to enter into indemnification contracts with any director, officer, employee or agent of the Corporation, or any person serving at the request of the Corporation as a director, officer, employee or agent of another corporation, partnership, joint venture, trust or other enterprise, including employee benefit plans, providing indemnification rights to such person. Such rights may be greater than those provided in this Article VI.

SECTION 6.5. EFFECT OF AMENDMENT. Any amendment, repeal or modification of any provision of this Article VI shall be prospective only, and shall not adversely affect any right or protection conferred on a person pursuant to this Article VI and existing at the time of such amendment, repeal or modification.

ARTICLE VII

NOTICES

SECTION 7.1. NOTICE.

(a) Except as otherwise specifically provided in these Bylaws (including, without limitation, Section 7.1(b) below) or required by law, all notices required to be given pursuant to these Bylaws shall be in writing and may in every instance be effectively given by hand delivery (including use of a delivery service), by depositing such notice in the mail, postage prepaid, or by sending such notice by prepaid telegram, telex, overnight express courier, mailgram or facsimile, electronic mail or other means of electronic transmission. Any such notice shall be addressed to the person to whom notice is to be given at such person's address as it appears on the records of the Corporation. The notice shall be deemed given (i) in the case of hand delivery, when received by the person to whom notice is to be given or by any person accepting such notice on behalf of such person, (ii) in the case of delivery by mail, upon deposit in the mail, (iii) in the case of delivery by overnight express courier, when dispatched, and (iv) in the case of delivery via telegram, telex, mailgram, facsimile, electronic mail or other means of electronic transmission, when dispatched. Notice given pursuant to this Section 7.1(a) shall be deemed given: (i) if by facsimile telecommunication, when directed to a number at which the person has consented to receive notice; (ii) if by electronic mail, when directed to an electronic mail address at which the person has consented to receive notice; (iii) if by any other form of electronic transmission, when directed to the person.

(b) Without limiting the manner by which notice otherwise may be given effectively to stockholders, any notice to stockholders given by the Corporation under any provision of the Delaware General Corporation Law, the Certificate of Incorporation of the Corporation, or these Bylaws shall be effective if given by a form of electronic transmission consented to by the stockholder to whom the notice is given. Any such consent shall be revocable by the stockholder by written notice to the Corporation. Any such consent shall be deemed revoked if (i) the Corporation is unable to deliver by electronic transmission two consecutive notices given by the Corporation in accordance with such consent and (ii) such inability becomes known to the Secretary or an Assistant Secretary of the Corporation or to the transfer agent, or other person responsible for the giving of notice; provided, however, the inadvertent failure to treat such inability as a revocation shall not invalidate any meeting or other action. Notice given pursuant

to this Section 7.1(b) shall be deemed given: (i) if by facsimile telecommunication, when directed to a number at which the stockholder has consented to receive notice; (ii) if by electronic mail, when directed to an electronic mail address at which the stockholder has consented to receive notice; (iii) if by a posting on an electronic network together with separate notice to the stockholder of such specific posting, upon the later of (A) such posting and (B) the giving of such separate notice; and (iv) if by any other form of electronic transmission, when directed to the stockholder.

(c) An affidavit of the Secretary or an Assistant Secretary or of the transfer agent or other agent of the Corporation that the notice has been given in writing or by a form of electronic transmission shall, in the absence of fraud, be prima facie evidence of the facts stated therein.

SECTION 7.2. WAIVER OF NOTICE. Whenever notice is required to be given under any provision of these Bylaws, a written waiver of notice, signed by the person entitled to notice, or waiver by electronic transmission by such person, whether before or after the time stated therein, shall be deemed equivalent to notice. Attendance of a person at a meeting shall constitute a waiver of notice of such meeting, except when the person attends a meeting for the express purpose of objecting at the beginning of the meeting to the transaction of any business because the meeting is not lawfully called or convened. Neither the business to be transacted at, nor the purpose of, any regular or special meeting of the stockholders, directors or members of a committee of directors need be specified in any waiver of notice.

## ARTICLE VIII

### INTERESTED DIRECTORS

SECTION 8.1. INTERESTED DIRECTORS; QUORUM. No contract or transaction between the Corporation and one or more of its directors or officers, or between the Corporation and any other corporation, partnership, association or other organization in which one or more of its directors or officers are directors or officers, or have a financial interest, shall be void or voidable solely for this reason, or solely because the director or officer is present at or participates in the meeting of the Board of Directors or committee thereof that authorizes the contract or transaction, or solely because his, her or their votes are counted for such purpose, if: (i) the material facts as to his, her or their relationship or interest and as to the contract or transaction are disclosed or are known to the Board of Directors or the committee, and the Board of Directors or committee in good faith authorizes the contract or transaction by the affirmative votes of a majority of the disinterested directors, even though the disinterested directors be less than a quorum; (ii) the material facts as to his, her or their relationship or interest and as to the contract or transaction are disclosed or are known to the stockholders entitled to vote thereon, and the contract or transaction is specifically approved in good faith by vote of the stockholders; or (iii) the contract or transaction is fair as to the Corporation as of the time it is authorized, approved or ratified by the Board of Directors, a committee thereof, or



the stockholders. Common or interested directors may be counted in determining the presence of a quorum at a meeting of the Board of Directors or of a committee which authorizes the contract or transaction.

## ARTICLE IX

### MISCELLANEOUS

SECTION 9.1. FISCAL YEAR. The fiscal year of the Corporation shall be determined by resolution of the Board of Directors.

SECTION 9.2. SEAL. The Board of Directors may provide for a corporate seal, which shall have the name of the Corporation inscribed thereon and shall otherwise be in such form as may be approved from time to time by the Board of Directors.

SECTION 9.3. FORM OF RECORDS. Any records maintained by the Corporation in the regular course of its business, including its stock ledger, books of account and minute books, may be kept on or by means of, or be in the form of, diskettes or any other information storage device or method, provided that the records so kept can be converted into clearly legible paper form within a reasonable time. The Corporation shall so convert any records so kept upon the request of any person entitled to inspect such records pursuant to any provision of the Delaware General Corporation Law.

SECTION 9.4. RELIANCE UPON BOOKS AND RECORDS. A member of the Board of Directors, or a member of any committee designated by the Board of Directors shall, in the performance of such person's duties, be fully protected in relying in good faith upon records of the Corporation and upon such information, opinions, reports or statements presented to the Corporation by any of the Corporation's officers or employees, or committees of the Board of Directors, or by any other person as to matters the member reasonably believes are within such other person's professional or expert competence and who has been selected with reasonable care by or on behalf of the Corporation.

SECTION 9.5. CERTIFICATE OF INCORPORATION GOVERNS. In the event of any conflict between the provisions of the Certificate of Incorporation of the Corporation and Bylaws, the provisions of the Certificate of Incorporation of the Corporation shall govern.

SECTION 9.6. SEVERABILITY. If any provision of these Bylaws shall be held to be invalid, illegal, unenforceable or in conflict with the provisions of the Certificate of Incorporation of the Corporation, then such provision shall nonetheless be enforced to the maximum extent possible consistent with such holding and the remaining provisions of these Bylaws (including without limitation, all portions of any section of these Bylaws containing any such provision held to be invalid, illegal, unenforceable or in conflict with the Certificate of Incorporation of the Corporation, that are not themselves invalid, illegal, unenforceable or in conflict with the Certificate of Incorporation of the Corporation) shall remain in full force and effect.

ARTICLE X

AMENDMENT

SECTION 10.1. AMENDMENTS. Stockholders of the Corporation holding a majority of the Corporation's outstanding voting stock then entitled to vote at an election of directors shall have the power to adopt, amend or repeal Bylaws. To the extent provided in the Certificate of Incorporation of the Corporation, the Board of Directors of the Corporation shall also have the power to adopt, amend or repeal Bylaws of the Corporation.

CERTIFICATION OF RESTATED BYLAWS

OF

ELECTRO-OPTICAL SCIENCES, INC.

(A DELAWARE CORPORATION)

KNOW ALL BY THESE PRESENTS:

I, William R. Bronner, certify that I am Secretary of Electro-Optical Sciences, Inc., a Delaware corporation (the "COMPANY"), that I am duly authorized to make and deliver this certification, that the attached Third Amended and Restated Bylaws are a true and correct copy of the Third Amended and Restated Bylaws of the Company in effect as of the date of this certificate.

Dated: \_\_\_\_\_, 2005

-----  
William R. Bronner, Secretary

[FACE]  
NUMBER

N  
THIS CERTIFICATE IS TRANSFERABLE IN NEW YORK, NY

[LOGO]  
INCORPORATED UNDER THE LAWS OF THE STATE OF DELAWARE  
SHARES

SEE REVERSE FOR CERTAIN DEFINITIONS AND A STATEMENT AS TO RIGHTS, PREFERENCES,  
PRIVILEGES AND RESTRICTIONS, IF ANY

CUSIP 285192 10 0

This Certifies that  
is the record holder of  
FULLY PAID AND NONASSESSABLE SHARES OF COMMON STOCK, \$.001 PAR VALUE PER SHARE,  
OF

Electro-Optical Sciences, Inc.  
transferable on the books of the Corporation by the holder hereof in person or  
by duly authorized Attorney upon surrender of this certificate properly  
endorsed. This certificate is not valid until countersigned by the Transfer  
Agent and registered by the Registrar.

WITNESS the facsimile seal of the Corporation and the facsimile signatures of  
its duly authorized officers.

Dated  
/sig/  
TREASURER AND CHIEF FINANCIAL OFFICER

[SEAL]  
/sig/  
PRESIDENT AND CHIEF EXECUTIVE OFFICER

COUNTERSIGNED AND REGISTERED:  
AMERICAN STOCK TRANSFER & TRUST COMPANY  
TRANSFER AGENT AND REGISTRAR  
BY  
AUTHORIZED SIGNATURE

[REVERSE OF CERTIFICATE]  
ELECTRO-OPTICAL SCIENCES, INC.

A statement of the powers, designations, preferences and relative,  
participating, optional or other special rights of each class of stock or series  
thereof and the qualifications, limitations or restrictions of such preferences  
and/or rights as established, from time to time, by the Certificate of  
Incorporation of the Corporation and by any certificate of determination, the  
number of shares constituting each class and series, and the designations  
thereof, may be obtained by the holder hereof upon request and without charge at  
the principal office of the Corporation. The following abbreviations, when used  
in the inscription on the face of this certificate, shall be construed as though  
they were written out in full according to applicable laws or regulations:

- TEN COM -- as tenants in common
- TEN ENT -- as tenants by the entireties
- JT TEN -- as joint tenants with right of survivorship and not as tenants in  
common
- UNIF GIFT MIN ACT -- ....(Cust).... Custodian ....(Minor).... under Uniform  
Gifts to Minors Act ....(State)....
- UNIF TRF MIN ACT -- ....(Cust).... Custodian (until age ....) ....(Minor)....  
under Uniform Transfers to Minors Act ....(State)....

