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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**  
Washington, DC 20549

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**FORM 10-Q**

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

For the quarterly period ended June 30, 2009

or

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number 000-51470



**AtriCure, Inc.**

(Exact name of Registrant as specified in its charter)

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

**34-1940305**  
(I.R.S. Employer  
Identification No.)

**6033 Schumacher Park Drive**  
**West Chester, OH 45069**  
(Address of principal executive offices)

**(513) 755-4100**  
(Registrant's telephone number, including area code)

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

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). YES  NO

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of "large accelerated filer, accelerated filer and smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large Accelerated Filer  Accelerated Filer   
Non-Accelerated Filer  (Do not check if smaller reporting company) Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act): YES  NO

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

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Class	Outstanding at July 31, 2009
Common Stock, \$.001 par value	14,992,303

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CONDENSED CONSOLIDATED BALANCE SHEETS  
(Unaudited)**

	June 30, 2009	December 31, 2008
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 13,728,047	\$ 11,448,451
Short-term investments	2,007,495	—
Accounts receivable, less allowance for doubtful accounts of \$66,406 and \$40,480, respectively	7,357,227	6,511,594
Inventories, net	5,932,089	6,361,242
Other current assets	1,568,396	1,781,825
Total current assets	30,593,254	26,103,112
Property and equipment, net	3,380,239	3,682,819
Intangible assets	428,403	569,153
Goodwill	—	6,812,389
Restricted cash and cash equivalents	—	6,000,000
Other assets	386,610	201,359
Total Assets	<u>\$ 34,788,506</u>	<u>\$ 43,368,832</u>
<b>Liabilities and Stockholders' Equity</b>		
Current liabilities:		
Accounts payable	\$ 4,315,832	\$ 5,150,033
Accrued liabilities	2,508,888	2,922,563
Current maturities of long-debt and capital leases	2,201,947	34,004
Total current liabilities	9,026,667	8,106,600
Long-term debt and capital leases	3,580,519	6,036,605
Other liabilities	66,057	106,470
Total Liabilities	12,673,243	14,249,675
Commitments and contingencies (Note 7)	—	—
Stockholders' Equity:		
Common stock, \$.001 par value, 90,000,000 shares authorized and 14,722,526 and 14,274,884 issued and outstanding, respectively	14,723	14,275
Additional paid-in capital	108,874,126	106,636,653
Accumulated other comprehensive income (loss)	109,386	(56,789)
Accumulated deficit	(86,882,972)	(77,474,982)
Total Stockholders' Equity	22,115,263	29,119,157
Total Liabilities and Stockholders' Equity	<u>\$ 34,788,506</u>	<u>\$ 43,368,832</u>

See accompanying notes to condensed consolidated financial statements.

**ATRICURE, INC. AND SUBSIDIARY**  
**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**  
**(Unaudited)**

	<u>Three Months Ended June 30,</u>		<u>Six Months Ended June 30,</u>	
	<u>2009</u>	<u>2008</u>	<u>2009</u>	<u>2008</u>
Revenues	\$13,777,950	\$14,858,514	\$27,451,853	\$28,388,659
Cost of revenues	3,107,816	3,494,908	6,052,474	6,725,788
Gross profit	10,670,134	11,363,606	21,399,379	21,662,871
Operating expenses:				
Research and development expenses	3,138,339	2,593,694	6,055,172	5,026,847
Selling, general and administrative expenses	8,565,233	10,595,334	17,497,376	22,357,756
Goodwill impairment	—	—	6,812,389	—
Total operating expenses	11,703,572	13,189,028	30,364,937	27,384,603
Loss from operations	(1,033,438)	(1,825,422)	(8,965,558)	(5,721,732)
Other income (expense):				
Interest expense	(278,415)	(43,125)	(339,144)	(82,513)
Interest income	15,593	72,642	35,835	233,771
Other	(157,841)	203,289	(181,396)	372,427
Loss before income tax benefit	(1,454,101)	(1,592,616)	(9,450,263)	(5,198,047)
Income tax benefit	11,033	—	42,273	—
Net loss	<u>\$ (1,443,068)</u>	<u>\$ (1,592,616)</u>	<u>\$ (9,407,990)</u>	<u>\$ (5,198,047)</u>
Basic and diluted net loss per share	<u>\$ (0.10)</u>	<u>\$ (0.11)</u>	<u>\$ (0.65)</u>	<u>\$ (0.37)</u>
Weighted average shares outstanding—basic and diluted	14,456,542	14,184,973	14,377,019	14,167,468

See accompanying notes to condensed consolidated financial statements.

**ATRICURE, INC. AND SUBSIDIARY**  
**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOW**  
**(Unaudited)**

	<u>Six Months Ended June 30,</u>	
	<u>2009</u>	<u>2008</u>
<b>Cash flows from operating activities:</b>		
Net loss	\$ (9,407,990)	\$ (5,198,047)
<b>Adjustments to reconcile net loss to net cash used in operating activities:</b>		
Goodwill impairment	6,812,389	—
Depreciation	1,044,518	1,258,499
Amortization of deferred financing costs	42,496	24,462
Write-off of deferred financing costs	102,485	—
Amortization of discount on long-term debt	44,657	—
Amortization of intangible assets	140,750	140,750
Loss on disposal of equipment	3,083	—
Change in provision for losses in accounts receivable	35,933	12,397
Share-based compensation expense	1,971,013	1,142,123
<b>Changes in assets and liabilities:</b>		
Accounts receivable	(855,135)	(2,192,408)
Inventories	437,382	(556,362)
Other current assets	83,162	92,879
Accounts payable	(772,508)	(860,417)
Accrued liabilities	(720,248)	(374,151)
Other non-current assets and non-current liabilities	(163,289)	150
Net cash used in operating activities	<u>(1,201,302)</u>	<u>(6,510,125)</u>
<b>Cash flows from investing activities:</b>		
Purchases of property and equipment	(757,958)	(1,092,423)
Purchases of available-for-sale securities	(2,009,267)	(1,903,974)
Maturities of available-for-sale securities	—	7,000,000
Change in restricted cash and cash equivalents	6,000,000	—
Cash paid for acquisition	—	(417,292)
Net cash provided by investing activities	<u>3,232,775</u>	<u>3,586,311</u>
<b>Cash flows from financing activities:</b>		
Payments on debt and capital leases	(6,377,799)	(221,139)
Proceeds from borrowings of long-term debt	6,500,000	—
Payment of debt origination fees	(123,233)	—
Proceeds from stock option exercises	—	174,122
Proceeds from issuance of common stock under employee stock purchase plan	120,410	—
Net cash provided by (used in) financing activities	<u>119,378</u>	<u>(47,017)</u>
Effect of exchange rate changes on cash and cash equivalents	128,745	(6,379)
Net increase (decrease) in cash and cash equivalents	2,279,596	(2,977,210)
Cash and cash equivalents—beginning of period	<u>11,448,451</u>	<u>13,000,652</u>
Cash and cash equivalents—end of period	<u>\$13,728,047</u>	<u>\$10,023,442</u>
<b>Supplemental cash flow information:</b>		
Cash paid for interest	\$ 161,737	\$ 24,438
<b>Non-cash investing and financing activities:</b>		
Purchases of property and equipment in current liabilities	\$ 6,721	\$ 142,246
Assets acquired through capital lease	\$ —	\$ 102,197
Warrant issued in connection with credit facility	\$ 455,000	\$ —

See accompanying notes to condensed consolidated financial statements.

ATRICURE, INC. AND SUBSIDIARY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. DESCRIPTION OF BUSINESS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

**Nature of the Business**—AtriCure, Inc. (the “Company” or “Atricure”) was incorporated in the State of Delaware on October 31, 2000. The Company develops, manufactures, and sells devices designed primarily for the surgical ablation of cardiac tissue. The Company sells its medical devices to hospitals and medical centers in the United States and internationally. International sales were \$2,552,485 and \$2,268,915 during the three months ended June 30, 2009 and 2008, respectively, and \$4,838,450 and \$3,926,621 during the six months ended June 30, 2009 and 2008, respectively.

**Basis of Presentation**—The accompanying interim financial statements have been prepared in accordance with the rules and regulations of the Securities and Exchange Commission (“SEC”). The accompanying interim financial statements are unaudited, but in the opinion of the Company’s management, contain all the normal, recurring adjustments considered necessary to present fairly the financial position, results of operations and cash flows for the periods presented in conformity with generally accepted accounting principles applicable to interim periods. Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States (“GAAP”) have been omitted or condensed. The Company believes the disclosures herein are adequate to make the information presented not misleading. Results of operations are not necessarily indicative of the results expected for the full fiscal year or for any future period.

The accompanying condensed consolidated financial statements should be read in conjunction with the audited financial statements of the Company included in the Company’s annual report on Form 10-K for the year ended December 31, 2008 filed with the SEC.

**Principles of Consolidation**—The condensed consolidated financial statements include the accounts of the Company and AtriCure Europe, B.V., the Company’s wholly-owned subsidiary incorporated in the Netherlands. All intercompany accounts and transactions have been eliminated in consolidation.

**Cash and Cash Equivalents**—The Company considers highly liquid investments with maturities of three months or less at the date of acquisition as cash equivalents in the accompanying condensed consolidated financial statements.

**Short-term Investments**—The Company places its investments primarily in U.S. Government securities, corporate notes, corporate bonds, medium term notes and commercial paper. The Company classifies all investments as available-for-sale. Such investments are recorded at fair value, with unrealized gains and losses recorded as a separate component of stockholders’ equity. The Company recognizes gains and losses when these securities are sold using the specific identification method.

**Revenue Recognition**—Revenues are generated primarily from the sale of the Company’s disposable surgical devices. Pursuant to the Company’s standard terms of sale, revenues are recognized when title to the goods and risk of loss transfers to customers and there are no remaining obligations that will affect the customers’ final acceptance of the sale. Generally, the Company’s standard terms of sale define the transfer of title and risk of loss to occur upon shipment to the respective customer. The Company generally does not maintain any post-shipment obligations to the recipients of the products. Typically, no installation, calibration or testing of this equipment is performed by the Company subsequent to shipment to the customer in order to render it operational. Product revenues include shipping and handling revenues of \$163,535 and \$197,782 for the three months ended June 30, 2009 and 2008, respectively, and \$332,891 and \$404,835 for the six months ended June 30, 2009 and 2008, respectively. Cost of freight for shipments made to customers is included in cost of revenues. Sales and other value-added taxes collected from customers and remitted to governmental authorities are excluded from product revenues. The Company sells its products primarily through a direct sales force and through AtriCure Europe, B.V. Terms of sale are generally consistent for both end-users and distributors. Payment terms are generally net 30 days for end-users and net 60 days for distributors.

The Company complies with the SEC Staff Accounting Bulletin No. 101, “Revenue Recognition in Financial Statements” (“SAB 101”), as amended by SAB 104. SAB 101 sets forth guidelines on the timing of revenue recognition based upon factors such as passage of title, installation, payment terms and ability to return products. The Company recognizes revenue when all of the following criteria are met: (i) persuasive evidence that an arrangement exists; (ii) delivery of the products and/or services has occurred; (iii) the selling price is fixed or determinable; and (iv) collectability is reasonably assured.

**Sales Returns and Allowances**—The Company maintains a provision for sales returns and allowances to account for potential returns of defective or damaged products and price reductions given to customers. The Company’s management estimates such provision based primarily on a specific identification basis. Increases to the provision result in reductions of revenues. The Company expects to continue to refine its methodology to estimate this provision as it accumulates additional historical data and experience.

## ATRICURE, INC. AND SUBSIDIARY

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

## (Unaudited)

**Allowance for Uncollectible Accounts Receivable**—The Company evaluates the collectability of accounts receivable in order to determine the appropriate reserve for doubtful accounts. In determining the amount of the reserve, the Company considers aging of account balances, historical credit losses, customer-specific information and other relevant factors. An increase to the allowance for doubtful accounts results in a corresponding increase in expense. The Company reviews accounts receivable and adjusts the allowance based on current circumstances and charges off uncollectible receivables against the allowance when all attempts to collect the receivable have failed.

**Inventories**—Inventories are stated at the lower of cost or market using the first-in, first-out cost method (“FIFO”) and consist of raw materials, work in process, and finished goods. A reserve for inventory is estimated and recorded for excess, slow moving and obsolete inventory as well as inventory with a carrying value in excess of its net realizable value. Write-offs are recorded when a product is destroyed. The Company reviews inventory on hand at least quarterly and records provisions for excess and obsolete inventory based on several factors including current assessment of future product demand, anticipated release of new products into the market, historical experience and product expiration. The Company’s industry is characterized by rapid product development and frequent new product introductions. Uncertain timing of product approvals, variability in product launch strategies, and variation in product utilization all impact the estimates related to excess and obsolete inventory. Inventories consisted of the following:

	June 30, 2009	December 31, 2008
Raw materials	\$2,280,472	\$2,518,226
Work in process	466,716	425,641
Finish goods	3,277,697	3,601,270
Reserve for obsolescence	(92,796)	(183,895)
Inventories, net	<u>\$5,932,089</u>	<u>\$6,361,242</u>

**Property and Equipment**—Property and equipment is stated at cost, less accumulated depreciation. Depreciation is computed on the straight-line method for financial reporting purposes and applied over the estimated useful lives of the assets. The estimated useful life by major asset category is the following: machinery and equipment is three to seven years, computer and other office equipment is three years, furniture and fixtures is three to seven years, and leasehold improvements and equipment leased under a capital lease are the shorter of their useful life or remaining lease term. Maintenance and repair costs are expensed as incurred.

Included in property and equipment are generators and other capital equipment (such as the Company’s ASB, or switch box) that are loaned at no cost to direct customers that use the Company’s disposable products. These generators are depreciated over a three year period and such depreciation is included in cost of revenues. The total of such depreciation was \$280,192 and \$281,123 for the three months ended June 30, 2009 and 2008, respectively, and \$533,257 and \$597,610 for the six months ended June 30, 2009 and 2008, respectively.

**Impairment of Long-Lived Assets (Other than Goodwill)**—The Company reviews property and equipment and definite-lived intangibles for impairment using its best estimates based on reasonable and supportable assumptions and projections in accordance with Statement of Financial Accounting Standards (“SFAS”) No. 144, “Accounting for the Impairment or Disposal of Long-Lived Assets” (“SFAS 144”). The Company did not recognize any impairment of long-lived assets for the three or six month periods ended June 30, 2009 and 2008.

ATRICURE, INC. AND SUBSIDIARY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

(Unaudited)

**Goodwill and Intangible Assets**—Goodwill represents the excess of costs over the fair value of the net assets acquired in business combinations. The Company historically tested its goodwill for impairment annually during its fourth quarter, or more frequently if impairment indicators were present or changes in circumstances indicated that carrying value of the asset exceeded the estimated fair value. SFAS No. 142, “Goodwill and Other Intangible Assets” (“SFAS 142”), required a two-step approach to determine any potential goodwill impairment. The first step (Step 1) required a comparison of the carrying value of the reporting unit to the fair value of the unit. Goodwill is considered potentially impaired if the carrying value of the reporting unit is greater than the estimated fair value. If potential impairment exists based upon completion of Step 1, SFAS 142 requires the completion of Step 2, which compares the implied fair value of a reporting unit’s goodwill to its carrying value. Step 2 involves an analysis allocating the fair value determined in Step 1 (as if it was the purchase price in a business combination). If the calculated fair value of the goodwill resulting from this allocation is lower than the carrying value of the goodwill of the reporting unit, an impairment loss is recorded. The Company recorded a charge for full impairment of its goodwill during the three months ended March 31, 2009 based on the results of its Step 1 analysis. During the three month period ended June 30, 2009, the Company performed its Step 2 analysis and concluded that the charge recorded to fully impair its goodwill was appropriate. The Company is not required to perform further tests of goodwill unless it records goodwill in the future as a result of acquisitions. See Note 4 for additional information related to this impairment.