Additional abbreviations may also be used though not in the above list.

FOR VALUE RECEIVED, \_\_\_ hereby sell, assign and transfer unto  
PLEASE INSERT SOCIAL SECURITY OR OTHER IDENTIFYING NUMBER OF ASSIGNEE

(PLEASE PRINT OR TYPEWRITE NAME AND ADDRESS, INCLUDING ZIP CODE, OF ASSIGNEE)  
Shares of the common stock represented by the within Certificate, and do hereby  
irrevocably constitute and appoint  
Attorney to transfer the said stock on the books of the within named Corporation  
with full power of substitution in the premises.

Dated  
NOTICE: THE SIGNATURE(S) TO THIS ASSIGNMENT MUST CORRESPOND WITH THE NAME(S) AS  
WRITTEN UPON THE FACE OF THE CERTIFICATE IN EVERY PARTICULAR, WITHOUT ALTERATION  
OR ENLARGEMENT OR ANY CHANGE WHATEVER.

Signature(s) Guaranteed

By  
THE SIGNATURE(S) MUST BE GUARANTEED BY AN ELIGIBLE GUARANTOR INSTITUTION (BANKS,  
STOCKBROKERS, SAVINGS AND LOAN ASSOCIATIONS AND CREDIT UNIONS WITH MEMBERSHIP IN  
AN APPROVED SIGNATURE GUARANTEE MEDALLION PROGRAM), PURSUANT TO S.E.C. RULE  
17Ad-15.

KEEP THIS CERTIFICATE IN A SAFE PLACE. IF IT IS LOST, STOLEN, MUTILATED OR  
DESTROYED, THE CORPORATION WILL REQUIRE A BOND OF INDEMNITY AS A CONDITION TO  
THE ISSUANCE OF A REPLACEMENT CERTIFICATE.

## [DREIER LLP LETTERHEAD]

August 8, 2005

Electro-Optical Sciences, Inc.  
3 West Main Street  
Suite 201  
Irvington, New York 10533

Ladies and Gentlemen:

At your request, we have examined the Registration Statement on Form S-1 (File Number 333-125517) filed by Electro-Optical Science, Inc., a Delaware corporation (the "Company"), with the Securities and Exchange Commission (the "Commission") on June 3, 2005 (as amended by Amendment No. 1 and Amendment No. 2 thereto filed on July 15, 2005, and August 8, 2005, respectively, as such may be further amended or supplemented, the "Registration Statement"), in connection with the registration under the Securities Act of 1933, as amended, of an aggregate of 3,450,000 shares of the Company's Common Stock (the "Shares"). The Shares, which include up to 450,000 shares of Common Stock issuable pursuant to an over-allotment option granted to the underwriters, are to be sold to the underwriters as described in such Registration Statement for sale to the public or issued to the representatives of the underwriters. As your counsel in connection with this transaction, we have examined the proceedings proposed to be taken in connection with said sale and issuance of the Shares.

As counsel for the Company, we have examined originals or copies, certified or otherwise identified to our satisfaction, of such documents, corporate records, certificates of public officials and other instruments as we have deemed necessary for the purposes of rendering this opinion. In our examination, we have assumed the genuineness of all signatures, the authenticity and completeness of all documents submitted to us as originals and the conformity to originals and completeness of all documents submitted to us as copies.

In connection with our opinion expressed below, we have assumed that, at or prior to the time of the delivery of any shares of Stock, the Registration Statement will have been declared effective under the Securities Act of 1933, as amended, that the registration will apply to the Shares and will not have been modified or rescinded and that there will not have occurred any change in law affecting the validity of the issuance of the Shares.

We are admitted to practice law in the State of New York, and we render this opinion only with respect to, and express no opinion herein concerning the application or effect of the laws of any jurisdiction other than, the existing laws of the United States of America, of the State

of New York and of the Delaware General Corporation Law, and reported judicial decisions relating thereto.

Based on the foregoing, it is our opinion that the Shares, when issued and sold in the manner and for the consideration described in the Registration Statement and in accordance with the resolutions previously adopted by the Board of Directors of the Company and to be adopted by the Pricing Committee of the Board of Directors of the Company, will be legally and validly issued, fully paid and nonassessable.

We consent to the use of this opinion as an exhibit to the Registration Statement and further consent to all references to us, if any, in the Registration Statement, the Prospectus constituting a part thereof and any amendments thereto. This opinion is intended solely for use in connection with issuance and sale of the Shares and is not to be relied upon for any other purpose. We assume no obligation to advise you of any fact, circumstance, event or change in the law or the facts that may hereafter be brought to our attention whether or not such occurrence would affect or modify the opinions expressed herein.

Very truly yours,

/s/ DREIER LLP

DREIER LLP

## FORM OF INDEMNITY AGREEMENT

This Indemnity Agreement (this "AGREEMENT"), dated as of \_\_\_\_\_, 2005, is made by and between Electro-Optical Sciences, Inc., a Delaware corporation (the "COMPANY"), and [ ], a director and/or officer of the Company (the "INDEMNITEE").

## RECITALS

A. The Company is aware that competent and experienced persons are increasingly reluctant to serve as directors or officers of corporations unless they are protected by comprehensive liability insurance and/or indemnification, due to increased exposure to litigation costs and risks resulting from their service to such corporations, and because the exposure frequently bears no reasonable relationship to the compensation of such directors and officers;

B. Based on their experience as business managers, the Board of Directors of the Company (the "BOARD") has concluded that, to retain and attract talented and experienced individuals to serve as officers and directors of the Company, and to encourage such individuals to take the business risks necessary for the success of the Company, it is necessary for the Company contractually to indemnify officers and directors and to assume for itself maximum liability for expenses and damages in connection with claims against such officers and directors in connection with their service to the Company;

C. Section 145 of the General Corporation Law of Delaware, under which the Company is organized (the "LAW") empowers the Company to indemnify by agreement its officers, directors, employees and agents, and persons who serve, at the request of the Company, as directors, officers, employees or agents of other corporations or enterprises, and expressly provides that the indemnification provided by the Law is not exclusive; and

D. The Company desires and has requested the Indemnitee to serve or continue to serve as a director or officer of the Company free from undue concern for claims for damages arising out of or related to such services to the Company.

NOW, THEREFORE, the parties hereto, intending to be legally bound, hereby agree as follows:

## 1. DEFINITIONS.

1.1 AGENT. For the purposes of this Agreement, "AGENT" of the Company means any person who is or was a director or officer of the Company or a subsidiary of the Company; or is or was serving at the request of, for the convenience of, or to represent the interest of the Company or a subsidiary of the Company as a director or officer of another foreign or domestic corporation, partnership, joint venture, trust or other enterprise or an affiliate of the Company; or was a director or officer of a foreign or domestic corporation which was a predecessor corporation of the Company, or was a director or officer of another enterprise or affiliate of the Company at the request of, for

the convenience of, or to represent the interests of such predecessor corporation. The term "ENTERPRISE" includes any employee benefit plan of the Company, its subsidiaries, affiliates and predecessor corporations.

1.2 EXPENSES. For purposes of this Agreement, "EXPENSES" includes all direct and indirect costs of any type or nature whatsoever (including, without limitation, all attorneys' fees and related disbursements and other out-of-pocket costs) actually and reasonably incurred by the Indemnitee in connection with the investigation, defense or appeal of a proceeding or establishing or enforcing a right to indemnification or advancement of expenses under this Agreement.

1.3 PROCEEDING. For the purposes of this Agreement, "PROCEEDING" means any threatened, pending or completed action, suit or other proceeding, whether civil, criminal, administrative, investigative or any other type whatsoever.

1.4 SUBSIDIARY. For purposes of this Agreement, "SUBSIDIARY" means any corporation of which more than fifty percent (50%) of the outstanding voting securities is owned directly or indirectly by the Company, by the Company and one or more of its subsidiaries or by one or more of the Company's subsidiaries.

2. AGREEMENT TO SERVE. The Indemnitee agrees to serve and/or continue to serve as an agent of the Company, at the will of the Company (or under separate agreement, if such agreement exists), in the capacity the Indemnitee currently serves as an agent of the Company, faithfully and to the best of his ability, so long as he or she is duly appointed or elected and qualified in accordance with the applicable provisions of the charter documents of the Company or any subsidiary of the Company; provided, however, that the Indemnitee may at any time and for any reason resign from such position (subject to any contractual obligation that the Indemnitee may have assumed apart from this Agreement), and the Company or any subsidiary shall have no obligation under this Agreement to continue the Indemnitee in any such position.

3. DIRECTORS' AND OFFICERS' INSURANCE. The Company shall, to the extent that the Board determines it to be economically reasonable, maintain a policy of directors' and officers' liability insurance ("D&O INSURANCE"), on such terms and conditions as may be approved by the Board.

4. MANDATORY INDEMNIFICATION. Subject to Section 9 below, the Company shall indemnify the Indemnitee:

4.1 THIRD PARTY ACTIONS. If the Indemnitee is a person who was or is a party or is threatened to be made a party to any proceeding (other than an action by or in the right of the Company) by reason of the fact that he is or was an agent of the Company, or by reason of anything done or not done by him in any such capacity, against any and all expenses and liabilities of any type whatsoever (including, but not limited to, judgments, fines, ERISA excise taxes or penalties and amounts paid in settlement) actually and reasonably incurred by him in connection with the investigation, defense, settlement or appeal of such proceeding if he acted in good faith and in a manner he reasonably believed to be in, or not opposed to, the best interests of the Company and, with respect to any criminal action or proceeding, had no reasonable cause to believe his conduct was unlawful; and



4.2 DERIVATIVE ACTIONS. If the Indemnitee is a person who was or is a party or is threatened to be made a party to any proceeding by or in the right of the Company to procure a judgment in its favor by reason of the fact that he is or was an agent of the Company, or by reason of anything done or not done by him in any such capacity, against any amounts paid in settlement of any such proceeding and all expenses actually and reasonably incurred by him in connection with the investigation, defense, settlement or appeal of such proceeding if he acted in good faith and in a manner he reasonably believed to be in, or not opposed to, the best interests of the Company; except that no indemnification under this subsection shall be made in respect of any claim, issue or matter as to which such person shall have been finally adjudged to be liable to the Company by a court of competent jurisdiction due to willful misconduct of a culpable nature in the performance of his duty to the Company, unless and only to the extent that the Court of Chancery or the court in which such proceeding was brought shall determine upon application that, despite the adjudication of liability but in view of all the circumstances of the case, such person is fairly and reasonably entitled to indemnity for such amounts which the Court of Chancery or such other court shall deem proper.