Intangible assets with determinable useful lives are amortized on a straight-line basis over the estimated periods benefited, which range from four to eight years.

**Restricted Cash and Cash Equivalents**—As of December 31, 2008, \$6,000,000 had been borrowed under a revolving credit facility with National City Bank and, in accordance with the terms of the agreement, \$6,000,000 was held as restricted cash and cash equivalents. The credit facility was terminated effective May 1, 2009, and therefore, no restricted cash and cash equivalents were recorded on its Condensed Consolidated Balance Sheet.

**Grant Income**—Through December 31, 2008, the Company had received research grants, which were recognized as funds were expended and not as awarded by awarding agencies. No research grants were received during the six month period ended June 30, 2009.

**Income Taxes**—Income taxes are computed using the asset and liability method in accordance with SFAS No. 109, “Accounting for Income Taxes” (“SFAS 109”) under which deferred income taxes are provided for the temporary differences between the financial reporting basis and the tax basis of the Company’s assets and liabilities. Deferred taxes are measured using provisions of currently enacted tax laws. A valuation allowance against deferred tax assets is recorded when it is more likely than not that such assets will not be fully realized. Tax credits are accounted for as a reduction of income taxes in the year in which the credit originates.

The Company’s estimate of the valuation allowance for deferred tax assets requires it to make significant estimates and judgments about its future operating results. The Company’s ability to realize the deferred tax assets depends on its future taxable income as well as limitations on their utilization. A deferred tax asset is reduced by a valuation allowance if it is more likely than not that some portion or all of the deferred tax asset will not be realized prior to its expiration. The projections of the Company’s operating results on which the establishment of a valuation allowance is based involve significant estimates regarding future demand for the Company’s products, competitive conditions, product development efforts, approvals of regulatory agencies and product cost. If actual results differ from these projections, or if the Company’s expectations of future results change, it may be necessary to adjust the valuation allowance.

**Net Loss Per Share**—Basic net loss per share is computed by dividing the net loss available to common stockholders by the weighted average number of common shares outstanding during the period. As a result of the Company’s net losses for each of the periods presented, net loss per share excludes the effect of 3,522,292 and 2,562,134 options, restricted stock, shares issuable under the warrant and performance based shares as of June 30, 2009 and 2008, respectively, because they are anti-dilutive. Therefore the number of shares calculated for basic net loss per share is also used for the diluted net loss per share calculation.



## ATRICURE, INC. AND SUBSIDIARY

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

(Unaudited)

**Accumulated Other Comprehensive (Loss) Income**—Other comprehensive (loss) income consisted of the following:

	<u>Unrealized Losses on Short-Term Investments</u>	<u>Foreign Currency Translation Adjustment</u>	<u>Other Comprehensive (Loss) Income</u>
Balance as of December 31, 2008	—	\$ (56,789)	\$ (56,789)
January 1, 2009 to March 31, 2009 change	—	(55,390)	(55,390)
Balance as of March 31, 2009	—	\$(112,179)	\$ (112,179)
April 1, 2009 to June 30, 2009 change	\$ (1,772)	223,337	221,565
Balance as of June 30, 2009	<u>\$ (1,772)</u>	<u>\$ 111,158</u>	<u>\$ 109,386</u>

**Foreign Currency Transaction Gain**—The Company recorded foreign currency transaction (losses) gains of (\$81,869) and \$24,549 for the three months ended June 30, 2009 and 2008, respectively, and (\$130,256) and \$57,623 for the six months ended June 30, 2009 and 2008, respectively, in connection with partial settlements of its intercompany payable balance with its subsidiary.

**Research and Development**—Research and development costs are expensed as incurred. These costs include compensation and other internal and external costs associated with the development and research of new products or concepts, preclinical studies, clinical trials and products used in trials.

**Share-Based Employee Compensation**—The Company follows SFAS No.123 (revised 2004), “Share-Based Payment,” (“SFAS 123(R)”) to record share-based compensation for all share-based payment awards made to employees and directors, including employee stock options, restricted stock, performance shares and employee stock purchases related to an employee stock purchase plan, based on estimated fair values. The Company’s employee share-based compensation expense recognized under SFAS 123(R) for the three months ended June 30, 2009 and 2008 was \$851,359 and \$1,963,916, respectively, and \$1,124,548 and \$1,121,606 for the six months ended June 30, 2009 and 2008, respectively, on a before and after tax basis.

SFAS 123(R) requires companies to estimate the fair value of share-based payment awards on the date of grant using an option-pricing model. The value of the portion of the award that is ultimately expected to vest is recognized as expense over the requisite service periods in the Company’s Consolidated Statement of Operations. The expense has been reduced for estimated forfeitures. SFAS 123(R) requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates.

The Company estimates the fair value of options on the date of grant using the Black-Scholes option-pricing model (“Black-Scholes model”). The Company’s determination of fair value of share-based payment awards on the date of grant using an option-pricing model is affected by the Company’s stock price, as well as assumptions regarding a number of highly complex and subjective variables. These variables include but are not limited to the Company’s and the peer group’s expected stock price volatility over the term of the awards and actual and projected employee stock option exercise behaviors.

The Company estimates the fair value of restricted stock and performance share awards based upon the grant date closing market price of the Company’s common stock. The Company’s determination of fair value is affected by the Company’s stock price as well as assumptions regarding the number of shares expected to be granted and, in the case of performance shares, the likelihood that the performance measures will be achieved.

The Company also has an employee stock purchase plan (“ESPP” or the “Plan”) which is available to all eligible employees as defined by the Plan. Under the ESPP, shares of the Company’s common stock may be purchased at a discount. The Company estimates the number of shares to be purchased under the Plan and records compensation expense based upon the fair value of the stock at the beginning of the purchase period using the Black-Scholes model.

ATRICURE, INC. AND SUBSIDIARY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

(Unaudited)

Certain of the Company's share-based payment arrangements are outside the scope of SFAS 123(R) and are subject to Emerging Issues Task Force ("EITF") Issue No. 00-19, "Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock" ("EITF 00-19"), which requires vested stock options held by certain non-employee consultants to be accounted for as liability awards until these awards are exercised or forfeited. The fair value of these awards is remeasured at each financial statement date until the awards are settled or expire. During the three months ended June 30, 2009 and 2008, (expense) income of (\$75,973) and \$104,552, respectively, was recorded as a result of the remeasurement of the fair value of these awards. During the six months ended June 30, 2009 and 2008, (expense) income of (\$51,143) and \$166,430, respectively, was recorded as a result of the remeasurement of the fair value of these awards. As of June 30, 2009 and December 31, 2008, respectively, fully vested options to acquire 52,687 and 54,660 shares of common stock held by non-employee consultants remained unexercised and a liability of \$91,512 and \$40,369 was included in accrued liabilities in the Condensed Consolidated Balance Sheets.

Also outside the scope of SFAS 123(R), in connection with the Company's \$6.5 million term loan, the lender received a warrant to purchase shares of the Company's common stock. The warrant allows the lender to purchase 371,732 shares of the Company's common stock at \$1.224 per share, exercisable for a term of 10 years. The warrant is immediately exercisable and provides for net share settlement. The Company determined this arrangement meets the requirements of EITF 00-19 and other relevant literature and, therefore, the warrant was recorded at its grant date intrinsic value and is classified as an equity transaction.

**Use of Estimates**—The preparation of the financial statements in conformity with GAAP requires the Company's management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

**Fair Value Disclosures**—The book value of the Company's financial instruments, including cash and cash equivalents, accounts receivable, restricted cash and cash equivalents, short-term investments, other assets, accounts payable, accrued expenses, other liabilities and debt, approximate their fair values.

## 2. RECENT ACCOUNTING PRONOUNCEMENTS

In June 2009, the FASB issued SFAS No. 168, "FASB Accounting Standards Codification" ("Codification" or "SFAS 168") as the single source of authoritative non-governmental U.S. GAAP to be launched on July 1, 2009. Other than resolving certain minor inconsistencies in current GAAP, the Codification does not change GAAP. The Codification is a new structure which takes accounting pronouncements and organizes them by approximately ninety accounting topics. The Codification will be the single source of authoritative U.S. GAAP. All guidance included in the Codification will be considered authoritative at that time, even guidance that comes from what is currently deemed to be a non-authoritative section of a standard. Once the Codification becomes effective, all non-grandfathered, non-SEC accounting literature not included in the Codification will become non-authoritative. The Codification is effective for interim and annual periods ending after September 15, 2009. The Codification is for disclosure only and will not impact the Company's financial condition or results of operations. The Company is currently evaluating the impact to its financial reporting process of providing Codification references in its public filings.

In May 2009, the FASB issued SFAS No. 165, "Subsequent Events" ("SFAS 165"). SFAS 165 establishes general standards of accounting for and disclosures of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. SFAS 165 was effective for interim or annual financial periods ending after June 15, 2009 and shall be applied prospectively. Effective in May 2009, the Company adopted SFAS 165, which did not have a material impact on the Company's reported financial results or disclosures.

In April 2009, the FASB issued FASB Staff Position ("FSP") SFAS No. 141(r)-1, "Accounting for Assets Acquired and Liabilities Assumed in a Business Combination that Arise from Contingencies" ("FSP SFAS 141(r)-1"). This FSP amends and clarifies SFAS 141(r) on initial recognition and measurement, subsequent measurement and accounting, and disclosure of assets and liabilities arising from contingencies in a business combination. It is effective for business combinations occurring in fiscal years beginning on or after December 15, 2008. The impact on our consolidated financial statements of adopting FSP SFAS 141(r)-1 will depend on the nature, terms and size of business combinations completed after the effective date.

**ATRICURE, INC. AND SUBSIDIARY**

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

**(Unaudited)**

Also in April 2009, the FASB issued FSP SFAS No. 157-4, “Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly” (“FSP SFAS 157-4”), which clarifies the methodology used to determine fair value when there is no active market or when the price inputs being used represent distressed sales. FSP SFAS 157-4 also reaffirms the objective of fair value measurement, as stated in SFAS 157, which is to reflect how much an asset would be sold for in an orderly transaction. It also reaffirms the need to use judgment to determine if a formerly active market has become inactive, as well as to determine fair values when markets have become inactive. FSP SFAS 157-4 will be applied prospectively and will be effective for interim and annual reporting periods ending after June 15, 2009. As of June 30, 2009, the Company has adopted FSP SFAS 157-4, and such adoption did not have a material impact on the Company’s reported financial results or disclosure.

Effective January 1, 2009, the Company adopted SFAS No. 161, “Disclosures about Derivative Instruments and Hedging Activities—an amendment of SFAS 133” (“SFAS 161”). SFAS 161 is intended to improve financial reporting about derivative instruments and hedging activities by requiring enhanced disclosures to enable investors to better understand their effects on an entity’s financial position, financial performance and cash flows. The adoption of SFAS 161 did not have a material impact on the Company’s reported financial results or disclosures.

**3. FAIR VALUE**

Effective January 1, 2008 the Company adopted SFAS No. 157, “Fair Value Measurements” (“SFAS 157”). In February 2008, the FASB issued FSP No. FAS 157-2, “Effective Date of FASB Statement No. 157” (“FSP 157-2”), which delayed the effective date of SFAS 157 for nonfinancial assets and nonfinancial liabilities, except for items that are recognized or disclosed at fair value in the financial statements on a recurring basis, to fiscal years beginning after November 15, 2008. On January 1, 2009, the Company adopted SFAS 157 for these non-financial assets and liabilities. The adoption of this statement did not have a material impact on the Company’s consolidated financial statements. SFAS 157 defines fair value, establishes a framework for measuring fair value under GAAP and enhances disclosures about fair value measurements. Fair value is defined under SFAS 157 as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. Valuation techniques used to measure fair value under SFAS 157 must maximize the use of observable inputs and minimize the use of unobservable inputs. The standard describes a fair value hierarchy based on three levels of inputs, of which the first two are considered observable and the last unobservable, that may be used to measure fair value which are the following:

- Level 1—Quoted prices in active markets for identical assets or liabilities.
- Level 2—Inputs other than Level 1 that are observable, either directly or indirectly, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.
- Level 3—Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

In accordance with SFAS 157, the following table represents the Company’s fair value hierarchy for its financial assets and liabilities measured at fair value on a recurring basis as of June 30, 2009:

<u>June 30, 2009</u>	<u>Quoted Prices in Active Markets for Identical Assets (Level 1)</u>	<u>Significant Other Observable Inputs (Level 2)</u>	<u>Significant Other Unobservable Inputs (Level 3)</u>	<u>Total</u>
<b>Assets:</b>				
Money market funds	\$ —	\$ 11,978,551	\$ —	\$ 11,978,551
Commercial paper	—	1,595,431	—	1,595,431
Corporate bond	—	412,064	—	412,064
Total assets	<u>\$ —</u>	<u>\$ 13,986,046</u>	<u>\$ —</u>	<u>\$ 13,986,046</u>
<b>Liabilities:</b>				
Derivatives instruments	\$ —	\$ —	\$ 91,512	\$ 91,512
Total liabilities	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 91,512</u>	<u>\$ 91,512</u>

ATRICURE, INC. AND SUBSIDIARY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

(Unaudited)

Certain of the Company's share-based payment arrangements are outside the scope of SFAS 123(R) and are subject to EITF 00-19, which requires fully vested stock awards held by certain non-employee consultants to be accounted for as liability awards until these awards are exercised or forfeited. The fair value of these awards is remeasured at each financial statement date until the awards are settled or expire. The liability for these awards is included in the other liabilities line item in the Condensed Consolidated Balance Sheets. In calculating the fair value of the options, they are estimated on the grant date using the Black-Scholes model subject to changes in stock price utilizing assumptions of risk-free interest rate, contractual life of option, expected volatility, weighted average volatility and dividend yield. Due to the lack of certain observable market quotes the Company utilizes valuation models that rely on some Level 3 inputs. Specifically, due to the Company's limited trading history, the Company used an equal weighting of both the Company's implied volatility and the implied volatility of a group of comparable companies in determining the Company's volatility.

	Fair Value Measurements Using Significant Other Unobservable Inputs	
	(Level 3) Derivative Instruments	
	For the Six Months Ended June 30, 2009	For the Three Months Ended March 31, 2009
<b>Beginning Balance</b>	\$ 40,369	\$ 40,369
Total (gain) losses (realized/unrealized) included in earnings	51,143	(24,830)
Purchases, issuances and settlement	—	—
<b>Ending Balance</b>	<u>\$ 91,512</u>	<u>\$ 15,539</u>
The amount of total gains (losses) for the six and twelve month period, respectively, included in earnings (or changes in net assets attributable to the change in unrealized gains or losses relating to assets still held at reporting date)	<u>\$ (51,143)</u>	<u>\$ 24,830</u>

4. GOODWILL AND INTANGIBLE ASSETS

Intangible assets with definite lives are amortized over their estimated useful lives. The following table provides a summary of the Company's intangible assets with definite lives:

	Proprietary manufacturing technology	Non-compete agreement	Tradename	Total
Net carrying amount as of December 31, 2007	\$ 558,778	\$ 94,792	\$ 197,083	\$ 850,653
Amortization	<u>(214,000)</u>	<u>(12,500)</u>	<u>(55,000)</u>	<u>(281,500)</u>
Net carrying amount as of December 31, 2008	344,778	82,292	142,083	569,153
Amortization	<u>(107,000)</u>	<u>(6,250)</u>	<u>(27,500)</u>	<u>(140,750)</u>
Net carrying amount as of June 30, 2009	<u>\$ 237,778</u>	<u>\$ 76,042</u>	<u>\$ 114,583</u>	<u>\$ 428,403</u>

Amortizable intangible assets are being amortized over eight years for a non-compete arrangement, four years for tradename usage and five years for proprietary manufacturing technology. Amortization expense related to intangible assets with definite lives was \$70,375 for each of the three month periods ended June 30, 2009 and 2008, and \$140,750 for each of the six month periods ended June 30, 2009 and 2008.

## ATRICURE, INC. AND SUBSIDIARY

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

(Unaudited)

Estimated future amortization expense related to intangible assets with definite lives is as follows:

<u>Year</u>	<u>Amortization</u>	
2009	\$ 140,750	July 1, 2009 through December 31, 2009
2010	198,278	
2011	44,583	
2012	12,500	
2013	12,500	
2014 and thereafter	19,792	
	<u>\$ 428,403</u>	

Goodwill represents the excess of costs over the fair value of the net assets acquired in business combinations. The Company historically tested its goodwill for impairment annually during the fourth quarter, or more frequently if impairment indicators were present or changes in circumstances indicated the carrying value of the asset exceeds the estimated fair value. SFAS 142 requires a two-step approach to determine any potential goodwill impairment. The first step (Step 1) requires a comparison of the carrying value of the reporting unit to the fair value of the unit. Goodwill is considered potentially impaired if the carrying value of the reporting unit is greater than the estimated fair value. If potential impairment exists based upon completion of Step 1, SFAS 142 requires the completion of the second step (Step 2), which compares the implied fair value of a reporting unit's goodwill to its carrying value. Step 2 involves an analysis allocating the fair value determined in Step 1 (as if it was the purchase price in a business combination). If the calculated fair value of the goodwill resulting from this allocation is lower than the carrying value of the goodwill of the reporting unit, an impairment loss is recorded.

As a result of a reduction in the Company's market capitalization during the first quarter of 2009, the Company believed an indication of impairment existed and performed a Step 1 analysis of its goodwill as of March 31, 2009. The Step 1 process concluded that the carrying value of the Company's single reporting unit exceeded its estimated fair value.

To estimate the fair value of the reporting unit for Step 1, the Company utilized the market valuation approach. Under the market valuation approach the estimated fair value of the reporting unit is based on the Company's market capitalization using the closing market price of the Company's stock and number of shares outstanding as of March 31, 2009. The Company also considered a control premium that represents the estimated amount an investor would pay for a controlling interest in the Company. An income approach was also used to corroborate the results of the Step 1 test. The discounted cash flow method was used to measure the fair value of the Company's equity under the income approach. Determining the fair value using a discounted cash flow method includes assumptions about future market conditions and operating results. The judgments are based upon historical experience, current market trends and projected estimated future revenues and profit margins. The Company believes that these estimates and assumptions are reasonable and that different estimates and assumptions could result in a different outcome. Determining the control premium to apply to the reporting unit is a subjective process that involves the use of estimates and judgments. The income approach supported the interim Step 1 test result using the market valuation approach in determining that the carrying value of the reporting unit exceeded the fair value.

Step 2 of the goodwill impairment test compares the implied fair value of the reporting unit's goodwill with the carrying amount of the goodwill. If the carrying amount of the Company's goodwill exceeds the implied fair value of goodwill, an impairment loss is recognized for an amount equal to that excess. As required, the Company performed Step 2 of the goodwill impairment test during the three month period ended June 30, 2009. Based on the results of this test, the Company concluded its goodwill was fully impaired and that the impairment of \$6,812,389 on a before and after tax basis was appropriately recorded as of March 31, 2009. This impairment was recorded as an increase in operating expenses, loss from operations, and net loss in the Condensed Consolidated Statement of Operation as of March 31, 2009.

The following table provides a summary of the Company's changes in the net carrying amount of goodwill:

Net carrying amount as of December 31, 2007	\$ 6,763,259
Goodwill amount recorded	49,130
Net carrying amount as of December 31, 2008	6,812,389
Goodwill impairment	(6,812,389)
Net carrying amount as of June 30, 2009	<u>\$ —</u>

## ATRICURE, INC. AND SUBSIDIARY

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

(Unaudited)

The additional goodwill recorded in 2008 relates to an increase in inventory reserves related to the August 7, 2007 acquisition of certain assets from Cooper Surgical, Inc.

**5. ACCRUED LIABILITIES**

Accrued liabilities consisted of the following:

	June 30, 2009	December 31, 2008
Accrued commissions	\$ 797,475	\$ 847,872
Accrued bonus	508,127	69,525
Accrued vacation	181,614	232,577
Accrued severance	45,487	579,077
Other accrued liabilities	976,185	1,193,512
Total	<u>\$2,508,888</u>	<u>\$2,922,563</u>

**6. INDEBTEDNESS**

On May 1, 2009, the Company and Silicon Valley Bank (the "Bank") entered into a Loan and Security Agreement (the "Agreement") that provides a term loan and a revolving credit facility under which the Company can borrow a maximum of \$10.0 million. The Company can borrow up to \$10.0 million under the revolving loan facility with the availability subject to a borrowing base formula. As of June 30, 2009, the Company has no borrowings under the revolving loan facility and borrowing availability of approximately \$1.0 million. On May 1, 2009, the Company borrowed the maximum amount of \$6.5 million under the term loan. In connection with the term loan, the Bank received a warrant to purchase 371,732 shares of the Company's common stock at \$1.224 per share, exercisable for a term of 10 years. The warrant was immediately exercisable. The Agreement also includes up to a \$1.0 million sublimit for stand-by letters of credit.

Interest on the term loan will accrue at a rate of 10.0% per year, and interest on the revolving loan will accrue at a fluctuating rate equal to the Bank's announced prime rate of interest, subject to a floor of 4.0%, plus between 1.0% and 2.0%, depending on the Company's Adjusted Quick Ratio (as defined in the Agreement). Principal on the term loan will be paid over 36 months of equal principal payments, plus applicable interest.

The Agreement matures on April 30, 2012 and is secured by all of the Company's assets, including intellectual property, and a pledge of sixty-five percent of the Company's stock in its subsidiary, AtriCure Europe, B.V.

The Agreement contains covenants that include, among others, covenants that limit the Company's and its subsidiaries' ability to dispose of assets, enter into mergers or acquisitions, incur indebtedness, incur liens, pay dividends or make distributions on the Company's capital stock, make investments or loans, and enter into certain affiliate transactions, in each case subject to customary exceptions for a credit facility of this size and type. Additional covenants apply when the Company has outstanding borrowings under the revolving loan facility or when the Company achieves specific covenant milestones. The occurrence of an event of default could result in an increase to the applicable interest rate by 3.0%, an acceleration of all obligations under the Agreement, an obligation of the Company to repay all obligations in full, and a right by the Bank to exercise all remedies available to it under the Agreement and related agreements including the Guaranty and Security Agreement.

## ATRICURE, INC. AND SUBSIDIARY

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

## (Unaudited)

As of June 30, 2009, the Company had no borrowings under its revolving credit facility and borrowings of \$6,138,889 under its term loan, which includes approximately \$2,166,667 classified as current maturities of long-term debt. The Company is required to make monthly principal payments on its term loan of \$180,556 plus interest. The warrant associated with the Company's term loan was recorded as discount on long-term debt at its intrinsic value and is being amortized over the term of the loan. Amortization expense totaled \$44,657 for the three and six month periods ended June 30, 2009. The effective interest rate on borrowings under the term loan, including amortization of the warrant and debt issuance costs, is 15.2%.

The Company has a capital lease for computer equipment that expires in 2010. As of June 30, 2009, the cost of the assets under lease was \$102,197. These assets are depreciated over the estimated useful life of the asset, which equals the term of the lease. Accumulated amortization of the capital lease was \$51,099 at June 30, 2009.

Maturities on long-term debt, including capital lease obligations, over the next five years are as follows:

2009	\$1,100,648	July 1, 2009 through December 31, 2009
2010	2,203,272	
2011	2,166,667	
2012	722,222	
Total maturities on long-term debt	<u>\$6,192,809</u>	

On July 1, 2008 the Company entered into a two-year \$10.0 million credit facility with National City Bank (subsequently merged with PNC Bank). The credit facility was secured by all of the Company's assets and property, tangible and intangible. As of December 31, 2008, the Company had \$6.0 million outstanding under its credit facility with National City Bank, all of which was held as restricted cash and cash equivalents and reported as long-term liabilities and assets, respectively. On May 1, 2009, the Company terminated its facility with National City Bank.

On July 2, 2008, as a condition to entering into the credit facility with National City Bank, the Company repaid in full its outstanding indebtedness to Lighthouse Capital Partners V, L.P. The Company paid \$713,032 to Lighthouse, which consisted of outstanding principal, accrued interest and a final payment fee due at maturity.

## 7. COMMITMENTS AND CONTINGENCIES

### *Operating Leases*

The Company leases various types of office, manufacturing and warehouse facilities and equipment under noncancelable operating leases that expire at various terms through 2013.

### *Royalty Agreement*

On November 21, 2005 the Company entered into a royalty agreement, effective as of October 1, 2005, with Randall K. Wolf, M.D., the co-inventor of the Lumitip dissector. Pursuant to the terms of the agreement, the Company will pay to Dr. Wolf royalties based on revenue from sales of the Lumitip dissector and certain other inventions, improvements or ideas, at royalty rates which range from 1.5% to 15% of such revenues. During the term of the agreement the Company is required to pay Dr. Wolf a minimum of \$50,000 in royalties per quarter and up to an aggregate of \$2.0 million in royalties over the term of the agreement. The agreement terminates on December 31, 2009; however, the Company and Dr. Wolf each have the right at any time to terminate the agreement immediately for cause. Royalties earned by Dr. Wolf related to sales of the Lumitip dissector were \$50,000 for each of the three month periods ended June 30, 2009 and 2008, and \$100,000 for each of the six month periods ended June 30, 2009 and 2008.

ATRICURE, INC. AND SUBSIDIARY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

(Unaudited)

**Purchase Agreement**

On June 15, 2007 the Company entered into a purchase agreement with Micropace Pty Ltd Inc., (“Micropace”), which was amended in June 2008. Under the amended agreement, Micropace produced a derivative of one of their products tailored for the cardiac surgical environment, known as the “Micropace ORLab™” for worldwide distribution by the Company. Pursuant to the terms of the amended agreement, in order for the Company to retain exclusive distribution rights, the Company was required to purchase a minimum of 70 units during 2008 and is required to purchase 80 units each for 2009 and 2010. Units purchased in excess of yearly minimums in a year reduce future minimum purchase requirements. The Company has 15 units remaining to purchase by December 31, 2010 under the commitment in order to retain exclusive distribution rights.

**Life Support Technology, LST b.v.**

In September of 2007 multiple proceedings between Life Support Technology, LST b.v., or L.S.T., a former distributor of AtriCure products in Europe, and the Company were settled. The settlement agreement provides for the Company to pay LST €257,360 (euros) in 16 payments of €16,085, with the final payment due January 1, 2011. If the U.S. Dollar to Euro conversion rate on any of the 16 payment due dates set forth in the agreement is less than \$1.36 to the Euro, the Company will owe LST additional compensation, up to a maximum of €28,310. The Company has recorded liabilities of \$147,534 and \$184,632 as of June 30, 2009 and December 31, 2008, respectively.

**Legal**

*Class Action Lawsuits*

The Company and certain of its current and former officers were named as defendants in a purported securities class action lawsuit filed in the United States District Court for the Southern District of New York (*Levine v. AtriCure, Inc.*, Case No. 06 CV 14324 (United States District Court for the Southern District of New York)). The suit alleges violations of the federal securities laws and seeks damages on behalf of purchasers of the Company’s common stock during the period from the Company’s initial public offering in August 2005 through February 16, 2006. The Company believes that the allegations are without merit. The Company filed a motion to dismiss the lawsuit for lack of subject matter jurisdiction. This motion was denied in September 2007, and a motion for reconsideration of that denial was denied in January 2009. The Company intends to vigorously defend this lawsuit.

On December 12, 2008 the Company and certain of its current executive officers were named in a putative class action lawsuit captioned *Halford vs. AtriCure, Inc., et al.*, filed in the U.S. District Court for the Southern District of Ohio, Western Division. The plaintiff alleges violations of Sections 10(b) and 20(a) of the Securities Exchange Act of 1934 and Rule 10b-5 promulgated thereunder and seeks unspecified damages against the Company and certain of its current executive officers. The plaintiff alleges, among other things, that the defendants issued materially false and misleading statements that failed to disclose that the Company improperly promoted certain products to physicians and caused the filing of false claims for reimbursement. The class period alleged runs from May 10, 2007 through October 31, 2008. The Company filed a motion to dismiss in July 2009. The Company intends to vigorously defend this lawsuit.

*Department of Justice Investigation*

The Company received a letter on October 27, 2008 from the U.S. Department of Justice-Civil Division (the “DOJ”) informing the Company that the DOJ was conducting an investigation for potential False Claims Act and common law violations relating to the Company’s surgical ablation devices. Specifically, the letter states that the DOJ is investigating the Company’s marketing practices utilized in connection with its surgical ablation system to treat atrial fibrillation, a specific use outside the Federal Food and Drug Administration’s 510(k) clearance. The letter also states that the DOJ is investigating whether AtriCure instructed hospitals to bill Medicare for cardiac surgical ablation using incorrect billing codes. The Company has received follow-up requests for documents from the DOJ. The Company is cooperating with the investigation and continues to operate its business in the ordinary course.



ATRICURE, INC. AND SUBSIDIARY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

(Unaudited)

*Qui Tam Suit*

A copy of a *qui tam* complaint against the Company was unsealed on July 10, 2009. The *qui tam* complaint, pending in the U.S. District Court for the Southern District of Texas, was originally filed by a relator in August 2007. The complaint alleges a cause of action under the federal False Claims Act relating to the Company's alleged marketing practices in connection with its surgical cardiac ablation devices. The Company believes that this complaint is related to the investigation by the DOJ. The Company is currently in the process of evaluating this complaint.

The Company's liability, if any, resulting from the class action lawsuits, the DOJ investigation and *qui tam* complaint cannot be estimated and as such the Company has not recorded any liability within the condensed consolidated financial statements in relation to these matters.

The Company may from time to time become a party to additional legal proceedings.

**8. INCOME TAX PROVISION**

On January 1, 2007 the Company adopted the provisions of FIN 48. FIN 48 addresses the determination of how tax benefits claimed or expected to be claimed on a tax return should be recorded in the financial statements. Under FIN 48, the Company must recognize the tax benefit from an uncertain tax position only if it is more likely than not that the tax position will be sustained on examination by the taxing authorities, based on the technical merits of the position. The Company examined its tax positions and concluded that each meets the more-likely-than-not recognition threshold of FIN 48 and is appropriately measured. Application of the provisions of FIN 48 therefore did not result in any change to the Company's tax account balances and the Company does not expect any significant unrecognized tax benefits to arise over the next twelve months.

The Company currently has not had to accrue interest and penalties related to unrecognized tax benefits, however when or if the situation occurs, the Company will recognize interest and penalties within the income tax expense (benefit) line in the accompanying Condensed Consolidated Statements of Operations and within the related tax liability in the Condensed Consolidated Balance Sheets.

The Company files federal, state, and foreign income tax returns in jurisdictions with varying statutes of limitations. Generally, all of the Company's federal, state and foreign tax filings remain subject to examination by the relevant tax authority until full utilization of net operating loss carryforwards. The Company's foreign income tax filings for the tax years 2008, 2007 and 2006 remain subject to examination.

**9. EQUITY COMPENSATION PLANS**

The Company has several share-based incentive plans: the 2001 Stock Option Plan (the "2001 Plan"), the 2005 Equity Incentive Plan (the "2005 Plan") and the 2008 Employee Stock Purchase Plan (the "ESPP").