4.3 EXCEPTION FOR AMOUNTS COVERED BY INSURANCE. Notwithstanding the foregoing, the Company shall not be obligated to indemnify the Indemnitee for expenses or liabilities of any type whatsoever (including, but not limited to, judgments, fines, ERISA excise taxes or penalties and amounts paid in settlement) to the extent such have been paid directly to the Indemnitee by D&O Insurance.

#### 5. PARTIAL INDEMNIFICATION AND CONTRIBUTION.

5.1 PARTIAL INDEMNIFICATION. If the Indemnitee is entitled under any provision of this Agreement to indemnification by the Company for some or a portion of any expenses or liabilities of any type whatsoever (including, but not limited to, judgments, fines, ERISA excise taxes or penalties and amounts paid in settlement) incurred by him or her in the investigation, defense, settlement or appeal of a proceeding but is not entitled, however, to indemnification for all of the total amount thereof, then the Company shall nevertheless indemnify the Indemnitee for such total amount except as to the portion thereof to which the Indemnitee is not entitled to indemnification.

5.2 CONTRIBUTION. If the Indemnitee is not entitled to the indemnification provided in Section 4 for any reason other than the statutory limitations set forth in the Law, then in respect of any threatened, pending or completed proceeding in which the Company is jointly liable with the Indemnitee (or would be if joined in such proceeding), the Company shall contribute to the amount of expenses (including attorneys' fees), judgments, fines and amounts paid in settlement actually and reasonably incurred and paid or payable by the Indemnitee in such proportion as is appropriate to reflect (i) the relative benefits received by the Company on the one hand and the Indemnitee on the other hand from the transaction from which such proceeding arose and (ii) the relative fault of the Company on the one hand and of the Indemnitee on the other hand in connection with the events which resulted in such expenses, judgments, fines or settlement amounts, as well as any other relevant equitable considerations. The relative fault of the Company on the one hand and of the Indemnitee on the other hand shall be determined by reference to, among other things, the parties' relative intent, knowledge,

access to information and opportunity to correct or prevent the circumstances resulting in such expenses, judgments, fines or settlement amounts. The Company agrees that it would not be just and equitable if contribution pursuant to this Section 5.2 were determined by pro rata allocation or any other method of allocation that does not take account of the foregoing equitable considerations.

6. MANDATORY ADVANCEMENT OF EXPENSES.

6.1 ADVANCEMENT. Subject to Section 9.1 below and except as prohibited by law, the Company shall advance all expenses incurred by the Indemnitee in connection with the investigation, defense, settlement or appeal of any proceeding to which the Indemnitee is a party or is threatened to be made a party by reason of the fact that the Indemnitee is or was an agent of the Company or by reason of anything done or not done by him in any such capacity. The Indemnitee hereby undertakes to promptly repay such amounts advanced only if, and to the extent that, it shall ultimately be determined that the Indemnitee is not entitled to be indemnified by the Company under the provisions of this Agreement, the Certificate of Incorporation or Bylaws of the Company, the Law or otherwise. The advances to be made hereunder shall be paid by the Company to the Indemnitee within thirty (30) days following delivery of a written request therefor by the Indemnitee to the Company.

6.2 EXCEPTION. Notwithstanding the foregoing provisions of this Section 6, the Company shall not be obligated to advance any expenses to the Indemnitee arising from a lawsuit filed directly by the Company against the Indemnitee if an absolute majority of the members of the Board reasonably determines in good faith, within thirty (30) days of the Indemnitee's request to be advanced expenses, that the facts known to them at the time such determination is made demonstrate clearly and convincingly that the Indemnitee acted in bad faith. If such a determination is made, the Indemnitee may have such decision reviewed by another forum, in the manner set forth in Sections 8.3, 8.4 and 8.5 hereof, with all references therein to "indemnification" being deemed to refer to "advancement of expenses," and the burden of proof shall be on the Company to demonstrate clearly and convincingly that, based on the facts known at the time, the Indemnitee acted in bad faith.

7. NOTICE AND OTHER INDEMNIFICATION PROCEDURES.

7.1 Promptly after receipt by the Indemnitee of notice of the commencement of or the threat of commencement of any proceeding, the Indemnitee shall, if the Indemnitee believes that indemnification with respect thereto may be sought from the Company under this Agreement, notify the Company of the commencement or threat of commencement thereof.

7.2 If, at the time of the receipt of a notice of the commencement of a proceeding pursuant to Section 7.1 hereof, the Company has D&O Insurance in effect, the Company shall give prompt notice of the commencement of such proceeding to the insurers in accordance with the procedures set forth in the respective policies. The Company shall thereafter take all necessary or desirable action to cause such insurers to pay, on behalf of

the Indemnitee, all amounts payable as a result of such proceeding in accordance with the terms of such D&O Insurance policies.

7.3 In the event the Company shall be obligated to advance the expenses for any proceeding against the Indemnitee, the Company, if appropriate, shall be entitled to assume the defense of such proceeding, with counsel approved by the Indemnitee (which approval shall not be unreasonably withheld), upon the delivery to the Indemnitee of written notice of its election to do so. After delivery of such notice, approval of such counsel by the Indemnitee and the retention of such counsel by the Company, the Company will not be liable to the Indemnitee under this Agreement for any fees of counsel subsequently incurred by the Indemnitee with respect to the same proceeding, provided that: (a) the Indemnitee shall have the right to employ his or her own counsel in any such proceeding at the Indemnitee's expense and (b) if (i) the employment of counsel by the Indemnitee has been previously authorized by the Company, (ii) the Indemnitee shall have reasonably concluded that there may be a conflict of interest between the Company and the Indemnitee in the conduct of any such defense or (iii) the Company shall not, in fact, have employed counsel to assume the defense of such proceeding, then the fees and expenses of the Indemnitee's counsel shall be at the expense of the Company.

#### 8. DETERMINATION OF RIGHT TO INDEMNIFICATION.

8.1 To the extent the Indemnitee has been successful on the merits or otherwise in defense of any proceeding referred to in Section 4.1 or 4.2 of this Agreement or in the defense of any claim, issue or matter described therein, the Company shall indemnify the Indemnitee against expenses actually and reasonably incurred by him or her in connection with the investigation, defense or appeal of such proceeding, or such claim, issue or matter, as the case may be.

8.2 In the event that Section 8.1 is inapplicable, or does not apply to the entire proceeding, the Company shall nonetheless indemnify the Indemnitee unless the Company shall prove by clear and convincing evidence the Indemnitee has not met the applicable standard of conduct required to entitle the Indemnitee to such indemnification.

8.3 Notwithstanding any other provision in this Agreement to the contrary, the Company shall indemnify the Indemnitee against all expenses incurred by the Indemnitee in connection with any hearing or proceeding under this Section 8 involving the Indemnitee and against all expenses incurred by the Indemnitee in connection with any other proceeding between the Company and the Indemnitee involving the interpretation or enforcement of the rights of the Indemnitee under this Agreement unless a court of competent jurisdiction finds that each of the material claims and/or defenses of the Indemnitee in any such proceeding was frivolous or not made in good faith.

9. EXCEPTIONS. Any other provision herein to the contrary notwithstanding, the Company shall not be obligated pursuant to the terms of this Agreement:

9.1 CLAIMS INITIATED BY INDEMNITEE. To indemnify or advance expenses to the Indemnitee with respect to proceedings or claims initiated or brought voluntarily by the

Indemnitee and not by way of defense, except with respect to proceedings specifically authorized by the Board or brought to establish or enforce a right to indemnification and/or advancement of expenses arising under this Agreement, the charter documents of the Company or any subsidiary or any statute or law or otherwise, but such indemnification or advancement of expenses may be provided by the Company in specific cases if the Board finds it to be appropriate; or

9.2 UNAUTHORIZED SETTLEMENTS. To indemnify the Indemnitee hereunder for any amounts paid in settlement of a proceeding unless the Company consents in advance in writing to such settlement, which consent shall not be unreasonably withheld; or

9.3 SECURITIES LAW ACTIONS. To indemnify the Indemnitee on account of any suit in which judgment is rendered against the Indemnitee for an accounting of profits made from the purchase or sale by the Indemnitee of securities of the Company pursuant to the provisions of Section 16(b) of the Securities Exchange Act of 1934 and amendments thereto or similar provisions of any federal, state or local statutory law; or

9.4 UNLAWFUL INDEMNIFICATION. To indemnify the Indemnitee if a final decision by a court having jurisdiction in the matter shall determine that such indemnification is not lawful. In this respect, the Company and the Indemnitee have been advised that the Securities and Exchange Commission takes the position that indemnification for liabilities arising under the federal securities laws is against public policy and is, therefore, unenforceable and that claims for indemnification should be submitted to appropriate courts for adjudication.

10. NON-EXCLUSIVITY. The provisions for indemnification and advancement of expenses set forth in this Agreement shall not be deemed exclusive of any other rights which the Indemnitee may have under any provision of law, the Company's Certificate of Incorporation or Bylaws, the vote of the Company's stockholders or disinterested directors, other agreements or otherwise, both as to action in the Indemnitee's official capacity and to action in another capacity while occupying his position as an agent of the Company, and the Indemnitee's rights hereunder shall continue after the Indemnitee has ceased acting as an agent of the Company and shall inure to the benefit of the heirs, executors and administrators of the Indemnitee.

11. GENERAL PROVISIONS.

11.1 INTERPRETATION OF AGREEMENT. It is understood that the parties hereto intend this Agreement to be interpreted and enforced so as to provide indemnification and advancement of expenses to the Indemnitee to the fullest extent now or hereafter permitted by law, except as expressly limited herein.

11.2 SEVERABILITY. If any provision or provisions of this Agreement shall be held to be invalid, illegal or unenforceable for any reason whatsoever, then: (a) the validity, legality and enforceability of the remaining provisions of this Agreement (including, without limitation, all portions of any paragraphs of this Agreement containing any such provision held to be invalid, illegal or unenforceable that are not themselves invalid, illegal or unenforceable) shall not in any way be affected or impaired thereby; and (b) to the fullest extent possible, the provisions of this Agreement (including, without

limitation, all portions of any paragraphs of this Agreement containing any such provision held to be invalid, illegal or unenforceable, that are not themselves invalid, illegal or unenforceable) shall be construed so as to give effect to the intent manifested by the provision held invalid, illegal or unenforceable and to give effect to Section 11.1 hereof.

11.3 MODIFICATION AND WAIVER. No supplement, modification or amendment of this Agreement shall be binding unless executed in writing by both of the parties hereto. No waiver of any of the provisions of this Agreement shall be deemed or shall constitute a waiver of any other provision hereof (whether or not similar), nor shall such waiver constitute a continuing waiver.

11.4 SUBROGATION. In the event of full payment under this Agreement, the Company shall be subrogated to the extent of such payment to all of the rights of recovery of the Indemnatee, who shall execute all documents required and shall do all acts that may be necessary or desirable to secure such rights and to enable the Company effectively to bring suit to enforce such rights.

11.5 COUNTERPARTS. This Agreement may be executed in one or more counterparts, which shall together constitute one agreement.

11.6 SUCCESSORS AND ASSIGNS. The terms of this Agreement shall bind, and shall inure to the benefit of, the successors and assigns of the parties hereto.

11.7 NOTICE. All notices, requests, demands and other communications under this Agreement shall be in writing and shall be deemed duly given: (a) if delivered by hand and signed for by the party addressee; or (b) if mailed by certified or registered mail, with postage prepaid, on the third business day after the mailing date. Addresses for notice to either party are as shown on the signature page of this Agreement or as subsequently modified by written notice.

11.8 GOVERNING LAW. This Agreement shall be governed exclusively by and construed according to the laws of the State of Delaware, without giving effect to that body of laws pertaining to conflict of laws.

11.9 CONSENT TO JURISDICTION. The Company and the Indemnatee each hereby irrevocably consent to the jurisdiction of the courts of the State of Delaware for all purposes in connection with any action or proceeding that arises out of or relates to this Agreement.

11.10 ATTORNEYS' FEES. In the event Indemnatee is required to bring any action to enforce rights under this Agreement (including, without limitation, the expenses of any Proceeding described in Section 1.3) the Indemnatee shall be entitled to all reasonable fees and expenses in bringing and pursuing such action, unless a court of competent jurisdiction finds each of the material claims of the Indemnatee in any such action was frivolous and not made in good faith.

[Remainder of Page Left Blank]

IN WITNESS WHEREOF, the parties hereto have entered into this Indemnity Agreement effective as of the date first written above.

ELECTRO-OPTICAL SCIENCES, INC.

By:

-----  
Name:

-----  
Title:

-----

SIGNATURE PAGE TO INDEMNITY AGREEMENT

ELECTRO-OPTICAL SCIENCES, INC.  
2005 STOCK INCENTIVE PLAN

1. Purpose. The purpose of the Electro-Optical Sciences, Inc. 2005 Stock Incentive Plan (the "Plan") is to establish a flexible vehicle through which Electro-Optical Sciences, Inc. (the "Company"), may offer equity-based compensation incentives to key employees and other persons (including, without limitation, directors, officers, consultants and scientific collaborators) employed or engaged by the Company and/or its subsidiaries (collectively, "Eligible Persons") to attract, motivate, reward and retain such Eligible Persons and to further align the interests of such Eligible Persons with those of the stockholders of the Company.

2. Types of Awards. Awards under the Plan may be in the form of (a) options to purchase shares of the Company's common stock, \$.001 par value per share (the "Common Stock") granted pursuant to Section 6 below, including options intended to qualify as "incentive stock options" ("ISOs") within the meaning of Section 422 of the Internal Revenue Code of 1986, as amended (the "Code") and options which do not qualify as ISOs, and (b) stock awards granted pursuant to Section 7 below (collectively, "Awards").

3. Administration.

(a) Compensation Committee. The Plan shall be administered by the Compensation Committee of the Board of Directors of the Company (the "Compensation Committee"). The Compensation Committee shall be comprised of independent outside directors.

(b) Authority of Compensation Committee. Subject to the limitations of the Plan, the Compensation Committee, acting in its sole and absolute discretion, shall have full power and authority to administer the Plan, including, without limitation, the power to (i) determine the eligibility and the particular persons to whom awards shall be made under the Plan, (ii) grant awards to such persons and prescribe the terms and conditions of such awards, (iii) construe, interpret and apply the provisions of the Plan and of any agreement or other instrument evidencing an award granted under the Plan, (iv) cancel, modify or waive the Company's rights with respect to, or modify, discontinue, suspend or terminate any or all outstanding Awards held by Participants, subject to any required consent under Paragraph 11, (v) prescribe, amend and rescind rules and regulations relating to the Plan, including rules governing its own operations, (vi) amend the Plan in any respect, including, without limitation, to correct any defect, supply any omission and reconcile any inconsistency in the Plan, (vii) amend any outstanding Award in any respect, including, without limitation, to accelerate the time or times at which the Award becomes vested or exercisable, (viii) carry out any responsibility or duty specifically reserved to the Compensation Committee under the Plan, and (ix) make any and all determinations and interpretations and take such other actions as may be necessary or desirable in order to carry out the provisions, intent and purposes of the Plan.

All decisions of the Compensation Committee, shall be reasonable and made in good faith and shall be conclusive and binding on all Participants in the Plan.

(c) Procedures. A majority of the members of the Compensation Committee shall constitute a quorum. The Compensation Committee may act by the vote of a majority of its members present at a meeting at which there is a quorum or by unanimous written consent. Members of the Compensation Committee shall abstain from participating in and deciding matters which directly affect their individual ownership interest under the Plan.

(d) Indemnification. The Company shall indemnify and hold harmless each member of the Compensation Committee and any employee or director of the Company to whom any duty or power relating to the administration or interpretation of the Plan is delegated from and against any loss, cost, liability (including any sum paid in settlement of a claim with the approval of the Board of Directors of the Company (the "Board"), damage and expense (including legal and other expenses incident thereto) arising out of or incurred in connection with the Plan, unless and except to the extent attributable to such person's fraud or willful misconduct.

(e) Compliance with Code Section 162(m). In the event the Company becomes a "publicly-held corporation" as defined in Code Section 162(m)(2), the Company may establish a Compensation Committee of outside directors meeting the requirements of Code Section 162(m)(2) to (i) approve Awards that might reasonably be anticipated to result in the payment of employee remuneration that would otherwise exceed the limit on employee remuneration deductible for income tax purposes by the Company pursuant to Code Section 162(m); and (ii) administer the Plan. In such event, Awards under the Plan shall be granted upon satisfaction of the conditions to such grants provided pursuant to Code Section 162(m) and any Treasury Regulations promulgated thereunder.

4. Share Limitations. Subject to adjustment pursuant to Section 9 below, the maximum number of shares of Common Stock that may be issued under the Plan is 1,000,000. The number of shares authorized for issuance under this Plan and all other share amounts set forth in this Plan reflect the 1-for-2 reverse split of the Company's Common Stock authorized by the Board of Directors of the Company on May 13, 2005. In determining the number of shares that remain issuable under the Plan at any time after the date the Plan is adopted, the following shares will be deemed not to have been issued (and will be deemed to remain available for issuance) under the Plan: (i) shares remaining under an Award made under the Plan that terminates or is canceled without having been exercised or earned in full; (ii) shares subject to an award under the Plan where cash is delivered to the holder of the Award in lieu of such shares; (iii) shares of restricted stock awarded under the Plan that are forfeited in accordance with the terms of the applicable Award; and (iv) shares that are withheld in order to pay the purchase price of shares acquired upon the exercise of Awards granted under the Plan or to satisfy the tax withholding obligations associated with such exercise. The number of shares of Common Stock issued in connection with an award under the Plan will be determined net of any previously-owned shares tendered by the holder of the Award in payment of the exercise price or of applicable withholding taxes. The number of shares available for grant and issuance under the Plan shall automatically be increased on the first day of each of January 2006 and January 2007 by the lesser of: (i) three percent (3%) of the number of shares of Common Stock issued and outstanding on the preceding December 31, and (ii) a lesser number of shares of Common Stock determined by the Board of Directors of the Company.



5. Eligibility. Awards under the Plan may be made to any Eligible Person as the Compensation Committee may select. Each such person to whom an Award is granted under the Plan is referred to herein as a "Participant".

6. Stock Options. Subject to the provisions of the Plan, the Compensation Committee may grant options to eligible personnel upon such terms and conditions as the Compensation Committee deems appropriate. Each option granted under the Plan shall be designated as either statutory or non-statutory and each option designated as a statutory option shall be further designated as qualified or non-qualified. The terms and conditions of any option shall be evidenced by a written option agreement or other instrument approved for this purpose by the Compensation Committee ("Option Agreement").

(a) Date of Grant. Except as may be otherwise provided in an Option Agreement, the date of grant of an option under this Plan shall be the date as of which the Compensation Committee approves the grant.

(b) Exercise Price. The exercise price per share of Common Stock covered by an option granted under the Plan may not be less than the Fair Market Value (as defined below) per share of the Common Stock at the time of grant (or, in the case of an ISO granted to a Participant who, at the time the option is granted, owns stock possessing more than 10% of the total combined voting power of all classes of stock of the Company or a "subsidiary" of the Company within the meaning of Section 424 of the Code, 110% of the Fair Market Value per share).

(c) Option Term. No option granted under the Plan may be exercisable (if at all) more than ten years after the date the option is granted (or, in the case of an ISO granted to a ten percent stockholder described in Section 422 of the Code, five years after the date the option is granted).

(d) Vesting and Exercise of Options. The Compensation Committee, in its sole discretion, may establish such vesting and other conditions and restrictions on the exercise of an option and/or upon the issuance of Common Stock in connection with the exercise of an option as it deems appropriate. Subject to satisfaction of applicable withholding requirements, once vested and exercisable, an option may be exercised by delivering a written notice (the "Notice") to the Secretary of the Company. The Notice shall state: (i) that the Participant elects to exercise the option; (ii) the number of shares with respect to which the option is being exercised (the "Option Shares"); (iii) the method of payment for the Option Shares; (iv) the date upon which the Participant desires to consummate the purchase of the Option Shares (which date must be prior to the termination of such option); and (v) any additional provisions consistent with the Plan as the Compensation Committee may from time to time require. The exercise date of an option shall be the date on which the Company receives the Notice from the Participant. The Compensation Committee, acting in its sole discretion, may permit the exercise price to be paid in whole or in part in cash or by check, by means of a cashless exercise procedure to the extent permitted by law, in the form of unrestricted shares of Common Stock (to the extent of the Fair Market Value thereof) or, subject to applicable law, by any other form of consideration deemed appropriate.