***2001 Plan and 2005 Plan***

The 2001 Plan is no longer used for granting incentives. Under the 2005 Plan, the Board of Directors may grant incentive stock options to employees and any parent or subsidiary's employees, and may grant nonstatutory stock options, restricted stock, stock appreciation rights, performance units or performance shares to employees, directors and consultants of the Company and any parent or subsidiary's employees, directors and consultants. The administrator (which is made up of the Company's Board of Directors or a committee of the Board of Directors) has the power to determine the terms of any awards, including the exercise price of options, the number of shares subject to each award, the exercisability of the awards and the form of consideration.

Options granted under the 2001 Plan and the 2005 Plan generally expire 10 years from the date of grant. Options granted from the 2001 Plan are generally exercisable beginning one year from the date of grant in cumulative yearly amounts of 25% of the shares granted. Options granted from the 2005 Plan generally vest at a rate of 25% on the first anniversary date of the grant and ratably each month thereafter. Certain options granted were exercisable at the time of the grant and the underlying unvested shares are subject to the Company's repurchase rights as stated in the applicable plan agreement.

ATRICURE, INC. AND SUBSIDIARY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

(Unaudited)

As of June 30, 2009, 4,804,149 shares of common stock were reserved for issuance under the 2005 Plan. The shares authorized for issuance under the 2005 Plan include (a) shares reserved but unissued under the 2001 Plan as of August 10, 2005, (b) shares returned to the 2001 Plan as the result of termination of options or the repurchase of shares issued under such plan, and (c) annual increases in the number of shares available for issuance on the first day of each year equal to the lesser of:

- 3.25% of the outstanding shares of common stock on the first day of the fiscal year;
- 825,000 shares; or
- an amount the Company's Board of Directors may determine.

On January 1, 2009, an additional 463,934 shares were authorized for issuance under the 2005 Equity Incentive Plan representing 3.25% of the outstanding shares on that date. As of June 30, 2009 there were 762,491 shares available for future grants under the plans.

Activity under the Plans was as follows:

	Number of Shares Outstanding	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value
<b>Stock Options</b>				
Outstanding at January 1, 2009	2,629,310	\$ 8.51		
Granted	96,750	\$ 2.35		
Cancelled or forfeited	(134,920)	\$ 9.65		
Exercised	—	\$ —		
Outstanding at June 30, 2009	<u>2,591,140</u>	<u>\$ 8.22</u>	<u>6.60</u>	<u>\$1,311,409</u>
Vested and expected to vest	<u>2,511,066</u>	<u>\$ 8.22</u>	<u>6.53</u>	<u>\$1,292,516</u>
Exercisable at June 30, 2009	<u>1,653,631</u>	<u>\$ 7.57</u>	<u>5.57</u>	<u>\$1,202,719</u>
	Number of Shares Outstanding	Weighted Average Grant Date Fair Value		
<b>Restricted Stock</b>				
Outstanding at January 1, 2009	161,893	\$ 2.15		
Granted	356,111	\$ 1.62		
Forfeited	(12,500)	\$ 2.15		
Released	(393,084)	\$ 1.64		
Outstanding at June 30, 2009	<u>112,420</u>	<u>\$ 2.27</u>		

There were no options exercised during the six month period ended June 30, 2009. The total intrinsic value of options exercised during the three and six month period ended June 30, 2008 was \$176,382 and \$586,768, respectively, and as a result of the Company's tax position, no tax benefit was recognized related to the stock option exercises. Additionally, there was no impact on operating or financing activities in the Company's Condensed Consolidated Statement of Cash Flow for the three month periods ended June 30, 2009. For the six month period ended June 30, 2008, \$174,122 in cash proceeds was included in the Company's Condensed Consolidated Statement of Cash Flows as a result of the exercise of stock options.

The exercise price per share of each option is equal to the fair market value of the underlying share on the date of grant. The Company issues registered shares of common stock to satisfy stock option exercises and restricted stock grants.

The Company recognized expense related to stock options and restricted stock for the three month periods ended June 30, 2009 and 2008 of \$759,996 and \$556,191, respectively, and for the six month periods ended June 30, 2009 and 2008 of \$1,797,645 and \$1,121,606, respectively. As of June 30, 2009 there was \$5,264,565 of unrecognized compensation costs (\$4,720,068 relating to stock options and \$544,497 relating to restricted stock) related to non-vested share-based compensation arrangements. This cost is expected to be recognized over a weighted-average period of 2.3 years for stock options and 0.9 years for restricted stock.

**ATRICURE, INC. AND SUBSIDIARY**

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

**(Unaudited)**

In 2008 the Company issued performance shares to certain employees to incent and reward them for the achievement of specified performance metrics during 2009 and 2010 over a service period under the awards through December 31, 2010. The participant receives an award for a specified number of shares of the Company's common stock at the beginning of an award period, which entitles the participant to payment at the end of the award period based upon achievement of the specified metrics and completion of specified service requirements. As of June 30, 2009 the Company has the potential to issue 447,000 shares of common stock based upon each participant meeting all of the specified metrics. In accordance with SFAS 123(R), the Company estimates the number of shares to be granted based upon the probability that the performance metric and service period will be achieved. The fair value of the estimated award is expensed over the award period. During the three and six month periods ended June 30, 2009, the Company recognized expense related to the performance shares of \$74,044 and \$124,552, respectively. The probability of meeting the specified metrics is reviewed quarterly and the estimated expense is adjusted in the current period. As of June 30, 2009 there was \$1,250,822 of unrecognized compensation costs related to non-vested share-based compensation arrangements associated with these performance shares. This cost is expected to be recognized over a weighted-average period of 1.5 years.

**Valuation and Expense Information Under FAS 123(R)**

The following table summarizes share-based compensation expense related to employee share-based compensation under SFAS 123(R) for the three and six month periods ended June 30, 2009 and 2008. This expense was allocated as follows:

	<u>Three Months Ended June 30,</u>		<u>Six Months Ended June 30,</u>	
	<u>2009</u>	<u>2008</u>	<u>2009</u>	<u>2008</u>
Cost of revenues	\$ 65,377	\$ 31,539	\$ 171,596	\$ 58,367
Research and development expenses	214,093	56,080	524,943	133,653
Selling, general and administrative expenses	571,889	478,572	1,267,377	929,586
Total share-based compensation expense related to employees	<u>\$ 851,359</u>	<u>\$ 566,191</u>	<u>\$1,963,916</u>	<u>\$1,121,606</u>

In calculating compensation expense under SFAS 123(R), the fair value of the options is estimated on the grant date using the Black-Scholes model including the following assumptions:

	<u>Three Months Ended June 30,</u>		<u>Six Months Ended June 30,</u>	
	<u>2009</u>	<u>2008</u>	<u>2009</u>	<u>2008</u>
Risk free interest rate	2.52%	3.50%	2.42%	2.88% -3.50%
Expected life of option (years)	6.00-6.25	6.00-6.50	6.00-6.25	6.00-6.50
Expected volatility of stock	62.00%	43.50%	53.50%-62.00%	43.00%-43.50%
Weighted-average volatility	62.00%	43.50%	60.16%	43.42%
Dividend yield	0.00%	0.00%	0.00%	0.00%

Due to the Company's limited operating and trading history, volatility is estimated based on an equal weighting of both the Company's trading history and other companies in the industry. The risk-free interest rate assumption is based upon the U.S. treasury yield curve at the time of grant for the expected option life. The simplified method is utilized in determining the expected life of the option.

## ATRICURE, INC. AND SUBSIDIARY

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

## (Unaudited)

Based on the assumptions noted above, the weighted average estimated fair values of the stock options and restricted stock granted for the respective periods were as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	2008	2009	2008
Stock options	\$ 1.51	\$ 4.80	\$ 1.36	\$ 5.00
Restricted stock	\$ 2.58	\$ —	\$ 1.62	\$ —

**Non-Employee Stock Compensation**

The Company has issued nonstatutory common stock options to consultants to purchase shares of common stock. Such options vest over a service period ranging from immediately to four years. After January 1, 2006, all stock options were issued with a four year vesting period and vest at a rate of 25% on the first anniversary date of the grant and ratably each month thereafter.

The fair value at the date of grant, which is subject to adjustment at each vesting date based upon the fair value of the Company's common stock, was determined using the Black-Scholes model. There were no non-employee stock options granted during the three or six month periods ended June 30, 2009. The following assumptions were used to determine the fair value of the non-employee stock options at the date of grant in 2008:

	2008
Risk free interest rate	3.45%
Expected life of option (years)	10.00
Expected volatility of stock	43.00%
Weighted-average volatility	43.00%
Dividend yield	—

The values attributable to non-employee options have been amortized over the service period on a graded vesting method and the vested portion of these options was remeasured at each vesting date.

Stock compensation (expense) income with respect to non-employee stock options totaled (\$8,919) and \$10,057 for the three month periods ended June 30, 2009 and 2008, respectively, and (\$7,097) and \$20,517 for the six month periods ended June 30, 2009 and 2008, respectively.

Certain of the Company's share-based payment arrangements are outside the scope of SFAS No. 123(R) and are subject to EITF 00-19, which requires vested stock awards held by certain non-employee consultants to be accounted for as liability awards until these awards are exercised or forfeited. The fair value of these awards is remeasured at each financial statement date until the awards are settled or expire. The Company recorded (expense) income as a result of the remeasurement of the fair value of these awards during the three month periods ended June 30, 2009 and 2008 of (\$75,973) and \$104,553, respectively, and during the six month periods ended June 30, 2009 and 2008 of (\$51,143) and \$166,431, respectively. As of June 30, 2009 and December 31, 2008, respectively, options to acquire 52,687 and 54,660 shares of common stock held by non-employee consultants remained unexercised and a liability of \$91,512 and \$40,369 was included in accrued liabilities in the Condensed Consolidated Balance Sheets.

## ATRICURE, INC. AND SUBSIDIARY

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

(Unaudited)

**Employee Stock Purchase Plan (ESPP)**

During the second quarter of 2008, the Company established its 2008 Employee Stock Purchase Plan (“ESPP”) which is available to eligible employees as defined in the plan. Under the ESPP, shares of the Company’s common stock may be purchased at a discount (currently 15%) of the lesser of the closing price of the Company’s common stock on the first trading day or the last trading day of the offering period. The offering period (currently six months) and the offering price are subject to change. Participants may not purchase more than \$25,000 of the Company’s stock in a calendar year and effective January 1, 2009, may not purchase more than 1,500 shares during an offering period. Beginning on January 1, 2009 and on the first day of each fiscal year thereafter during the term of the ESPP, the number of shares available for sale under the ESPP shall be increased by the lesser of (i) two percent (2%) of the Company’s outstanding shares of Common Stock as of the close of business on the last business day of the prior calendar year, not to exceed 600,000 shares, or (ii) a lesser amount determined by the Board of Directors. At June 30, 2009, there were 466,185 shares available for future issuance under the ESPP, including 285,498 shares approved for issuance by the Company’s Board of Directors effective January 1, 2009. Stock compensation expense with respect to the ESPP was \$17,319 and \$41,719, respectively, for the three and six month periods ended June 30, 2009.

**10. SEGMENT AND GEOGRAPHIC INFORMATION**

The Company considers reporting segments in accordance with SFAS 131, “Disclosure about Segments of an Enterprise and Related Information.” The Company develops, manufactures, and sells devices designed primarily for the surgical ablation of cardiac tissue. These devices are developed and marketed to a broad base of medical centers in the United States and internationally. Management considers all such sales to be part of a single operating segment. Geographic revenues were as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	2008	2009	2008
United States	\$ 11,225,465	\$ 12,589,599	\$ 22,613,403	\$ 24,462,038
International	2,552,485	2,268,915	4,838,450	3,926,621
Total	\$ 13,777,950	\$ 14,858,514	\$ 27,451,853	\$ 28,388,659

Substantially all of the Company’s long-lived assets are located in the United States.

**11. SUBSEQUENT EVENT**

The Company has considered subsequent events through August 10, 2009, the date of this filing, in preparing the condensed consolidated financial statements and notes thereto, and, other than the unsealing of a *qui tam* case, as further discussed in Note 7, “Commitments and Contingencies,” no additional significant subsequent events occurred since June 30, 2009.

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

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with the accompanying condensed consolidated financial statements and notes thereto contained in Item 1 of Part I of this Form 10-Q and our audited financial statements and notes thereto as of and for the year ended December 31, 2008 included in our Form 10-K filed with the Securities and Exchange Commission (“SEC”) to provide an understanding of our results of operations, financial condition and cash flows.

**Forward-Looking Statements**

This Form 10-Q, including the sections titled “Management’s Discussion and Analysis of Financial Condition and Results of Operations” and “Risk Factors,” contains forward-looking statements regarding our future performance. All forward-looking information is inherently uncertain and actual results may differ materially from assumptions, estimates or expectations reflected or contained in the forward-looking statements as a result of various factors, including those set forth under “Risk Factors” and elsewhere in this quarterly report on Form 10-Q, and in our annual report on Form 10-K for the year ended December 31, 2008. Forward-looking statements convey our current expectations or forecasts of future events. All statements contained in this Form 10-Q other than statements of historical fact are forward-looking statements. Forward-looking statements include statements regarding our future financial position, business strategy, budgets, projected costs, plans and objectives of management for future operations. The words “may,” “continue,” “estimate,” “intend,” “plan,” “will,” “believe,” “project,” “expect,” “anticipate” and similar expressions may identify forward-looking statements, but the absence of these words does not necessarily mean that a statement is not forward-looking. With respect to the forward-looking statements, we claim the protection of the safe harbor for forward-looking statements contained in the Private Securities Litigation Reform Act of 1995. These forward-looking statements speak only as of the date of this Form 10-Q. Unless required by law, we undertake no obligation to publicly update or revise any forward-looking statements to reflect new information or future events or otherwise.

**Overview**

We are a medical device company and a leader in developing, manufacturing and selling innovative cardiac surgical ablation systems designed to create precise lesions, or scars, in cardiac, or heart, tissue. Our primary product line, which accounts for a majority of our revenues, is our AtriCure Isolator® bipolar ablation system, or Isolator system. Our Isolator system consists primarily of a compact power generator known as an ablation and sensing unit, or ASU, a switchbox unit, or ASB, which allows physicians to toggle between multiple products and multiple configurations of our Isolator Synergy™ clamps. We sell two configurations of our clamps, one designed for ablation during open-heart, or open, procedures and one designed for ablation during sole-therapy minimally invasive procedures. We also sell a multifunctional pen which is often used by physicians in combination with our Isolator system to ablate cardiac tissue and for temporary pacing, sensing, stimulating and recording during the evaluation of cardiac arrhythmias. During 2008, we introduced our Coolrail linear ablation device which has been adopted by physicians to create an extended lesion set during minimally invasive procedures. Additionally, we sell various configurations of enabling devices, such as our Lumitip dissection tool. In August 2007, we acquired a cardiac cryoablation product line, which uses extreme cold to ablate tissue. Prior to our acquisition of this product line, we sold the product line as a distributor. In March 2009, we introduced a disposable cryoablation device, Cryo1™, which is being adopted by physicians for cardiac ablation during open procedures.

In the United States, we primarily sell our products through our direct sales force. AtriCure Europe, B.V., our wholly-owned European subsidiary, which is incorporated and based in the Netherlands, sells our products throughout Europe, primarily through distributors, with the exception of Germany, Switzerland and Austria, where we sell our products through our direct sales force. Additionally, we sell our products to other international distributors, primarily in Asia, South America and Canada. Our business is primarily transacted in U.S. dollars, with the exception of transactions with our European subsidiary, which are primarily transacted in Euros. Our sales outside of the United States represented 18.5% and 15.3% of our revenues for three month periods ended June 30, 2009 and 2008, respectively, and 17.6% and 13.8% of our revenues for the six month periods ended June 30, 2009 and 2008, respectively.