(e) Rights as a Stockholder. No shares of Common Stock shall be issued in respect of the exercise of an option until full payment of the exercise price and the applicable tax withholding obligation with respect to such exercise has been made or provided for. The holder

of an option shall have no rights as a stockholder with respect to any shares covered by the option until the option is validly exercised, the exercise price is paid fully and applicable withholding obligations are satisfied.

(f) Termination of Employment or other Service. Unless otherwise determined by the Compensation Committee at grant or, if no rights of the Participant are reduced, thereafter, and subject to earlier termination in accordance with the provisions hereof, the following rules apply with regard to options held by a Participant at the time of his or her termination of employment or other service with the Company and its subsidiaries.

(i) Termination by Reason of Death or Disability. If a Participant's employment or other service terminates by reason of death or Disability (as defined below), then (1) any portion of an option held by the Participant which is not then exercisable shall thereupon terminate, and (2) any portion of an option held by the Participant which is then exercisable shall remain exercisable by the Participant (or beneficiary) for a period of one year following such termination of employment or other service or, if sooner, until the expiration of the term of the option, and, to the extent not exercised within such period, shall thereupon terminate. For purposes of the Plan, the term Disability shall mean, unless the Compensation Committee determines otherwise at the time of grant, the inability of a person to perform the essential functions of his or her position, with or without reasonable accommodation, by reason of a physical or mental incapacity or illness which is expected to result in death or to be of indefinite duration of not less than 12 months.

(ii) Termination for Cause. If a Participant's employment or other service is terminated by the Company or any of its subsidiaries for Cause (as defined below), then any option held by the Participant, whether or not then exercisable, shall immediately terminate and cease to be exercisable. For purposes of the Plan, a termination for "Cause" means (1) in the case where there is no employment, consulting or similar service agreement between the Participant and the Company or any of its subsidiaries or where such an agreement exists but does not define "cause" (or words of like import), a termination classified by the Company or any of its subsidiaries, as a termination due to the Participant's (i) commission of, or entry of a plea of guilty or no contest to any felony, fraud, misappropriation, embezzlement or other crime of moral turpitude; (ii) commission of, or entry of a plea of guilty or no contest to any crime or offense involving money or property of the Company; (iii) dishonesty or fraud; or (iv) insubordination, willful misconduct, refusal to perform services or materially unsatisfactory performance of duties, or (2) in the case where there is an employment, consulting or similar service agreement between the Participant and the Company or any of its subsidiaries that defines "cause" (or words of like import), a termination that is or would be deemed for "cause" (or words of like import) under such agreement.

(iii) Other Termination. If a Participant's employment or other service terminates for any reason (other than death, Disability or Cause) or no reason, then (1) any portion of an option held by the Participant which is not then exercisable shall thereupon terminate, and (2) any portion of an option held by the Participant which is then exercisable shall remain exercisable during the ninety (90) day period following such termination or, if sooner, until the expiration of the term of the option and, to the extent not exercised within such period, shall thereupon terminate.

(g) Nontransferability. No option shall be assignable or transferable except upon the Participant's death to a beneficiary designated by the Participant in a manner prescribed or approved for this purpose by the Compensation Committee or, if no designated beneficiary shall survive the Participant, pursuant to the Participant's will or by the laws of descent and distribution. During a Participant's lifetime, options may be exercised only by the Participant or the Participant's guardian or legal representative. Notwithstanding the foregoing, the Compensation Committee may permit the inter vivos transfer of a Participant's options (other than options designated as ISOs) by gift to such persons and on such terms and conditions as the Compensation Committee deems appropriate.

7. Stock Awards. Subject to the provisions of the Plan, the Compensation Committee may grant stock awards to eligible Participants upon such terms and conditions as the Compensation Committee deems appropriate. The terms and conditions of any stock award shall be evidenced by a written stock award agreement or other instrument approved for this purpose by the Compensation Committee. A stock award may take the form of the issuance and transfer to the recipient of shares of Common Stock or a grant of stock units representing a right to receive shares of Common Stock in the future and, in either case, may be subject to designated vesting conditions and transfer restrictions.

(a) Purchase Price. The purchase price payable for shares of Common Stock transferred pursuant to a stock award must be at least equal to their Fair Market Value on the date of the grant.

(b) Stock Certificates for Non-Vested Stock. Shares of Common Stock issued pursuant to a non-vested stock award may be evidenced by book entries on the Company's stock transfer records pending satisfaction of the applicable vesting conditions. If a stock certificate for shares is issued before the stock award vests, the certificate will bear an appropriate legend to reflect the nature of the conditions and restrictions applicable to the shares, and the Company may require that any or all such stock certificates be held in custody by the Company until the applicable conditions are satisfied and other restrictions lapse. The Compensation Committee may establish such other conditions as it deems appropriate in connection with the issuance of certificates for shares issued pursuant to non-vested stock awards, including, without limitation, a requirement that the recipient deliver a duly signed stock power, endorsed in blank, for the shares covered by the award.

(c) Stock Certificates for Vested Stock. The recipient of a vested stock award will be entitled to receive a certificate, free and clear of conditions and restrictions (except as may be imposed in order to comply with applicable law or the terms of any stockholders' agreement), for vested shares covered by the award, subject, however, to the payment or satisfaction of withholding tax obligations in accordance with Section 10.

(d) Rights as a Stockholder. Unless otherwise determined by the Compensation Committee, (i) the recipient of a stock award will be entitled to receive dividend payments, if any (or, in the case of an award of stock units, dividend equivalent payments), on or with respect to the shares that remain covered by the award (which the Compensation Committee may specify are payable on a deferred basis and are forfeitable to the same extent as the underlying award), (ii) the recipient of a non-vested stock award may exercise voting rights if and to the extent that shares of Common Stock have been issued to him pursuant to the award, and (iii) the

recipient will have no other rights as a stockholder with respect to such shares unless and until the shares are issued to him free of all conditions and restrictions under the Plan.

(e) Termination of Employment or other Service Before Vesting; Forfeiture. Unless the Compensation Committee determines otherwise, a non-vested stock award will be forfeited upon the termination of a recipient's employment or other service with the Company and its subsidiaries. If a non-vested stock award is forfeited, any certificate representing shares subject to such award will be canceled on the books of the Company and the recipient will be entitled to receive from the Company an amount equal to any cash purchase price paid by him for such shares. If an award of stock units is forfeited, the recipient will have no further right to receive the shares of Common Stock represented by such units.

(f) Nontransferability. With respect to any stock Award, unless and until all applicable vesting conditions, if any, are satisfied and vested shares are issued, neither the stock Award nor any shares of Common Stock issued pursuant to the Award may be sold, assigned, transferred, disposed of, pledged or otherwise hypothecated other than to the Company in accordance with the terms of the Award or the Plan. Any attempt to do any of the foregoing before such time shall be null and void and, unless the Compensation Committee determines otherwise, shall result in the immediate forfeiture of the shares or the Award, as the case may be.

8. Fair Market Value. For purposes of the Plan, the Fair Market Value of a share of Common Stock, as of any date shall mean, unless otherwise required by other applicable law, the closing sale price per share of Common Stock as published by the principal national securities exchange on which the Common Stock is traded on such date or, if there is no sale of Common Stock on such date, the average of the bid and asked prices on such exchange at the close of trading on such date, or if shares of the Common Stock are not listed on a national securities exchange on such date, the closing price or, if none, the average of the bid and asked prices in the over-the-counter market at the close of trading on such date, or if the Common Stock is not traded on a national securities exchange or the over-the-counter market, the Compensation Committee shall determine its Fair Market Value in such a manner as it deems appropriate (such determination will be made in good faith as required by Section 422(c)(1) of the Code, may be based on the advice of an independent investment banker or appraiser recognized to be an expert in making such valuations and will take into consideration the factors listed in 26 C.F.R. Section 20.2031.2).

#### 9. Capital Changes; Acquisition Events.

(a) Capital Changes. The maximum number and class of shares that may be issued under the Plan, the number and class of shares covered by each outstanding Award and, if applicable, the exercise price per share shall all be adjusted proportionately or as otherwise appropriate to reflect any increase or decrease in the number of issued shares of Common Stock resulting from a split-up or consolidation of shares or any like capital adjustment, or the payment of any stock dividend, and/or to reflect a change in the character or class of shares covered by the Plan arising from a readjustment or recapitalization of the Company's capital stock.

(b) Acquisition Events. In the event of a merger, consolidation, mandatory share exchange or other similar business combination of the Company with or into any other entity ("Successor Entity") or any transaction in which a Successor Entity acquires all the issued and outstanding capital stock of the Company, or all or substantially all the assets of the Company

(each, an "Acquisition Event"), outstanding options may be assumed or an equivalent option may be substituted by the Successor Entity or a parent of the Successor Entity. If and to the extent that outstanding options are not assumed or replaced with substantially equivalent options in connection with an Acquisition Event, then each Participant shall have the right to exercise in full all of his or her outstanding options, whether or not such options are otherwise vested or exercisable, but contingent upon the occurrence of the Acquisition Event, for a period of at least twenty (20) days prior to the consummation of the Acquisition Event, in which case the Company shall notify the Participant in writing or electronically that his or her options shall become fully exercisable at least thirty (30) days prior to the consummation of the Acquisition Event, and any outstanding options which are not exercised prior to the consummation of the Acquisition Event shall thereupon terminate. Notwithstanding the preceding sentence, if and to the extent outstanding options are not assumed or replaced with substantially equivalent options in connection with an Acquisition Event, the Compensation Committee, acting in its sole discretion and without the consent of any Participant, may provide for the cancellation of any outstanding options in exchange for payment in cash or other property of the Fair Market Value of the shares of Common Stock covered by such options (whether or not otherwise vested or exercisable), reduced by the exercise price thereof (and any applicable withholdings thereon). The Compensation Committee, acting in its sole discretion, may accelerate vesting of non-vested stock awards, provide for cash settlement and/or make such other adjustments to the terms of any outstanding stock award as it deems appropriate in the context of an Acquisition Event.

(c) Fractional Shares. In the event of any adjustment in the number of shares covered by any option pursuant to the provisions hereof, any fractional shares resulting from such adjustment shall be disregarded, and each such option shall cover only the number of full shares resulting from the adjustment.

(d) Determinations Final. All adjustments under this Section 9 shall be made by the Compensation Committee, and its determination as to what adjustments shall be made, and the extent thereof, shall be final, binding and conclusive.

10. Tax Withholding. As a condition to the exercise of any Award or the delivery of any shares of Common Stock pursuant to any Award or the lapse of restrictions on any Award, or in connection with any other event that gives rise to a federal or other governmental tax withholding obligation on the part of the Company or any of its subsidiaries relating to an Award (including, without limitation, an income tax deferral arrangement pursuant to which employment tax is payable currently), the Company and/or the subsidiary may (a) deduct or withhold (or cause to be deducted or withheld) from any payment or distribution to an award recipient whether or not pursuant to the Plan or (b) require the recipient to remit cash (through payroll deduction or otherwise), in each case in an amount sufficient in the opinion of the Company to satisfy such withholding obligation. If the event giving rise to the withholding obligation involves a transfer of shares of Common Stock, then, at the sole discretion of the Compensation Committee, the recipient may satisfy the withholding obligation described under this Section by electing to have the Company withhold shares of Common Stock or by tendering previously-owned shares of Common Stock, in each case having a Fair Market Value equal to the amount of tax to be withheld (or by any other mechanism as may be required or appropriate to conform with local tax and other rules); provided, however, that no shares may be withheld if and to the extent that such withholding would result in the recognition of additional accounting expense by the Company.

11. Amendment and Termination. The Board may amend or terminate the Plan, provided, however, that no such action may adversely affect the rights of the holder of any outstanding Award in a material way without the written consent of the holder. Except as otherwise provided in Section 9, any amendment which would increase the number of shares of Common Stock which may be issued under the Plan or modify the class of persons eligible to receive Awards under the Plan shall be subject to the approval of the Company's stockholders if and to the extent that such approval is necessary or desirable to comply with applicable law or exchange or listing requirements. The Board or the Compensation Committee may amend the terms of any agreement or certificate made or issued hereunder at any time and from time to time, provided, however, that any amendment which would adversely affect the rights of the holder in a material way may not be made without his or her written consent.

12. No Rights Conferred. Nothing contained in the Plan or in any Option Agreement shall confer upon any recipient of an Award any right with respect to the continuation of his employment or other service with the Company or its subsidiaries or interfere in any way with the right of the Company and its subsidiaries at any time to terminate such employment or other service or to increase or decrease, or otherwise adjust, the other terms and conditions of the recipient's employment or other service.

13. Compliance with Law.

(a) Compliance with Securities Laws. No Awards shall be granted and no shares of Common Stock shall be issued or delivered pursuant to the Plan, unless the issuance and delivery of such shares complies with applicable law, including, without limitation, the Securities Act of 1933, as amended, the Securities Exchange Act of 1934, as amended, and the requirements of any stock exchange or market upon which the Common Stock may then be listed, and shall be further subject to the approval of counsel for the Company with respect to such compliance.

The Compensation Committee in its discretion may, as a condition to the delivery of any shares pursuant to any Award granted under the Plan, require the applicable Participant (i) to represent in writing that the shares received pursuant to such Award are being acquired for investment and not with a view to distribution and (ii) to make such other representations and warranties as are deemed reasonably appropriate by the Compensation Committee. Stock certificates representing shares acquired under the Plan that have not been registered under the Securities Act shall, if required by the Compensation Committee, bear such legends as may be required by the applicable Option Agreement, if any.

(b) No Right to an Award or Grant. Neither the adoption of the Plan nor any action of the Compensation Committee shall be deemed to give an employee, director or consultant any right to be granted an Award to purchase Common Stock, receive an Award under the Plan except as may be evidenced by an Option Agreement duly executed on behalf of the Company, and then only to the extent of and on the terms and conditions expressly set forth in the Option Agreement. The Plan will be unfunded. The Company will not be required to establish any special or separate fund or to make any other segregation of funds or assets to assure the payment of any Award.

(c) No Restriction of Corporate Action. Nothing contained in the Plan or in any Option Agreement will be construed to prevent the Company or any Subsidiary or Affiliate of

the Company from taking any corporate action which is deemed by the Company or by its Subsidiaries and Affiliates to be appropriate or in its best interest, whether such action would have an adverse effect on the Plan or any Award made under the Plan. No Participant or beneficiary of a Participant will have any claim against the Company or any affiliate as a result of any corporate action.

14. Transfer Orders; Placement of Legends. All certificates for shares of Common Stock delivered under the Plan shall be subject to such stock-transfer orders and other restrictions as the Company may deem advisable under the rules, regulations, and other requirements of the Securities and Exchange Commission, any stock exchange or market upon which the Common Stock may then be listed, and any applicable federal or state securities law. The Company may cause a legend or legends to be placed on any such certificates to make appropriate reference to such restrictions.

15. Decisions and Determinations to be Final. All decisions and determinations made by the Compensation Committee pursuant to the provisions hereof shall be final, binding and conclusive.

16. Governing Law. All rights and obligations under the Plan and each Option Agreement or instrument shall be governed by and construed in accordance with the laws of the State of New York, without regard to its principles of conflict of laws.

17. Term of the Plan. The Plan shall become effective on the date of its adoption by the Board, subject to the approval of the Company's stockholders within 12 months of such date. Unless sooner terminated by the Compensation Committee, the Plan shall terminate on the tenth anniversary of the date of its adoption by the Board. The rights of any person with respect to an Award granted under the Plan that is outstanding at the time of the termination of the Plan shall not be affected solely by reason of the termination of the Plan and shall continue in accordance with the terms of the Award (as then in effect or thereafter amended) and the Plan.

18. Supersession. This Plan supersedes the Electro-Optical Sciences, Inc. 2003 Stock Incentive Plan, as amended, (the "Prior Plan"). Although options may be outstanding under the Prior Plan, no Awards will be granted under the Prior Plan after December 31, 2004.

19. Code Section 409A Compliance. This Plan is intended to provide for statutory and non-statutory stock option benefits that are not deemed to be deferred compensation and thus are not subject to the provisions of Code Section 409A. If the Plan is deemed to be subject to Code Section 409A, however, the Company may modify the Plan and any Awards granted under the Plan to comply with Code Section 409A guidance; provided, however, that the present value of Awards granted to Participants after such modification shall not be less than the present value of the Awards granted to Participants prior to the modification.

20. Section 16 Compliance. It is intended that the Plan and any Award made to a Participant subject to Section 16 of the Exchange Act meet all of the requirements of Rule 16b-3. If any provisions of the Plan or any Award would disqualify the Plan or the Award, or would otherwise not comply with Rule 16b-3, such provision or Award will be construed or deemed amended to conform to Rule 16b-3.

21. Related Agreements: Lock-Up.

(a) As a condition to the issuance of shares of Common Stock pursuant to a stock

award or upon exercise of an option granted pursuant to the Plan, the recipient shall, at the request of the Board, be required to become a party to any stockholders' or similar agreement(s) to which the Company and some or all of its stockholders may from time to time be party.

(b) As a condition to the issuance of shares of Common Stock pursuant to a stock award or upon exercise of an option granted pursuant to the Plan, the recipient shall, at the request of the Compensation Committee, agree that he or she will not, without the prior written consent of the managing underwriter, if any, for any public offering of the Company's securities, during the period commencing on the date of the final prospectus relating to such public offering and ending on the date specified by the Company and the managing underwriter (such period not to exceed one hundred eighty (180) days), (i) lend, offer, pledge, sell, contract to sell, sell any option or contract to purchase, purchase any option or contract to sell, grant any option, right or warrant to purchase, or otherwise transfer or dispose of, directly or indirectly, any shares of Common Stock or any securities convertible into or exercisable or exchangeable for Common Stock (whether such shares or any such securities are then owned by the recipient or are thereafter acquired), or (ii) enter into any swap or other arrangement that transfers to another, in whole or in part, any of the economic consequences of ownership of the Common Stock, whether any such transaction described in clause (i) or (ii) above is to be settled by delivery of Common Stock or such other securities, in cash or otherwise. In order to enforce the foregoing covenant, the Company may impose stop-transfer instructions with respect to the securities of the recipient (and the shares or securities of every other person subject to the foregoing restriction) until the end of such period.



## TASK ORDER AGREEMENT

AGREEMENT NUMBER OP35085

BATTELLE MEMORIAL INSTITUTE, through its COLUMBUS OPERATIONS (BATTELLE) agrees to provide to ELECTRO-OPTICAL SCIENCES, INC. (CLIENT) technical/research services through individual Tasks as mutually agreed in writing, under the following terms and conditions:

## 1. ACCEPTANCE AND TASK AUTHORIZATIONS

This Agreement will become effective upon BATTELLE's receipt of an executed copy of this Agreement from CLIENT and will continue until terminated by either party. BATTELLE will submit separate written proposals for individual Tasks under this Agreement, and such Task proposals shall become part of this Agreement upon CLIENT's written acceptance thereof.

## 2. PAYMENT

CLIENT agrees to pay BATTELLE's charges for labor services and other expenses for performance in the amount(s) established by mutual written agreement for each individual Task. CLIENT agrees to pay BATTELLE's charges, without set-off, as follows:

- A. Initial payment of one-third (1/3) of the total estimated cost of the Task Order, due prior to commencement of Project activities.
- B. Thereafter, payment of monthly invoices based upon costs incurred.

CLIENT will not be required to reimburse and BATTELLE will not be required to incur charges in excess of the estimate established for a Task unless mutually agreed upon in writing. Invoices not paid within the prescribed payment period for a Task shall accrue interest at the rate of two percent (2%) per month. The amount above includes current Federal, state or local taxes levied in the United States on this Agreement or on the wages paid to BATTELLE U.S. employees. Any other present or future taxes, duties, tariffs, fees or other charges, including but not limited to excise, import, purchase, sales, use, turnover, added value, consular, gross receipts, gross wages or other assessments imposed by the government of any other country or subdivision thereof shall be the obligation of CLIENT. Any such amounts paid by BATTELLE shall be added to the estimated amount above and paid by CLIENT within thirty (30) days of the date of invoice. Payments shall be made in United States Dollars.

## 3. INTELLECTUAL PROPERTY

Title to all technical data including, but not limited to, drawings, bills of material, flow diagrams, layout details and specifications and contents thereof furnished to BATTELLE by CLIENT shall remain with CLIENT. BATTELLE shall have the right to use such data as it may receive hereunder from CLIENT only for the purposes stated herein.

All tangible work product of BATTELLE created under the Project, including, but not limited to, any drawings, plans, sketches or other documents and any prototypes (hereafter "Work Product"), shall be exclusive property of CLIENT; provided that BATTELLE may retain and use copies of the Work Product delivered under this Agreement for the purposes intended and for archival purposes.