Our costs and expenses consist of cost of revenues, research and development expenses, selling, general and administrative expenses and a non-recurring expense related to the impairment of our goodwill during the six month period ended June 30, 2009. Cost of revenues consist principally of the cost of purchasing materials and manufacturing our products. Research and development expenses consist principally of expenses incurred with respect to internal and external research and development activities and the conduct of clinical activities and trials. Selling, general and administrative expenses consist principally of costs associated with our sales, marketing and administrative functions.

## Results of Operations

### Three months ended June 30, 2009 compared to June 30, 2008

The following table sets forth, for the periods indicated, our results of operations expressed as dollar amounts and as percentages of total revenues:

	Three Months Ended June 30,			
	2009		2008	
	<u>Amount</u>	<u>% of Revenues (dollars in thousands)</u>	<u>Amount</u>	<u>% of Revenues</u>
Revenues	\$13,778	100.0%	\$14,859	100.0%
Cost of revenues	3,108	22.6%	3,495	23.5%
Gross profit	10,670	77.4%	11,364	76.5%
Operating expenses:				
Research and development expenses	3,138	22.8%	2,594	17.5%
Selling, general and administrative expenses	8,565	62.1%	10,595	71.3%
Total operating expenses	11,703	84.9%	13,189	88.8%
Loss from operations	(1,033)	(7.5)%	(1,825)	(12.3)%
Other income (expense):				
Interest expense	(278)	(2.0)%	(43)	(0.3)%
Interest income	15	0.1%	73	0.5%
Other	(158)	(1.2)%	203	1.4%
Other (expense) income	(421)	(3.1)%	233	1.6%
Loss before income tax benefit	(1,454)	(10.6)%	(1,593)	(10.7)%
Income tax benefit	11	0.1%	—	—
Net loss	<u>\$ (1,443)</u>	<u>(10.5)%</u>	<u>\$ (1,593)</u>	<u>(10.7)%</u>

**Revenues.** Total revenues decreased 7.3%, from \$14.9 million for the three months ended June 30, 2008 to \$13.8 million for the three months ended June 30, 2009. The decrease in revenues was due primarily to a reduction in revenues from capital equipment sales. This reduction was partially due to fewer ORLab units being sold, which was driven by the current hospital spending environment on capital equipment and adoption by a majority of minimally invasive customers during 2008. In addition, we experienced a reduction in unit sales of our CCS-200 cryo generator due to our conversion during the second quarter to placing them on loan with our direct customers in combination with our launch of our disposable cryo probe, Cryo1 contributed to the reduction in revenues.

**Cost of revenues.** Cost of revenues decreased \$0.4 million, from \$3.5 million for the three months ended June 30, 2008 to \$3.1 million for the three months ended June 30, 2009. As a percentage of revenues, cost of revenues decreased from 23.5% for the three months ended June 30, 2008 to 22.6% for the three months ended June 30, 2009. The decrease in gross profit and the decrease in cost of revenues was primarily due to a reduction in capital equipment sales, which carry a higher cost of revenue than our disposable products, and a reduction in product cost for our disposable products, partially offset by an increased mix in the percentage of units sold internationally.

**Research and development expenses.** Research and development expenses increased \$0.5 million, from \$2.6 million for the three months ended June 30, 2008 to \$3.1 million for the three months ended June 30, 2009. As a percentage of revenues, research and development expenses increased from 17.5% for the three months ended June 30, 2008 to 22.8% for the three months ended June 30, 2009. The increase was primarily attributable to an increase in expenditures for our ABLATE and EXCLUDE clinical trials of \$0.4 million, an increase in share-based compensation of \$0.2 million and an increase in product development project costs of \$0.2 million.

**Selling, general and administrative expenses.** Selling, general and administrative expenses decreased \$2.0 million or 19.2%, from \$10.6 million for the three months ended June 30, 2008 to \$8.6 million for the three months ended June 30, 2009. The decrease was primarily due to lower headcount-related expenses of approximately \$1.4 million, primarily the result of our reduction in force which occurred in the fourth quarter of 2008, and a \$0.5 million decrease in sales and marketing expenses, due primarily to reduced spending in support of tradeshow and educational grants. These reductions were partially offset by an increase in legal expense of \$0.3 million, due primarily to our investigation by the DOJ, and an increase in share-based compensation. As a percentage of total revenues, selling, general and administrative expenses decreased from 71.3% for the three months ended June 30, 2008 to 62.2% for the three months ended June 30, 2009.

**Net interest expense.** Net interest expense increased \$0.3 million to \$0.3 million for the three months ended June 30, 2009, due primarily to the write-off of deferred financing costs of \$0.1 million in connection with the termination of our credit facility with National City Bank, interest associated with borrowings under the term loan component of our new credit facility with Silicon Valley Bank of \$0.1 million and the amortization of the discount on long-term debt related to the warrant issued in conjunction with the new credit facility of \$44,657.

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**Other (expense) income.** Other (expense) income consists of foreign currency transaction (loss) gain, grant income and non-employee option (expense) income related to the fair market value change for fully vested options outstanding for consultants, which are accounted for as free standing derivatives. For the three months ended June 30, 2009, other expense of \$0.2 million included \$0.1 million related to foreign currency transaction losses associated with partial settlement of intercompany balances and \$0.1 million of certain non-employee option expense due to an increase in the value of the options. Other income of \$0.2 million for the three months ended June 30, 2008 included income of \$0.1 million associated with a reduction in value of certain non-employee stock options and \$0.1 million in grant income related to our grant agreement with the Cleveland Clinic Foundation.

### **Six months ended June 30, 2009 compared to June 30, 2008**

The following table sets forth, for the periods indicated, the results of operations expressed as dollar amounts and as percentages of total revenues:

	Six Months Ended June 30,			
	2009		2008	
	Amount	% of Revenues (dollars in thousands)	Amount	% of Revenues
Revenues	\$27,452	100.0%	\$28,389	100.0%
Cost of revenues	6,053	22.0%	6,726	23.7%
Gross profit	21,399	78.0%	21,663	76.3%
Operating expenses:				
Research and development expenses	6,055	22.1%	5,027	17.7%
Selling, general and administrative expenses	17,497	63.7%	22,358	78.8%
Goodwill impairment	6,812	24.8%	—	—
Total operating expenses	30,364	110.6%	27,385	96.5%
Loss from operations	(8,965)	(32.7)%	(5,722)	(20.2)%
Other income (expense):				
Interest expense	(339)	(1.2)%	(82)	(0.3)%
Interest income	36	0.1%	234	0.8%
Other	(182)	(0.7)%	372	1.3%
Other (expense) income	(485)	(1.8)%	524	1.8%
Loss before income tax benefit	(9,450)	(34.4)%	(5,198)	(18.3)%
Income tax benefit	42	0.1%	—	—
Net loss	<u>\$ (9,408)</u>	<u>(34.3)%</u>	<u>\$ (5,198)</u>	<u>(18.3)%</u>

**Revenues.** Total revenues decreased 3.3%, from \$28.4 million for the six months ended June 30, 2008 to \$27.5 million for the six months ended June 30, 2009. The decrease in revenues was due primarily to a decrease in revenues from the sale of capital equipment. This reduction was partially due to fewer ORLab units being sold, which was driven by the current hospital spending environment on capital equipment and adoption by a majority of minimally invasive customers during 2008. In addition, we experienced a reduction in unit sales of our CCS-200 cryo generator due to our conversion during the second quarter to placing them on loan with our direct customers in combination with our launch of our disposable cryo probe, Cryo1 contributed to the reduction in revenues.

**Cost of revenues.** Cost of revenues decreased \$0.7 million, from \$6.7 million for the six months ended June 30, 2008 to \$6.0 million for the six months ended June 30, 2009. As a percentage of revenues, cost of revenues decreased from 23.7% for the six months ended June 30, 2008 to 22.0% for the six months ended June 30, 2009. The decrease in gross profit and cost of revenues was primarily due to a reduction in sales of capital equipment, which carry a higher cost of revenues than our disposable products and a reduction in product cost for our disposable products, partially offset by an increased mix in the percentage of units sold internationally.

**Research and development expenses.** Research and development expenses increased \$1.0 million, from \$5.0 million for the six months ended June 30, 2008 to \$6.0 million for the six months ended June 30, 2009. As a percentage of revenues, research and development expenses increased from 17.7% for the six months ended June 30, 2008 to 22.1% for the six months ended June 30, 2009. The increase was primarily attributable to an increase in expenditures for our ABLATE and EXCLUDE clinical trials of \$0.6 million, an increase in share-based compensation of \$0.4 million and an increase in product development project costs of \$0.4 million.

**Selling, general and administrative expenses.** Selling, general and administrative expenses decreased \$4.9 million, from \$22.4 million for the six months ended June 30, 2008 to \$17.5 million for the six months ended June 30, 2009. The decrease was primarily due to lower headcount-related expenses and travel of \$3.9 million, primarily the result of our reduction in force which occurred in the fourth quarter of 2008 and a \$0.5 million decrease in marketing expenses due primarily to reduced spending in support of tradeshow.



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Those reductions were partially offset by an increase in share-based compensation of \$0.3 million and legal expenses of \$0.2 million related primarily to our DOJ investigation. As a percentage of total revenues, selling, general and administrative expenses decreased from 78.8% for the six months ended June 30, 2008 to 63.7% for the six months ended June 30, 2009.

**Goodwill impairment.** As a result of a reduction in our market capitalization during the first quarter of 2009, we believed an indication of impairment existed and we performed an interim Step 1 analysis of our goodwill as of March 31, 2009. The Step 1 analysis concluded that the carrying value of our goodwill exceeded the estimated fair value, and as such, we recognized a full impairment loss of \$6.8 million as of March 31, 2009. As required, we performed a Step 2 goodwill analysis, which compares the implied fair value of the reporting unit's goodwill with the carrying amount of the goodwill. If the carrying amount of our goodwill exceeds the implied fair value of goodwill, an impairment loss is recognized for an amount equal to that excess. We completed our Step 2 analysis during the three month period ended June 30, 2009. Based on the results of our Step 2 analysis, we concluded our goodwill was fully impaired and that the loss of \$6.8 million on a before and after tax basis was appropriately recorded as of March 31, 2009. This loss was recorded as an increase in operating expenses, loss from operations, and net loss in the Condensed Consolidated Statement of Operation as of March 31, 2009.

**Net interest income (expense).** Net interest income (expense) decreased from \$0.2 million for the six months ended June 30, 2008 to (\$0.3) million for the six months ended June 30, 2009 primarily due to the write-off of deferred financing costs of \$0.1 million in connection with the termination of our credit facility with National City Bank, interest associated with borrowings under the term loan component of our new credit facility and the amortization of the discount on long-term debt related to the warrant issued in conjunction with our new credit facility.

**Other (expense) income.** Other (expense) income consists of foreign currency transaction (loss) gain, grant income and non-employee option (expense) income related to the fair market value change for fully vested options outstanding for consultants, which are accounted for as free standing derivatives. For the six months ended June 30, 2009, other expense of \$0.2 million included \$0.1 million related to foreign currency transaction losses associated with partial settlements of intercompany balances and \$0.1 million of certain non-employee option expense due to an increase in the value of the options. Other income of \$0.4 million for the six months ended June 30, 2008 included income of \$0.2 million associated with a reduction in value of certain non-employee stock options, \$0.1 million related to foreign currency transaction gains associated with the partial settlement of intercompany balances, and \$0.1 million in grant income related to our grant agreement with the Cleveland Clinic Foundation.

### **Liquidity and Capital Resources**

As of June 30, 2009, we had cash, cash equivalents and short-term investments of \$15.7 million and short-term and long-term debt of \$5.8 million (net of \$0.4 million discount on long-debt), resulting in a net cash position of \$9.9 million. We had working capital of \$21.6 million and an accumulated deficit of \$86.9 million.

**Cash flows used in operating activities.** Net cash used in operating activities was \$1.2 million for the six months ended June 30, 2009 and \$6.5 million for the six months ended June 30, 2008. Net cash used in operating activities for the six months ended June 30, 2009 was primarily attributable to the net loss of \$9.4 million, an increase in accounts receivable of \$0.9 million due to an increased mix of international revenues and the timing of revenues within the quarter and a decrease in accounts payable and accrued liabilities of \$1.5 million due primarily to a reduction in our overall expense structure. These uses of cash were offset by a goodwill impairment charge of \$6.8 million and non-cash charges related to share-based compensation of \$2.0 million. Net cash used in operating activities was \$6.5 million for the six months ended June 30, 2008. Net cash used in operating activities for the six months ended June 30, 2008 was primarily attributable to the net loss of \$5.2 million, increases in accounts receivable and inventory of approximately \$2.2 million and \$0.6 million, respectively, and decreases in accounts payable and accrued liabilities of approximately \$1.2 million. Net cash used by operations was partially offset by adjustments for depreciation and amortization of \$1.4 million and non-cash charges related to share-based compensation of \$2.0 million. The increase in accounts receivable was primarily due to an increase in and the timing of revenues. The increase in inventories was primarily related to anticipated growth and new product introductions. The decrease in accounts payable and accrued liabilities was primarily related to payments for year-end legal, accounting, and other professional services, as well as payments to material suppliers.

**Cash flows provided by investing activities.** Net cash provided by investing activities was \$3.2 million for the six months ended June 30, 2009 and \$3.6 million for the six months ended June 30, 2008. Net cash provided by investing activities for the six months ended June 30, 2009 was due to \$6.0 million in positive cash flows related to the release of the restriction on our cash and cash equivalents due to the re-payment of the borrowings under the National City credit facility, partially offset by \$2.0 million in purchases of available-for-sale securities and \$0.8 million in purchases of property and equipment relating primarily to capital equipment loaned to our customers. Net cash provided by investing activities for the six months ended June 30, 2008 was attributable to net purchases and maturities of available-for-sale securities of \$5.1 million, offset by purchases of property and equipment of \$1.1 million relating primarily to capital equipment loaned to our customers and the repayment of a \$0.4 million note associated with our acquisition of a product line.

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**Cash flows provided by (used in) financing activities.** Net cash provided by (used in) financing activities for the six months ended June 30, 2009 and 2008 was \$0.1 million and (\$47,017), respectively. For the six months ended June 30, 2009, cash flows provided by financing activities was attributable to proceeds from borrowings of long-term debt under our new credit facility of \$6.5 million, and \$0.1 million in proceeds from the issuance of common stock under our employee stock purchase plan, offset by payments made on our debt and capital lease obligations of \$6.4 million, including a \$6.0 million repayment in full of our National City credit facility, and \$0.1 million in payment of debt origination fees. For the six months ended June 30, 2008, cash flows used in financing activities included payments made on our debt and capital lease obligations of \$0.2 million, partially offset by proceeds from exercises of stock options of \$0.2 million.

**Credit facility.** On May 1, 2009, we entered into a Loan and Security Agreement (the "Agreement") with Silicon Valley Bank (the "Bank") that provides a term loan and a revolving credit facility under which we can borrow a maximum of \$10.0 million. We have borrowed the maximum amount of \$6.5 million under the term loan. We can borrow up to \$10.0 million under the revolving loan facility with the availability subject to a borrowing base formula. The Agreement also includes up to a \$1.0 million sublimit for stand-by letters of credit. As of June 30, 2009, we have no outstanding borrowings under the revolving loan facility and borrowing availability of approximately \$1.0 million. The Agreement matures on April 30, 2012 and is secured by all of our assets, including intellectual property, and a pledge of sixty-five percent of our stock in our subsidiary, AtriCure Europe, B.V.

Interest on the term loan accrues at a rate of 10.0% per year, and interest on the revolving loan will accrue at a fluctuating rate equal to the Bank's announced prime rate of interest, subject to a floor of 4.0%, plus between 1.0% and 2.0%, depending on our Adjusted Quick Ratio (as defined in the Agreement). Principal on the term loan will be amortized over 36 months of equal principal payments, plus applicable interest. In addition, in connection with the term loan under the Agreement, the Bank received a warrant to purchase 371,732 shares of our common stock at \$1.224 per share, exercisable for a term of 10 years.

As of June 30, 2009, we had no borrowings under the revolving credit facility and borrowings of \$6.1 million under the term loan, which includes approximately \$2.2 million classified as current maturities of long-term debt. We are required to make monthly principal payments on the term loan of \$0.2 million plus interest. The warrant associated with our term loan was recorded as discount on long-term debt at its intrinsic value and is being amortized over the term of the loan. It is reflected as a reduction of long-term debt in our Condensed Consolidated Financial Statements. Amortization expense totaled \$44,657 for the three and six month periods ended June 30, 2009. The effective interest rate on borrowings under the term loan, including amortization of the warrant and debt issuance costs, is 15.2%.

On July 1, 2008 we entered into a two-year credit facility with National City Bank. This credit facility was terminated effective May 1, 2009 and the outstanding balance was repaid in full. As of December 31, 2008, \$6.0 million was outstanding under the credit facility and \$6.0 million was held as restricted cash and cash equivalents and reported as long-term liabilities and assets, respectively.

**Uses of liquidity and capital resources.** Our future capital requirements depend on a number of factors, including possible acquisitions and joint ventures, the rate of market acceptance of our current and future products, the resources we devote to developing and supporting our products, future expenses to expand and support our sales and marketing efforts, costs associated with the Department of Justice investigation, costs relating to changes in regulatory policies or laws that affect our operations and costs of filing, prosecuting, defending and enforcing our intellectual property rights. Global economic turmoil may adversely impact our revenue, access to the capital markets or future demand for our products.

We believe that our current cash, cash equivalents and short-term investments, combined with availability under our revolving loan with Silicon Valley Bank and cash we expect to generate from operations, will be sufficient to meet our anticipated cash needs for working capital and capital expenditures for at least the next 12 months. If these sources of cash are insufficient to satisfy our liquidity requirements, we may seek to sell additional equity or debt securities. The sale of additional equity or convertible debt securities could result in dilution to our stockholders. 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. Further, our credit facility with Silicon Valley Bank limits our ability to secure additional debt.

### **Off-Balance-Sheet Arrangements**

As of June 30, 2009, we had operating lease agreements not recorded on the condensed consolidated balance sheet. Operating leases are utilized in the normal course of business.

### **Seasonality**

During the first quarter, we have historically experienced an increase in our operating expenses and operating loss due to higher selling, general and administrative expenses related primarily to our participation in and attendance at large industry events. During the third quarter, we typically experience a decline in revenues that we attribute primarily to the elective nature of the procedures in which our products are used, which we believe arises from fewer people choosing to undergo elective procedures during the summer months.

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**Critical Accounting Policies and Estimates**

Our discussion and analysis of our financial condition and results of operations is based upon our financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States (“GAAP”). The preparation of financial statements requires management to make estimates and judgments that affect the reported amounts of assets and liabilities, revenues and expenses, and disclosures of contingent assets and liabilities at the date of the financial statements. On a periodic basis, we evaluate our estimates, including those related to sales returns and allowances, accounts receivable, inventories and share-based compensation. We use authoritative pronouncements, historical experience and other assumptions as the basis for making estimates. Actual results could differ from those estimates under different assumptions or conditions. Our Annual Report on Form 10-K for the fiscal year ending December 31, 2008 includes additional information about the Company, our operations, our financial position, our critical accounting policies and accounting estimates and should be read in conjunction with this Quarterly Report.

**Recent Accounting Pronouncements**

Please see Note 2 in the Notes to the Condensed Consolidated Financial Statements for a discussion of recent accounting pronouncements.

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

As of June 30, 2009, there were no material changes to the information provided under Item 7A-Quantitative and Qualitative Disclosures About Market Risk in the Company's Form 10-K for the year ended December 31, 2008.

**Item 4. Controls and Procedures**

**Disclosure Controls and Procedures**

We have evaluated the effectiveness of the design and operation of our disclosure controls and procedures, as defined in Rules 13(a)-15(e) and 15(d)-15(e) of the Securities Exchange Act of 1934 (the "Exchange Act"), as of the end of the period covered by this report. Our management, including the Chief Executive Officer and Chief Financial Officer, supervised and participated in the evaluation. Based on the evaluation, we concluded that, as of the end of the period covered by this report, our disclosure controls and procedures were effective in providing reasonable assurance that information required to be disclosed by us in the reports we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's forms and rules, and the material information relating to the Company is accumulated and communicated to management, including the Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosures.

Control systems, no matter how well designed and operated, can provide only reasonable, not absolute, assurance that control objectives are met. Because of inherent limitations in all control systems, no evaluation of controls can provide assurance that all control issues and instances of fraud, if any, within a company will be detected. Additionally, controls can be circumvented by individuals, by collusion of two or more people, or by management override. Over time, controls can become inadequate because of changes in conditions or the degree of compliance may deteriorate. Further, the design of any system of controls is based in part upon assumptions about the likelihood of future events. There can be no assurance that any design will succeed in achieving its stated goals under all future conditions. Because of the inherent limitations in any cost-effective control system, misstatements due to errors or fraud may occur and not be detected.

**Changes in Internal Control Over Financial Reporting**

There were no changes in our internal control over financial reporting that occurred during the six months ended June 30, 2009 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

## **PART II. OTHER INFORMATION**

### **Item 1. Legal Proceedings**

We are not party to any material pending or threatened litigation, except as described below:

#### *Class Action Lawsuits*

AtriCure, Inc. and certain of its current and former officers were named as defendants in a purported securities class action lawsuit filed in the United States District Court for the Southern District of New York (*Levine v. AtriCure, Inc.*, Case No. 06 CV 14324 (United States District Court for the Southern District of New York)). The suit alleges violations of the federal securities laws and seeks damages on behalf of purchasers of our common stock during the period from our initial public offering in August 2005 through February 16, 2006. We filed a motion to dismiss the lawsuit for lack of subject matter jurisdiction. This motion was denied in September 2007, and a motion for reconsideration of that denial was denied in January 2009. We intend to vigorously defend this lawsuit.

On December 12, 2008 AtriCure, Inc. and certain of its current executive officers were named in a putative class action lawsuit captioned *Halford vs. AtriCure, Inc., et al.*, filed in the U.S. District Court for the Southern District of Ohio, Western Division. The plaintiff alleges violations of Sections 10(b) and 20(a) of the Securities Exchange Act of 1934 and Rule 10b-5 promulgated thereunder and seeks unspecified damages against AtriCure, Inc. and certain of its current executive officers. The plaintiff alleges, among other things, that the defendants issued materially false and misleading statements that failed to disclose that we improperly promoted certain products to physicians and caused the filing of false claims for reimbursement. The class period alleged ran from May 10, 2007 through October 31, 2008. In July 2009, we filed a motion to dismiss. We intend to vigorously defend this lawsuit.

#### *Department of Justice Investigation*

We received a letter on October 27, 2008 from the U.S. Department of Justice-Civil Division (the "DOJ") informing us that the DOJ was conducting an investigation for potential False Claims Act and common law violations relating to our surgical ablation devices. Specifically, the letter states that the DOJ is investigating our marketing practices utilized in connection with our surgical ablation system to treat atrial fibrillation, a specific use outside the Federal Food and Drug Administration's 510(k) clearance. The letter also states that the DOJ is investigating whether we instructed hospitals to bill Medicare for surgical ablation using incorrect billing codes. We have received follow-up requests for documents from the DOJ. We are cooperating with the investigation and continue to operate our business in the ordinary course.

#### *Qui Tam Suit*

A copy of a *qui tam* complaint against us was unsealed on July 10, 2009. The *qui tam* complaint, pending in the U.S. District Court for the Southern District of Texas, was originally filed by a relator in August 2007. The complaint alleges a cause of action under the federal False Claims Act relating to our alleged marketing practices in connection with its surgical cardiac ablation devices. We believe that this complaint is related to the investigation by the Department of Justice. We are currently in the process of evaluating this complaint.

Our liability, if any, resulting from the class action lawsuits, the DOJ investigation and *qui tam* complaint cannot be estimated and as such we have not recorded a liability within the condensed consolidated financial statements in relation to these matters.

We may from time to time become a party to additional legal proceedings.

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

In addition to the other information set forth in this report, careful consideration should be given to the factors discussed in Part I, "Item 1A. Risk Factors" in our Form 10-K for the year ended December 31, 2008, all of which could materially affect our business, financial condition or future results. The risks described are not the only risks facing us. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may adversely affect our business, financial condition and/or operating results.

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

The stockholders of the Company voted on three items at the Annual Meeting of Stockholders held on May 21, 2009:

1. The election of eight directors to terms ending in 2010;
2. A proposal to approve the 2009 Employee Stock Purchase Plan; and
3. A proposal to ratify the appointment of Deloitte & Touche LLP as the Company's independent registered public accounting firm for the fiscal year ending December 31, 2009.

The nominees for director were elected based upon the following votes:

<u>Nominee</u>	<u>Shares Voted For</u>	<u>Shares Withheld</u>
Mark A. Collar	13,524,837	173,470
David J. Drachman	13,517,257	181,050
Donald C. Harrison, M.D.	11,272,092	2,426,215
Michael D. Hooven	13,518,691	179,616
Elizabeth D. Krell, Ph.D.	11,271,992	2,426,315
Richard M. Johnston	13,504,073	194,234
Mark R. Lanning	13,525,537	172,770
Karen P. Robards	11,271,992	2,426,315

The proposal to approve the 2009 Employee Stock Purchase Plan received the following votes:

Votes for approval:	9,220,899
Votes against:	1,508,121
Abstentions:	252,910
Broker non-votes:	2,716,377

The proposal to ratify the appointment of Deloitte & Touche LLP as the Company's independent registered public accounting firm for the fiscal year ending December 31, 2009 received the following votes:

Votes for approval:	11,364,752
Votes against:	13,930
Abstentions:	2,319,624

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### **Item 6. Exhibits**

<u>Exhibit No.</u>	<u>Description</u>
4.1	Warrant to purchase AtriCure, Inc. common stock issued to Silicon Valley Bank on May 1, 2009
10.1	Loan and Security Agreement, dated as of May 1, 2009, between Silicon Valley Bank and AtriCure, Inc.
31.1	Rule 13a-14(a) Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Rule 13a-14(a) Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1	Certification pursuant to 18 U.S.C. Section 1350 by the Chief Executive Officer, as adopted, pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32.2	Certification pursuant to 18 U.S.C. Section 1350 by the Chief Financial Officer, as adopted, pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

**SIGNATURES**

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

AtriCure, Inc.  
(REGISTRANT)

Date: August 10, 2009

/s/ David J. Drachman  
\_\_\_\_\_  
David J. Drachman  
President and Chief Executive Officer  
(Principal Executive Officer)

Date: August 10, 2009

/s/ Julie A. Piton  
\_\_\_\_\_  
Julie A. Piton  
Vice President, Finance and Administration and Chief Financial Officer  
(Principal Financial and Accounting Officer)



**EXHIBIT INDEX**

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32.1	Certification pursuant to 18 U.S.C. Section 1350 by the Chief Executive Officer, as adopted, pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32.2	Certification pursuant to 18 U.S.C. Section 1350 by the Chief Financial Officer, as adopted, pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

THIS WARRANT AND THE SHARES ISSUABLE HEREUNDER HAVE NOT BEEN REGISTERED UNDER THE SECURITIES ACT OF 1933, AS AMENDED (THE "ACT"), OR THE SECURITIES LAWS OF ANY STATE AND, EXCEPT AND PURSUANT TO THE PROVISIONS OF ARTICLE 5 BELOW, MAY NOT BE OFFERED, SOLD OR OTHERWISE TRANSFERRED, PLEDGED OR HYPOTHECATED UNLESS AND UNTIL REGISTERED UNDER SAID ACT AND APPLICABLE STATE SECURITIES LAW OR, IN THE OPINION OF LEGAL COUNSEL IN FORM AND SUBSTANCE SATISFACTORY TO THE ISSUER OF THESE SECURITIES, SUCH OFFER, SALE OR TRANSFER, PLEDGE OR HYPOTHECATION IS EXEMPT FROM REGISTRATION.

### WARRANT TO PURCHASE STOCK

Company: AtriCure, Inc., a Delaware corporation  
 Number of Shares: 371,732  
 Class of Stock: Common Stock  
 Warrant Price: \$1.224 per share  
 Issue Date: May 1, 2009  
 Expiration Date: The 10th anniversary after the Issue Date  
 Credit Facility: This Warrant is issued in connection with the Term Loan referenced in the Loan and Security Agreement between Company and Silicon Valley Bank dated May 1, 2009.

THIS WARRANT CERTIFIES THAT, for good and valuable consideration, SILICON VALLEY BANK (Silicon Valley Bank, together with any registered holder from time to time of this Warrant or any holder of the shares issuable or issued upon exercise of this Warrant, "Holder") is entitled to purchase the number of fully paid and nonassessable shares of the class of securities (the "Shares") of the Company at the Warrant Price, all as set forth above and as adjusted pursuant to Article 2 of this Warrant, subject to the provisions and upon the terms and conditions set forth in this Warrant.

#### ARTICLE 1. EXERCISE.

1.1 Method of Exercise. Holder may exercise this Warrant, in whole or part, by delivering a duly executed Notice of Exercise in substantially the form attached as Appendix 1 to the principal office of the Company. Unless Holder is exercising the conversion right set forth in Article 1.2, Holder shall also deliver to the Company a check, wire transfer (to an account designated by the Company), or other form of payment acceptable to the Company for the aggregate Warrant Price for the Shares being purchased.

1.2 Conversion Right. In lieu of exercising this Warrant as specified in Article 1.1, Holder may from time to time convert this Warrant, in whole or in part, into a number of Shares determined by dividing (a) the aggregate fair market value of the Shares or other securities otherwise issuable upon exercise of this Warrant minus the aggregate Warrant Price of such Shares by (b) the fair market value of one Share. The fair market value of the Shares shall be determined pursuant to Article 1.3.

1.3 Fair Market Value. If the Company's common stock is traded in a public market and the Shares are common stock, the fair market value of each Share shall be the closing price of a Share reported for the business day immediately before Holder delivers its Notice of Exercise to the Company. If the Company's common stock is traded in a public market and the Shares are preferred stock, the fair market value of a Share shall be the closing price of a share of the Company's common stock reported for the business day immediately before Holder delivers its Notice of Exercise to the Company, multiplied by the number of shares of the Company's common stock into which a Share is convertible. If the Company's common stock is not traded in a public market, the Board of Directors of the Company shall determine fair market value in its reasonable good faith judgment.

1.4 Delivery of Certificate and New Warrant. Promptly after Holder exercises or converts this Warrant and, other than in connection with a conversion set forth in Article 1.2, the Company receives payment of the aggregate Warrant Price, the Company shall deliver to Holder certificates for the Shares acquired and, if this Warrant has not been fully exercised or converted and has not expired, a new Warrant representing the Shares not so acquired.

1.5 Replacement of Warrants. On receipt of evidence reasonably satisfactory to the Company of the loss, theft, destruction or mutilation of this Warrant and, in the case of loss, theft or destruction, on delivery of an indemnity agreement reasonably satisfactory in form and amount to the Company or, in the case of mutilation on surrender and cancellation of this Warrant, the Company shall execute and deliver, in lieu of this Warrant, a new warrant of like tenor, terms and amount.