Should BATTELLE develop any novel and useful ideas, innovations, or inventions, whether or not patentable, directly in the performance of this Project within the scope of the Project (Project IP), BATTELLE shall so inform CLIENT. BATTELLE may file for Letters Patent on Project IP, and where the Project IP constitutes an Improvement (as hereinafter defined), BATTELLE grants CLIENT an exclusive, paid-up, royalty-free, worldwide license, including the right to sublicense to all rights under Project IP retained by BATTELLE in the CLIENT Field; and where the Project IP is not an Improvement, BATTELLE shall negotiate in good faith with CLIENT regarding an exclusive worldwide license to practice such Project IP, including the rights to sublicense to all rights under such Project IP in the CLIENT Field (as defined below).

If BATTELLE does not pursue the patenting of any such Project IP within one (1) year of the Project final report, either BATTELLE or CLIENT may file for Letters Patent on any such Project IP. To enable CLIENT to do so, upon CLIENT's request BATTELLE shall assign to CLIENT all right, title and interest in and to any such Project IP. CLIENT grants BATTELLE an exclusive, paid-up, royalty-free, worldwide license, including the right to sublicense, to all rights under Project IP that is assigned to CLIENT, in all fields outside the CLIENT Field.

An "Improvement" is defined as Project IP which can be practiced only by using existing proprietary, non-public CLIENT technical data received by BATTELLE hereunder.

The "CLIENT Field" is defined as the application of computer vision technology and related optics to obtaining information relevant to the diagnosis of diseases to human skin and other epithelial tissues.

The party who has filed or issued a patent application covering Project IP (the "filing party") shall notify the other party in writing of its intent to abandon the prosecution or maintenance of any patent application or patent covering Project IP at least forty-five (45) days prior to the last day on which action is required to preserve such applications or patents from abandonment so that the other may, at its option and its own expense, take the required action or authorize the filing party to take such action.

In the event CLIENT is in material breach of its payment obligations under this Agreement, or is otherwise in material breach of its obligations under this Agreement, no rights described in this provision shall accrue to CLIENT.

#### 4. NO ENDORSEMENT/LITIGATION

BATTELLE does not endorse products or services. Therefore, CLIENT agrees that it will not use or imply BATTELLE's name, or use BATTELLE's reports, for advertising, promotional purposes, raising of capital, recommending investments, or any way that implies endorsement by BATTELLE, except with prior written approval of the Office of the General Counsel of BATTELLE.

BATTELLE does not undertake Projects for the purposes of litigation or to assign fault or blame and does not provide expert witness services. Therefore, CLIENT agrees not to use any Project results in any dispute, litigation, or other legal action.

In any event, if, at any time, BATTELLE or its employees are required to respond to any subpoenas, orders for attendance at depositions, hearings or trials, document requests, or other legal proceedings as a result of or relating to BATTELLE's work on the Project, CLIENT agrees to reimburse BATTELLE, in addition to any other amounts payable under this Agreement, BATTELLE's labor charges, attorney time and/or fees, travel, photocopying and other miscellaneous expenses.

#### 5. CONFIDENTIALITY

BATTELLE agrees not to disclose the specific results of any Task performed hereunder, as embodied in reports and correspondence transmitted to CLIENT, and not available to the public generally, without CLIENT's written consent, except as required by law, or except as necessary to protect BATTELLE's rights to intellectual property rights, such as filing for patent(s). Acceptance of this Agreement does not preclude BATTELLE's undertaking work in this general field for others.

#### 6. LIMITATION OF LIABILITY

BATTELLE will provide a high standard of professional service on a best efforts basis. However, BATTELLE, as a provider of such services, cannot guarantee success, thus BATTELLE PROVIDES NO WARRANTY OR GUARANTEE, EXPRESS OR IMPLIED, INCLUDING WITHOUT LIMITATION WARRANTIES OF FITNESS FOR A PARTICULAR PURPOSE OR MERCHANTABILITY, FOR ANY REPORT, DESIGN, ITEM, SERVICE OR OTHER RESULT TO BE DELIVERED UNDER THIS AGREEMENT.

CLIENT assumes all responsibility for its use, misuse, or inability to use the results of any Task performed pursuant to this Agreement, and in no event shall BATTELLE have any liability for damages, including but not limited to any indirect, incidental or consequential damages, arising from or in connection with this Agreement.

CLIENT agrees to indemnify and hold BATTELLE harmless from any and all liabilities, suits, claims, demands and damages, and all costs and expenses in connection therewith, asserted by third parties from any cause whatsoever arising out of this Agreement or any Task performed pursuant hereto, except for injury or damage occurring during performance of a Task under this Agreement on BATTELLE-owned premises where fault of CLIENT is not a contributing cause.

#### 7. NATURE OF SERVICES

CLIENT agrees that BATTELLE is an independent contractor and specifically acknowledges that BATTELLE is a service provider, not a manufacturer, distributor or supplier. CLIENT retains all final decision making authority and all responsibility for the formulation, design, manufacture, assembly, packaging, marketing, distribution and sale of CLIENT's products, including, without limitation, product labeling, warnings, instructions to users, reporting and for obtaining any governmental or other pre- or post market approvals, certifications, registrations, licenses, or permits.

#### 8. PRODUCT LIABILITY INSURANCE/CLINICAL TRIALS INSURANCE

CLIENT shall maintain adequate product liability insurance coverage in amounts customary and prudent for a responsible entity in its industry in light of the nature of its product(s). Such insurance shall specifically cover any CLIENT products that may be developed in whole or in part based on BATTELLE's work under this Agreement, and CLIENT shall provide evidence of such insurance upon request.

If any work product(s) developed under this agreement are used by CLIENT in clinical trial(s), CLIENT agrees to maintain adequate clinical trials liability insurance coverage in amounts customary and prudent for a responsible entity in its industry in light of the nature of its products. Such insurance shall cover any CLIENT products that may be developed in whole or in part based on BATTELLE's work under this

Agreement and used in a clinical trial. CLIENT shall provide a certificate of insurance to BATTELLE evidencing such coverage upon request.

9. FORCE MAJEURE

Neither CLIENT nor BATTELLE shall be liable in any way for failure to perform any provision of this Agreement (except payment of monetary obligations) if such failure is caused by any law, rule, or regulation, or any cause beyond the control of the party in default.

10. EARLY TERMINATION

Either party shall have the right to terminate this Agreement upon Thirty (30) days' written notice for any good-faith basis. Any such termination shall not affect any Tasks in progress, unless such Task termination is accomplished as a separate action. In the event of a Task termination, BATTELLE agrees to provide CLIENT with all reports, materials, or other deliverable items available as of the date of termination, provided that CLIENT is not in default of its obligations under this Agreement. In any event, CLIENT agrees to pay all charges incurred or committed by BATTELLE, including costs of termination, within thirty (30) days of receipt of a final invoice.

11. U.S. EXPORT CONTROL

CLIENT agrees not to export or re-export any products, materials, items and/or technical data, or the products(s) thereof, received from Battelle unless CLIENT has obtained in advance all required licenses, agreements or other authorizations from the U.S. Government. Exports include, without limitation, the sending or taking of products, materials, items or technical data out of the United States in any manner; disclosing or transferring technical data to a Foreign Person (i.e. any person who is not a lawful permanent resident of the U.S. or is not a protected individual as defined by 8 U.S.C sections 1101 and 1324) whether in the United States or abroad; or performing services for a foreign client, whether in the United States or abroad.

12. ENTIRE AGREEMENT

This Agreement, including any Task Proposals now or in the future incorporated herein, represents the entire Agreement of the parties and supersedes any prior discussions or understandings, whether written or oral, relating to the subject matter hereof. This Agreement may be modified or amended only by mutual agreement in writing. No course of dealing, usage of trade, waiver or non-enforcement shall be construed to modify or otherwise alter the terms and conditions of this Agreement. In the event of any conflict or inconsistency between these terms and conditions and the Task Proposals accepted pursuant to this Agreement, these terms and conditions shall control.

13. APPLICABLE LAW

This Agreement shall be construed in accordance with the laws and enforced within the jurisdiction of the State of Ohio, without regard to its principles of conflicts of law.

14. MISCELLANEOUS

This Agreement may not be assigned in whole or in part without the prior written approval of both parties. In any event, however, this Agreement shall be binding upon, inure to the benefit of, and be enforceable by and against the successors, assigns and transferees of the parties. If any part of this Agreement shall be held

invalid or unenforceable, such invalidity and unenforceability shall not affect any other part of this Agreement. Captions used as headings in this Agreement are for convenience only and are not to be construed as a substantive part of this Agreement.

ELECTRO-OPTICAL SCIENCES, INC.

BATTELLE MEMORIAL INSTITUTE  
COLUMBUS OPERATIONS

By /s/ William R. Bronner  
-----

By /s/ Beth A. Gustin  
-----

Name William R. Bronner  
-----

Name Beth A. Gustin  
-----

Title Vice President  
-----

Title Contracting Officer  
-----

Date July 13, 2005  
-----

Date July 13, 2005  
-----

CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

We consent to the reference to our firm under the caption "Experts" and to the use of our report dated May 31, 2005 in the Registration Statement on Form S-1 (No.333-125517) and related Prospectus of Electro-Optical Sciences, Inc.

/s/ Eisner LLP  
New York, New York  
August 8, 2005

Consent of Director Nominee (Martin D. Cleary)

CONSENT OF NOMINEE

I, the undersigned, consent to be referred to as a nominee to the Board of Directors of Electro-Optical Sciences, Inc. in the Registration Statement on Form S-1 of Electro-Optical Sciences, Inc., the Prospectus constituting a part thereof and any amendments thereto.

/s/ Martin D. Cleary

-----  
Martin D. Cleary

August 8, 2005

Securities and Exchange Commission  
450 Fifth Street N.W.  
Washington, DC 20549

Re: Electro-Optical Sciences, Inc.  
Registration Statement on Form S-1  
Registration Statement on Form 8-A  
Request for Acceleration  
File No. 333-125517  
-----

Dear Sir or Madam:

Pursuant to Rule 461(a) of the General Rules and Regulations under the Securities Act of 1933 (the "Act"), Electro-Optical Sciences, Inc. (the "Company") request acceleration of the effective date of the above captioned Registration Statement for August 9, 2005 at 4:30 p.m., Eastern Daylight Savings Time, or as soon thereafter as practicable.

This is to confirm that the Company is aware of its responsibility under the Act as it relates to the proposed public offering of the securities specified in such Registration Statement.

Very truly yours,

ELECTRO-OPTICAL SCIENCES, INC.

By: /s/ Joseph V. Gulfo

-----  
Joseph V. Gulfo, M.D., M.B.A.  
President and Chief Executive Officer

cc: Valerie A. Price, Esq.  
David C. Peck, Esq.