1.6 Treatment of Warrant Upon Acquisition of Company.

1.6.1 "Acquisition". For the purpose of this Warrant, "Acquisition" means any sale, license, or other disposition of all or substantially all of the assets of the Company, or any reorganization, consolidation, or merger of the Company where the holders of the Company's securities before the transaction beneficially own less than 50% of the outstanding voting securities of the surviving entity after the transaction.

1.6.2 Treatment of Warrant at Acquisition.

A) Upon the written request of the Company, Holder agrees that, in the event of an Acquisition that is not an asset sale and in which the sole consideration is cash, either (a) Holder shall exercise its conversion or purchase right under this Warrant and such exercise will be deemed effective immediately prior to the consummation of such Acquisition or (b) if Holder elects not to exercise the Warrant, this Warrant will expire upon the consummation of such Acquisition. The Company shall provide Holder with written notice of its request relating to the foregoing (together with such reasonable information as Holder may request in connection with such contemplated Acquisition giving rise to such notice), which is to be delivered to Holder not less than ten (10) days prior to the closing of the proposed Acquisition.

B) Upon the written request of the Company, Holder agrees that, in the event of an Acquisition that is an "arms length" sale of all or substantially all of the Company's assets (and only its assets) to a third party (a "True Asset Sale"), either (a) Holder shall

exercise its conversion or purchase right under this Warrant and such exercise will be deemed effective immediately prior to the consummation of such Acquisition or (b) if Holder elects not to exercise the Warrant, this Warrant will continue until the Expiration Date. The Company shall provide Holder with written notice of its request relating to the foregoing (together with such reasonable information as Holder may request in connection with such contemplated Acquisition giving rise to such notice), which is to be delivered to Holder not less than ten (10) days prior to the closing of the proposed Acquisition.

C) Upon the closing of any Acquisition other than those particularly described in subsections (A) and (B) above, the successor entity shall assume the obligations of this Warrant, and this Warrant shall be exercisable for the same securities, cash, and property as would be payable for the Shares issuable upon exercise of the unexercised portion of this Warrant as if such Shares were outstanding on the record date for the Acquisition and subsequent closing. The Warrant Price and/or number of Shares shall be adjusted accordingly.

## ARTICLE 2. ADJUSTMENTS TO THE SHARES.

2.1 Stock Dividends, Splits, Etc. If the Company declares or pays a dividend on the Shares payable in common stock, or other securities, then upon exercise of this Warrant, for each Share acquired, Holder shall receive, without cost to Holder, the total number and kind of securities to which Holder would have been entitled had Holder owned the Shares of record as of the record date for the dividend payment. If the Company subdivides the Shares by reclassification or otherwise into a greater number of shares or takes any other action which increase the amount of stock into which the Shares are convertible, the number of shares purchasable hereunder shall be proportionately increased and the Warrant Price shall be proportionately decreased. If the outstanding shares are combined or consolidated, by reclassification or otherwise, into a lesser number of shares, the Warrant Price shall be proportionately increased and the number of Shares shall be proportionately decreased.

2.2 Reclassification, Exchange, Combinations or Substitution. Upon any reclassification, exchange, substitution, or other event that results in a change of the number and/or class of the securities issuable upon exercise or conversion of this Warrant, Holder shall be entitled to receive, upon exercise or conversion of this Warrant, the number and kind of securities and property that Holder would have received for the Shares if this Warrant had been exercised immediately before such reclassification, exchange, substitution, or other event. Such an event shall include any automatic conversion of the outstanding or issuable securities of the Company of the same class or series as the Shares to common stock pursuant to the terms of the Company's Articles or Certificate (as applicable) of Incorporation upon the closing of a registered public offering of the Company's common stock. The Company or its successor shall promptly issue to Holder an amendment to this Warrant setting forth the number and kind of such new securities or other property issuable upon exercise or conversion of this Warrant as a result of such reclassification, exchange, substitution or other event that results in a change of the number and/or class of securities issuable upon exercise or conversion of this Warrant. The amendment to this Warrant shall provide for adjustments which shall be as nearly equivalent as may be practicable to the adjustments provided for in this Article 2 including, without limitation, adjustments to the Warrant Price and to the

number of securities or property issuable upon exercise of the new Warrant. The provisions of this Article 2.2 shall similarly apply to successive reclassifications, exchanges, substitutions, or other events.

2.3 [Reserved].

2.4 No Impairment. The Company shall not, by amendment of its Articles or Certificate (as applicable) of Incorporation or through a reorganization, transfer of assets, consolidation, merger, dissolution, issue, or sale of securities or any other voluntary action, avoid or seek to avoid the observance or performance of any of the terms to be observed or performed under this Warrant by the Company, but shall at all times in good faith assist in carrying out of all the provisions of this Article 2 and in taking all such action as may be necessary or appropriate to protect Holder's rights under this Article.

2.5 Fractional Shares. No fractional Shares shall be issuable upon exercise or conversion of this Warrant and the number of Shares to be issued shall be rounded down to the nearest whole Share. If a fractional share interest arises upon any exercise or conversion of the Warrant, the Company shall eliminate such fractional share interest by paying Holder the amount computed by multiplying the fractional interest by the fair market value of a full Share as determined pursuant to Article 1.3 hereof.

2.6 Certificate as to Adjustments. Upon each adjustment of the Warrant Price and/or number of Shares, the Company shall promptly notify Holder in writing, and, at the Company's expense, promptly compute such adjustment, and furnish Holder with a certificate from its Chief Financial Officer setting forth such adjustment and the facts upon which such adjustment is based. The Company shall, upon written request, furnish Holder a certificate setting forth the Warrant Price and number of Shares in effect upon the date thereof and the series of adjustments leading to such Warrant Price and number of Shares.

ARTICLE 3. REPRESENTATIONS AND COVENANTS OF THE COMPANY.

3.1 Representations and Warranties. The Company represents and warrants to Holder as follows:

(a) All Shares which may be issued upon the exercise of the purchase right represented by this Warrant, and all securities, if any, issuable upon conversion of the Shares, shall, upon issuance, be duly authorized, validly issued, fully paid and nonassessable, and free of any liens and encumbrances except for restrictions on transfer provided for herein or under applicable federal and state securities laws.

(b) The Company's capitalization table attached hereto as Schedule 1 is true and complete as of the Issue Date.

3.2 Notice of Certain Events. If the Company proposes at any time (a) to declare any dividend or distribution upon any of its stock, whether in cash, property, stock, or other securities and whether or not a regular cash dividend; (b) to offer for sale any shares of the Company's capital stock (or other securities convertible into such capital stock), other than (i) pursuant to the Company's stock option or other

compensatory plans, (ii) in connection with commercial credit arrangements or equipment financings, or (iii) in connection with strategic transactions for purposes other than capital raising; (c) to effect any reclassification or recapitalization of any of its stock; (d) to merge or consolidate with or into any other corporation, or sell, lease, license, or convey all or substantially all of its assets, or to liquidate, dissolve or wind up; or (e) offer holders of registration rights the opportunity to participate in an underwritten public offering of the Company's securities for cash, then, in connection with each such event, the Company shall give Holder: (1) at least 10 days prior written notice of the date on which a record will be taken for such dividend, distribution, or subscription rights (and specifying the date on which the holders of common stock will be entitled thereto) or for determining rights to vote, if any, in respect of the matters referred to in (a) and (b) above; (2) in the case of the matters referred to in (c) and (d) above at least 10 days prior written notice of the date when the same will take place (and specifying the date on which the holders of common stock will be entitled to exchange their common stock for securities or other property deliverable upon the occurrence of such event); and (3) in the case of the matter referred to in (e) above, the same notice as is given to the holders of such registration rights. Notwithstanding the foregoing, the Company shall not be required to provide such a notice described in subpart (1) or (2) above to the extent that the information to be included in the notice is available publicly pursuant to a filing made by the Company with the Securities and Exchange Commission (even if such information is not required to be filed with the Securities and Exchange Commission within the same time period for which the Company would otherwise have been required to provide such information to the Holder pursuant to the foregoing). Company will also provide information requested by Holder reasonably necessary to enable Holder to comply with Holder's accounting or reporting requirements.

3.3 Registration Under Securities Act of 1933, as amended. The Company agrees that the Shares shall have "piggyback" and "S-3" registration rights pursuant to and as set forth in Sections 2.3 and 2.4 of the Amended and Restated Investors' Rights Agreement dated as of June 6, 2002, as amended March 8, 2005 (as amended, the "Investors' Rights Agreement"), among the Company and the Investors (the "IRA Holders") listed in such Investors' Rights Agreement, provided however that should the "piggyback" or "S-3" registration involve an underwriting and should the managing underwriter limit the number of shares to be underwritten, no Shares shall be included in such "piggyback" or "S-3" registration pursuant to the terms of this Section 3.3 unless all shares requested to be included by the IRA Holders are so included. The provisions set forth in the Investors' Rights Agreement in effect as of the Issue Date may not be amended, modified or waived without the prior written consent of Holder unless such amendment, modification or waiver affects the rights associated with the Shares in the same manner as such amendment, modification, or waiver affects the rights associated with all shares held by the IRA Holders. In the event of any conflict between the "piggyback" and "S-3" registration rights granted pursuant to this Section 3.3 and the provisions of the Investors' Rights Agreement, Holder acknowledges and agrees that the terms of the Investors' Rights Agreement shall control.

3.4 No Shareholder Rights. Except as provided in this Warrant, Holder will not have any rights as a shareholder of the Company until the exercise of this Warrant.

ARTICLE 4. REPRESENTATIONS, WARRANTIES OF HOLDER. Holder represents and warrants to the Company as follows:

4.1 Purchase for Own Account. This Warrant and the securities to be acquired upon exercise of this Warrant by Holder will be acquired for investment for Holder's account, not as a nominee or agent, and not with a view to the public resale or distribution within the meaning of the Act. Holder also represents that Holder has not been formed for the specific purpose of acquiring this Warrant or the Shares.

4.2 Disclosure of Information. Holder has received or has had full access to all the information (including all reports, accounts and other information filed with the Securities and Exchange Commission) it considers necessary or appropriate to make an informed investment decision with respect to the acquisition of this Warrant and its underlying securities. Holder further has had an opportunity to ask questions and receive answers from the Company regarding the terms and conditions of the offering of this Warrant and its underlying securities and to obtain additional information (to the extent the Company possessed such information or could acquire it without unreasonable effort or expense) necessary to verify any information furnished to Holder or to which Holder has access.

4.3 Investment Experience. Holder understands that the purchase of this Warrant and its underlying securities involves substantial risk. Holder has experience as an investor in securities of companies in the development stage and acknowledges that Holder can bear the economic risk of such Holder's investment in this Warrant and its underlying securities and has such knowledge and experience in financial or business matters that Holder is capable of evaluating the merits and risks of its investment in this Warrant and its underlying securities and/or has a preexisting personal or business relationship with the Company and certain of its officers, directors or controlling persons of a nature and duration that enables Holder to be aware of the character, business acumen and financial circumstances of such persons.

4.4 Accredited Investor Status. Holder is an "accredited investor" within the meaning of Regulation D promulgated under the Act.

4.5 The Act. Holder understands that this Warrant and the Shares issuable upon exercise or conversion hereof have not been registered under the Act in reliance upon a specific exemption therefrom, which exemption depends upon, among other things, the bona fide nature of Holder's investment intent as expressed herein. Holder understands that this Warrant and the Shares issued upon any exercise or conversion hereof must be held indefinitely unless subsequently registered under the Act and qualified under applicable state securities laws, or unless exemption from such registration and qualification is otherwise available.

ARTICLE 5. MISCELLANEOUS.

5.1 Term. This Warrant is exercisable in whole or in part at any time and from time to time on or before the Expiration Date.

5.2 Legends. This Warrant and the Shares (and the securities issuable, directly or indirectly, upon conversion of the Shares, if any) shall be imprinted with a legend in substantially the following form:

THIS WARRANT AND THE SHARES ISSUABLE HEREUNDER HAVE

NOT BEEN REGISTERED UNDER THE SECURITIES ACT OF 1933, AS AMENDED (THE "ACT"), OR THE SECURITIES LAWS OF ANY STATE AND, EXCEPT AND PURSUANT TO THE PROVISIONS OF ARTICLE 5 BELOW, MAY NOT BE OFFERED, SOLD OR OTHERWISE TRANSFERRED, PLEDGED OR HYPOTHECATED UNLESS AND UNTIL REGISTERED UNDER SAID ACT AND APPLICABLE STATE SECURITIES LAW OR, IN THE OPINION OF LEGAL COUNSEL IN FORM AND SUBSTANCE SATISFACTORY TO THE ISSUER OF THESE SECURITIES, SUCH OFFER, SALE OR TRANSFER, PLEDGE OR HYPOTHECATION IS EXEMPT FROM REGISTRATION.

5.3 Compliance with Securities Laws on Transfer. This Warrant and the Shares issuable upon exercise of this Warrant (and the securities issuable, directly or indirectly, upon conversion of the Shares, if any) may not be transferred or assigned in whole or in part without compliance with applicable federal and state securities laws by the transferor and the transferee (including, without limitation, the delivery of investment representation letters and legal opinions reasonably satisfactory to the Company, as reasonably requested by the Company). The Company shall not require Silicon Valley Bank ("Bank") to provide an opinion of counsel if the transfer is to Bank's parent company, SVB Financial Group (formerly Silicon Valley Bancshares), or any other affiliate of Bank (but may require customary representations and warranties similar to those set forth in Article 4 hereof). Additionally, the Company shall also not require an opinion of counsel if there is no material question as to the availability of current information as referenced in Rule 144(c), Holder represents that it has complied with Rule 144(d) and (e) in reasonable detail, the selling broker represents that it has complied with Rule 144(f), and the Company is provided with a copy of Holder's notice of proposed sale.

5.4 Transfer Procedure. After receipt by Bank of the executed Warrant, Bank will transfer all of this Warrant to SVB Financial Group by execution of an Assignment substantially in the form of Appendix 2. Subject to the provisions of Article 5.3 and upon providing the Company with written notice, SVB Financial Group and any subsequent Holder may transfer all or part of this Warrant or the Shares issuable upon exercise of this Warrant (or the Shares issuable directly or indirectly, upon conversion of the Shares, if any) to any transferee, provided, however, in connection with any such transfer, SVB Financial Group or any subsequent Holder will give the Company notice of the portion of the Warrant being transferred with the name, address and taxpayer identification number of the transferee and Holder will surrender this Warrant to the Company for reissuance to the transferee(s) (and Holder if applicable). The Company may refuse to transfer this Warrant or the Shares to any person who directly competes with the Company.

5.5 Notices. All notices and other communications from the Company to Holder, or vice versa, shall be deemed delivered and effective when given personally or mailed by first-class registered or certified mail, postage prepaid, at such address as may have been furnished to the Company or Holder, as the case may (or on the first business day after transmission by facsimile) be, in writing by the Company or such Holder from time to time. Effective upon receipt of the fully executed Warrant and the initial transfer described in Article 5.4 above, all notices to Holder shall be addressed as follows until the Company receives notice of a change of address in connection with a transfer or otherwise:

SVB Financial Group  
Attn: Treasury Department  
3003 Tasman Drive, HA 200  
Santa Clara, CA 95054  
Telephone: 408-654-7400  
Facsimile: 408-496-2405



Notice to the Company shall be addressed as follows until Holder receives notice of a change in address:

AtriCure, Inc.  
Attn: Julie A. Piton  
6033 Schumacher Park Drive  
West Chester, OH 45069  
Telephone: (513) 755-4561  
Facsimile: (513) 644-1315

5.6 Waiver. This Warrant and any term hereof may be changed, waived, discharged or terminated only by an instrument in writing signed by the party against which enforcement of such change, waiver, discharge or termination is sought.