DREIER LLP

Attorneys at Law  
499 Park Avenue  
New York, New York 10022  
Tel: (212) 328-6100  
Facsimile: (212) 328-6101

Valerie A. Price  
Direct Dial: (212) 328-6144  
Direct Fax: (212) 652-3789  
Partner  
vprice@dreierllp.com

August 8, 2005

Securities and Exchange Commission  
450 Fifth Street N.W.  
Washington, DC 20549

Re: Electro-Optical Sciences, Inc.  
Registration Statement on Form S-1  
Registration Statement on Form 8-A  
Request for Acceleration  
File No. 333-125517  
-----

Dear Sir or Madam:

On behalf of Electro-Optical Sciences, Inc. (the "Company"), we enclose an acceleration request executed by the Company which is being filed pursuant to Rule 461 promulgated under the Securities Act of 1933, as amended.

On June 3, 2005, the Company filed with the Securities and Exchange Commission a Registration Statement on Form S-1 (Registration No. 333-125515) (the "Registration Statement") relating to the offering of up to 3,000,000 shares of the common stock of the Company. The Company filed an Amendment No. 1 to the Registration Statement on July 15, 2005, filed an Amendment No. 2 to the Registration Statement on August 8, 2005. The Company plans to file an Amendment No. 3 to the Registration Statement on or before August 10, 2005 containing price information.

The Company's Registration Statement on Form S-1 has been assigned to Peggy A. Fisher, Assistant Director, Division of Corporation Finance, for review. The Company has requested the staff to waive the time period requirements for requesting acceleration of the effective date and would like the Registration Statement on Form S-1 and the Registration Statement on Form 8-A to be declared effective at 4:30 p.m. (Eastern Daylight Savings Time) on or before August 9, 2005 or as soon thereafter as possible.

If you have any questions or require further information, please call the undersigned at (212) 328-6144

Very truly yours,  
  
/s/ Valerie A. Price  
  
Valerie A. Price

VAP/ma  
Enclosure

cc: David C. Peck, Esq.

August 8, 2005

SENT VIA FAX AND FEDERAL EXPRESS  
-----

United States Securities and Exchange Commission  
100 F Street, N.E.  
Washington, DC 20549  
Attention: Peggy A. Fisher, Assistant Director, Division of Corporation Finance

Re: Electro-Optical Sciences, Inc.  
Registration Statement on Form S-1  
Filed June 3, 2005  
File No. 333-125517  
-----

Ladies and Gentlemen:

On behalf of Electro-Optical Sciences, Inc., a Delaware corporation (the "Company"), and pursuant to the applicable provisions of the Securities Act of 1933, and the rules and regulations promulgated thereunder, we are submitting for filing with the Securities and Exchange Commission Amendment No. 2 to the above-captioned Registration Statement on Form S-1 ("Amendment No. 2"). A copy of Amendment No. 2 to the Registration Statement has been manually signed in accordance with Rule 302 of Regulation S-T and the signature pages thereto will be retained by the Company for a period of five years. The Company has authorized us to respond to the comment letter sent to Joseph V. Gulfo, M.D. of Electro-Optical Sciences, Inc., dated July 27, 2005, from the Staff of the Commission.

For your convenience, we enclose a marked copy of Amendment No. 2 marked to show changes to the Amendment No. 1 to the Registration Statement, as filed with the Commission on July 15, 2005.

We have referenced the appropriate page number of the prospectus contained in Amendment No. 2 in our responses contained herein. The numbered paragraphs below set forth the Staff's comments, together with our responses. Unless otherwise indicated, capitalized terms used herein have the meanings assigned to them in Amendment No. 2

Financial Statements

Statements of Operations, page F-4

1. Please tell us why your pro forma losses per share are not calculated using the loss from continuing operations. Refer to SAB Topic 1B2 and Article 11 of Regulation S-X. Revise the filing as necessary based on our comment.

Response: In accordance with Article 11 of Regulation S-X, the Company has calculated and disclosed in Amendment No. 2 pro forma losses per share from continuing operations in the Statements of Operations and Notes to Financial Statements on pages F-4 and F-11, as well as in Summary Financial Data on pages 5 and 6, and Selected Financial Data on pages 34 and 35.

Statement of Cash Flows, page F-6

2. We see this Statement indicates you "redeemed" marketable securities during the June 30, 2005 interim period. Please tell us why classification of marketable securities as held-to-maturity under FAS 115 is appropriate if you are redeeming securities. Tell us, in detail, how your accounting for marketable securities complies with FAS 115. Revise the filing as necessary based on our comment or tell us why no revisions are considered necessary.

Response: The marketable securities that were redeemed by the Company during the six months ended June 30, 2005 were redeemed at their maturity dates. As disclosed in Note 2 to the financial statements, the Company's marketable securities at December 31, 2004 and June 30, 2005 were due to mature within one year. No securities were sold or redeemed prior to their maturity dates. There have been no early dispositions of these securities or other events which might call into question the Company's positive intent or ability to hold these securities until maturity. Accordingly, the Company believes classification of these securities as held-to-maturity is appropriate under the requirements of SFAS 115. To avoid potential confusion, the Company has changed the line item "Redemption (purchase) of marketable securities" in the Statement of Cash Flows on page F-6 to read "Maturities (purchase) of marketable securities."

Note 8. Stockholders' (Deficiency) Equity and Redeemable Preferred Stock, page F-14

3. Please refer to prior comment 32 from our letter dated June 30, 2005. We note your previous response to our comment which detailed the allocation of the net proceeds based on the relative fair values of the warrants and the Series C preferred stock. However, you have not addressed how you determined the total amount of the beneficial conversion feature and its recognition in your statements of operations during the periods presented nor have you discussed how you calculated the effective conversion price of the Series C preferred stock. Please provide us with this information.

Additionally, please tell us the specific issues and guidance included in EITF 98-5 and EITF 00-27 upon which you relied to support your accounting and disclosures for this transaction, rather than simply citing the entire EITF.

Response: The total amount of the beneficial conversion feature originally recorded was \$2,385,063 and this amount was being accreted to the redemption value for the Series C redeemable convertible preferred stock based on the earliest redemption date of June 2008. The total accretion originally recognized in the Statement of Operations for the year ended December 31, 2004 and the six months ended June 30, 2005 was \$322,800 and \$842,260, respectively, and included the amounts of \$108,413 and \$325,236, respectively, specifically related to the beneficial conversion feature.

In determining the amount of the beneficial conversion feature, the Company (after consultation with the SEC staff) has now applied the guidance provided by EITF 00-27 par. 5, 6 and 7. The following presents the details of the aforementioned calculation:

I. Determination of Relative Values:

|  |                      |                 |
|--|----------------------|-----------------|
| Series C preferred stock<br>(Fair value based on 2,253,851 shares of common stock valued at \$4.00 per share into which the preferred stock is convertible)  | \$9,015,404          | 74.05%          |
| Warrants issued in connection with Series C preferred stock<br><br>(Fair value determined using the Black-Scholes method. The assumptions used and disclosed in Note 9 on pages F-16 and F-17 assumed a common stock value per share of \$4.00, a warrant life of 7 years, a risk-free interest rate of 3.67%, and an expected volatility of 60%.) | \$3,158,948<br>----- | 25.95%<br>----- |
| Total Fair Value   | \$12,174,352         | 100.00%         |

II. Allocation of Proceeds Based on Relative Fair Values:

|   |                      |
|---|----------------------|
| Gross Proceeds  | \$10,186,480         |
| Value allocated to Series C preferred stock at 74.05% | \$7,543,088          |
| Value allocated to warrants at 25.95%                 | \$2,643,392<br>----- |
|   | \$10,186,480         |

III. Determination of Beneficial Conversion Feature:

|   |             |
|---|-------------|
| Allocated value of Series C preferred stock per share converted into 2,253,851 common shares (\$7,543,088 divided by 2,253,851) | \$3.35      |
| Fair value of common stock per share  | \$4.00      |
| Beneficial conversion per share   | \$0.65      |
| Number of common shares   | 2,253,851   |
| Beneficial conversion feature   | \$1,465,003 |

The application of the guidance under EITF 00-27 as presented in the aforementioned calculations reflects a beneficial conversion feature of \$1,465,003 which has now been reflected in the Company's financial statements and includes expanded disclosure of the accretion and carrying value of the Series C preferred stock in the notes to the financial statements. In addition, the Company noted that, in allocating the proceeds between the warrants and Series C preferred stock, it previously had recorded the fair value of the warrants, \$3,158,948, instead of the relative fair value of \$2,643,392, which has now been reflected in the financial statements.

As a result of the aforementioned changes, the Company has also recomputed and revised the amount of accretion applicable to Series C preferred stock for the year ended December 31, 2004 and the six months ended June 30, 2005.

The Company has added note 13 to the financial statements to describe the aforementioned changes to its previously issued financial statements, and believes it has thereby addressed the disclosure requirements of APB Opinion No. 20.

Our auditors have advised that they will dual-date their audit report.

Redemption Provisions, page F-16

4. We note that you present and refer to your Series B and Series C preferred stock as "temporary equity". Tell us why this presentation is appropriate as opposed to classifying the securities as liabilities in accordance with SFAS 150. Please revise your financial statements and the notes thereto to properly present and disclose these items or tell us why your current designation as "temporary equity", rather than liabilities, is proper. Please cite the appropriate authoritative literature that supports your conclusions.

Response: The Company has presented its Series B and Series C preferred stock as temporary equity in its Balance Sheets as of December 31, 2003 and 2004, and June 30, 2005 and has so described these securities in Note 8 to Financial Statements, in accordance with the provisions of ASR 268, Rule 5-02.28 of Regulation S-X, and EITF Issue D-98. These securities are convertible, and redeemable at the option of the holder, but not mandatorily redeemable, and are required to be classified outside of permanent equity. These securities do not fall into one of the three classes of freestanding financial instruments that are required to be classified as liabilities under the provisions of SFAS No.150, and are therefore outside the scope of SFAS No.150. Accordingly, the Company believes that Series B and Series C preferred stock are appropriately classified as temporary equity in accordance with applicable accounting literature.

Exhibit 23.1

5. Please refer to prior comment 37 from our letter dated June 30, 2005. Please include a currently dated and signed consent from your independent auditors with any amendment filed.

Response: A currently dated consent signed by our independent auditors has been included in Amendment No.2.

\* \* \* \*

We hope that the foregoing has been responsive to the Staff's comments.

Should you have any questions relating to any of the foregoing, please feel free to contact the undersigned at (212) 328-6144. Thank you for your cooperation and attention to this matter.

Very truly yours,

Valerie A. Price, Esq.

VAP/ma  
Enclosure

cc: Joseph V. Gulfo, M.D.  
Karen Krumeich  
William Bronner, Esq.  
David C. Peck, Esq.