5.7 Attorneys' Fees. In the event of any dispute between the parties concerning the terms and provisions of this Warrant, the party prevailing in such dispute shall be entitled to collect from the other party all costs incurred in such dispute, including reasonable attorneys' fees.

5.8 Automatic Conversion upon Expiration. In the event that, upon the Expiration Date, the fair market value of one Share (or other security issuable upon the exercise hereof) as determined in accordance with Section 1.3 above is greater than the Warrant Price in effect on such date, then this Warrant shall automatically be deemed on and as of such date to be converted pursuant to Section 1.2 above as to all Shares (or such other securities) for which it shall not previously have been exercised or converted, and the Company shall promptly deliver a certificate representing the Shares (or such other securities) issued upon such conversion to Holder.

5.9 Counterparts. This Warrant may be executed in counterparts, all of which together shall constitute one and the same agreement.

5.10 Governing Law. This Warrant shall be governed by and construed in accordance with the laws of the State of Delaware, without giving effect to its principles regarding conflicts of law.

[Signature page follows.]

“COMPANY”

ATRICURE, INC.

By: /s/ David J. Drachman  
Name: David J. Drachman  
(Print)  
Title: Chairman of the Board, President or Vice President

By: /s/ Julie A. Piton  
Name: Julie A. Piton  
(Print)  
Title: Chief Financial Officer, Secretary, Assistant Treasurer or Assistant Secretary

“HOLDER”

SILICON VALLEY BANK

By: /s/ Janice Galbavy  
Name: Janice Galbavy  
(Print)  
Title: Relationship Manager

SCHEDULE 1

CAPITALIZATION TABLE

ATRICURE, INC.

As of April 24, 2009

Basic Shares outstanding	14,335,993
Restricted stock outstanding	<u>414,068</u>
Adjusted shares outstanding	14,750,061
Options outstanding	2,577,894
Performance shares outstanding	482,000
Warrants outstanding	<u>0</u>
Fully diluted Shares outstanding	<u><u>17,809,955</u></u>

**APPENDIX 1**

**NOTICE OF EXERCISE**

1. Holder elects to purchase \_\_\_\_\_ shares of the Common Stock of AtriCure, Inc. pursuant to the terms of the attached Warrant, and tenders payment of the purchase price of the shares in full.

[or]

1. Holder elects to convert the attached Warrant into Shares/cash [strike one] in the manner specified in the Warrant. This conversion is exercised for \_\_\_\_\_ of the Shares covered by the Warrant.

[Strike paragraph that does not apply.]

2. Please issue a certificate or certificates representing the shares in the name specified below:

\_\_\_\_\_  
Holder's Name

\_\_\_\_\_

\_\_\_\_\_  
(Address)

3. By its execution below and for the benefit of the Company, Holder hereby restates each of the representations and warranties in Article 4 of the Warrant as the date hereof.

HOLDER:

\_\_\_\_\_  
By: \_\_\_\_\_  
Name: \_\_\_\_\_  
Title: \_\_\_\_\_  
(Date): \_\_\_\_\_

**APPENDIX 2**

**ASSIGNMENT**

For value received, Silicon Valley Bank hereby sells, assigns and transfers unto

Name: SVB Financial Group  
Address: 3003 Tasman Drive (HA-200)  
Santa Clara, CA 95054  
  
Tax ID: 91-1962278

that certain Warrant to Purchase Stock issued by AtriCure, Inc. (the "Company"), on interest therein.

, 2009 (the "Warrant") together with all rights, title and

SILICON VALLEY BANK

By: \_\_\_\_\_  
Name: \_\_\_\_\_  
Title: \_\_\_\_\_

Date: \_\_\_\_\_

By its execution below, and for the benefit of the Company, SVB Financial Group makes each of the representations and warranties set forth in Article 4 of the Warrant and agrees to all other provisions of the Warrant as of the date hereof.

SVB FINANCIAL GROUP

By: \_\_\_\_\_  
Name: \_\_\_\_\_  
Title: \_\_\_\_\_

## LOAN AND SECURITY AGREEMENT

THIS LOAN AND SECURITY AGREEMENT (this “**Agreement**”) dated as of May 1, 2009 (the “**Effective Date**”) between **SILICON VALLEY BANK**, a California corporation (“**Bank**”), and **ATRICURE, INC.**, a Delaware corporation (“**Borrower**”), provides the terms on which Bank shall lend to Borrower and Borrower shall repay Bank. The parties agree as follows:

**1 ACCOUNTING AND OTHER TERMS**

Accounting terms not defined in this Agreement shall be construed following GAAP. Calculations and determinations must be made following GAAP, unless provided otherwise herein. Capitalized terms not otherwise defined in this Agreement shall have the meanings set forth in Section 13. All other terms contained in this Agreement, unless otherwise indicated, shall have the meaning provided by the Code to the extent such terms are defined therein.

**2 LOAN AND TERMS OF PAYMENT**

**2.1 Promise to Pay.** Borrower hereby unconditionally promises to pay Bank the outstanding principal amount of all Credit Extensions and accrued and unpaid interest thereon as and when due in accordance with this Agreement.

**2.1.1 Revolving Advances.**

(a) Availability. Subject to the terms and conditions of this Agreement and to deduction of Reserves, Bank shall make Advances not exceeding the Availability Amount. Amounts borrowed hereunder may be repaid and, prior to the Revolving Line Maturity Date, reborrowed, subject to the applicable terms and conditions precedent herein.

(b) Streamline Period. During certain periods of time (each, a “**Streamline Period**”), provided that the Streamline Requirements are all met, Borrower’s reporting requirements shall be reduced, and certain proceeds shall be deposited in Borrower’s operating account instead of being applied to the Advances, as set forth in other provisions of this Agreement. Such a Streamline Period shall be deemed to be in effect as of the Effective Date. If at any time during any Streamline Period the Streamline Requirements are not met, the Streamline Period shall immediately cease to be effective, and any terms or conditions of this Agreement that are dependent upon the existence of a Streamline Period will immediately revert to the respective terms and conditions that are to be in force when a Streamline Period is not in effect, without the need for any further action on the part of Bank or Borrower. Further, if following the cessation of a Streamline Period the Streamline Requirements are thereafter satisfied for 90 consecutive days, Borrower may elect to again put a Streamline Period into effect pursuant to the terms hereof by giving Bank at least 10 days prior written notice, specifying the date the Streamline Period is to begin. Thus, it is the intention of the parties that Borrower have the opportunity for successive Streamline Periods to apply when and to the extent the conditions thereto are satisfied.

(c) Termination; Repayment. The Revolving Line terminates on the Revolving Line Maturity Date, when the principal amount of all Advances, the unpaid interest thereon, and all other Obligations relating to the Revolving Line shall be immediately due and payable.

**2.1.2 Letters of Credit Sublimit.**

(a) As part of the Revolving Line, Bank shall issue or have issued Letters of Credit denominated in Dollars or a Foreign Currency for Borrower’s account. The aggregate Dollar Equivalent amount utilized for the issuance of Letters of Credit shall at all times reduce the amount otherwise available for Advances under the Revolving Line (as specified in the definition of Availability Amount). The aggregate Dollar Equivalent of the face amount of outstanding Letters of Credit (including drawn but unreimbursed Letters of Credit) may not exceed the lesser of (A) One Million Dollars (\$1,000,000), minus the sum of all amounts used for Cash Management Services, or (B) the lesser of Net Maximum Dollar Amount or the Borrowing Base, minus the sum of all outstanding principal amounts of any Advances (including any amounts used for Cash Management Services).

(b) If, on the Revolving Line Maturity Date (or the effective date of any termination of this Agreement), there are any outstanding Letters of Credit, then on such date Borrower shall provide to Bank cash collateral in an amount equal to 105% of the Dollar Equivalent of the face amount of all such Letters of Credit, to secure all of the Obligations relating to such Letters of Credit. All Letters of Credit shall be in form and substance acceptable to Bank in its sole discretion and shall be subject to the terms and conditions of Bank's standard Application and Letter of Credit Agreement (the "**Letter of Credit Application**"). Borrower agrees to execute any further documentation in connection with the Letters of Credit as Bank may reasonably request. Borrower further agrees to be bound by the regulations and interpretations of the issuer of any Letters of Credit guaranteed by Bank and opened for Borrower's account or by Bank's interpretations of any Letter of Credit issued by Bank for Borrower's account, and Borrower understands and agrees that Bank shall not be liable for any error, negligence, or mistake, whether of omission or commission, in following, in good faith, Borrower's instructions or those contained in the Letters of Credit or any modifications, amendments, or supplements thereto.

(c) The obligation of Borrower to immediately reimburse Bank for drawings made under Letters of Credit shall be absolute, unconditional, and irrevocable, and shall be performed strictly in accordance with the terms of this Agreement, such Letters of Credit, and the Letter of Credit Application.

(d) Bank shall not be required to issue any Letter of Credit payable in a Foreign Currency.

### 2.1.3 [Reserved].

**2.1.4 Cash Management Services Sublimit.** Borrower may use the Revolving Line for Bank's cash management services, which may include merchant services, direct deposit of payroll, business credit card, and check cashing services identified in Bank's various cash management services agreements (collectively, the "**Cash Management Services**"), in an aggregate amount not to exceed the lesser of (A) One Million Dollars (\$1,000,000), minus the aggregate Dollar Equivalent of the face amount of any outstanding Letters of Credit (including drawn but unreimbursed Letters of Credit), or (B) the lesser of Net Maximum Dollar Amount or the Borrowing Base, minus (i) the sum of all outstanding principal amounts of any Advances, and minus (ii) the Dollar Equivalent of the face amount of any outstanding Letters of Credit (including drawn but unreimbursed Letters of Credit). Any amounts Bank pays on behalf of Borrower for any Cash Management Services will be treated as Advances under the Revolving Line and will accrue interest at the interest rate applicable to Advances.

### 2.1.5 Term Loan.

(a) Availability. Bank shall make one (1) term loan (the "**Term Loan**") available to Borrower in the amount of \$6,500,000 (the "**Term Loan Amount**") within ten (10) days from the Effective Date subject to the satisfaction of the terms and conditions of this Agreement. After repayment, the Term Loan may not be re-borrowed.

(b) Repayment. Borrower shall repay the Term Loan in thirty-six (36) installments of principal equal to \$180,555.56 each, beginning on May 31, 2009 and continuing on the last day of each month thereafter until April 30, 2012 (the "**Term Loan Maturity Date**"), on which date all outstanding principal and accrued and unpaid interest under the Term Loan shall be paid in full.

(c) Fee and Final Payment Due Upon Acceleration. If all or any portion of the Term Loan becomes due and payable according to the terms hereof because of the occurrence and continuance of an Event of Default, Borrower shall pay to Bank on the date that it has become due and payable according to the terms hereof, in addition to any other sums owing, a fee equal to the Make-Whole Premium. Without limitation on the fact that such fee shall be due as set forth in the preceding sentence, such fee shall bear interest until paid at a rate equal to the highest rate applicable to the Obligations.

(d) Permitted Prepayment of Loans. Borrower shall have the option to prepay all, but not less than all, of the Term Loan (a "**Voluntary Term Loan Prepayment**"), provided Borrower (i) provides written notice to Bank of its election to prepay the Term Loan at least five (5) days prior to such prepayment, and (ii) pays, on the date of such prepayment (A) all outstanding principal plus accrued interest, (B) a fee equal to the Make-Whole Premium, plus (C) all other sums, if any, that shall have become due and payable; provided that no Make-Whole Premium fee shall be charged if the Term Loan is replaced with a new facility from the Bank. Without limitation on the fact that such fee shall be due on the date of the prepayment, such fee shall bear interest until paid at a rate equal to the highest rate applicable to the Obligations.

**2.2 Overadvances.** If, at any time, the sum of (a) the outstanding principal amount of any Advances (including any amounts used for Cash Management Services), plus (b) the face amount of any outstanding Letters of Credit (including drawn but unreimbursed Letters of Credit), exceeds the lesser of either the Net Maximum Dollar Amount or the Borrowing Base (such excess being an “**Overadvance**”), Borrower shall immediately pay to Bank in cash such Overadvance. Without limiting Borrower’s obligation to repay Bank any amount of the Overadvance, Borrower agrees to pay Bank interest on the outstanding amount of any Overadvance, on demand, at the Default Rate.

**2.3 Payment of Interest on the Credit Extensions.**

(a) Interest Rate.

(i) Advances. Subject to Section 2.3(b), the principal amount outstanding under the Revolving Line shall accrue interest at a floating per annum rate based on Borrower’s Adjusted Quick Ratio (and the existence or non-existence of an Event of Default) as set forth below, which interest shall be payable monthly in accordance with Section 2.3(f) below.

<u>Adjusted Quick Ratio as of the end of a month and Event of Default status</u>	<u>Interest Rate</u>
Greater than or equal to 2 to 1, and no Event of Default has occurred and is continuing	One percentage point (1.0%) above the Base Rate (the “ <b>First Tier Rate</b> ”)
Greater than or equal to 1.5 to 1 but less than 2 to 1, and no Event of Default has occurred and is continuing	One and one-half percentage points (1.5%) above the Base Rate (the “ <b>Second Tier Rate</b> ”)
Less than 1.5 to 1, or an Event of Default has occurred and is continuing	Two percentage points (2.0%) above the Base Rate (the “ <b>Regular Rate</b> ”)

The initial interest rate in effect on the date hereof shall be the First Tier Rate. Changes in the interest rate based on the Borrower’s Adjusted Quick Ratio as provided above shall go into effect as of the first day of the month following the month in which Borrower’s financial statements are received by Bank. If, based on the Adjusted Quick Ratio as shown in Borrower’s financial statements there is to be an increase in the interest rate, the interest rate increase may be put into effect by Bank as of the first day of the month following the month in which Borrower’s financial statements were due, even if the delivery of the financial statements is delayed. The Regular Rate shall go into effect immediately upon the occurrence and during the continuance of an Event of Default unless Bank otherwise elects from time to time in its sole discretion to delay its effect of impose a smaller increase.

(ii) Term Loan. Subject to Section 2.3(b), the principal amount outstanding under the Term Loan shall accrue interest at a per annum rate equal to 10%, which interest shall be payable monthly in accordance with Section 2.3(f) below.

(b) Default Rate. Immediately upon the occurrence and during the continuance of an Event of Default, Obligations shall bear interest at a rate per annum which is three percentage points (3.00%) above the rate that is otherwise applicable thereto (the “**Default Rate**”) unless Bank otherwise elects from time to time in its sole discretion to impose a smaller increase. Fees and expenses which are required to be paid by Borrower pursuant to the Loan Documents (including, without limitation, Bank Expenses) but are not paid when due shall bear interest until paid at a rate equal to the highest rate applicable to the Obligations. Payment or acceptance of the increased interest rate provided in this Section 2.3(b) is not a permitted alternative to timely payment and shall not constitute a waiver of any Event of Default or otherwise prejudice or limit any rights or remedies of Bank.

(c) Adjustment to Interest Rate. Changes to the interest rate of any Credit Extension based on changes to the Prime Rate shall be effective on the effective date of any change to the Prime Rate and to the extent of any such change.



(d) **Debit of Accounts.** Bank may debit any of Borrower's deposit accounts, including the Designated Deposit Account, for principal and interest payments or any other amounts Borrower owes Bank when due. These debits shall not constitute a set-off.

(e) **[Reserved].**

(f) **Payment; Interest Computation; Float Charge.** Interest is payable monthly on the last calendar day of each month and shall be computed on the basis of a 360-day year for the actual number of days elapsed. In computing interest, (i) all Payments received on or before 12:00 p.m. Pacific time on any Business Day shall be deemed received on such Business Day, (ii) all Payments received after 12:00 p.m. Pacific time on any day shall be deemed received at the opening of business on the next Business Day, and (iii) the date of the making of any Credit Extension shall be included and the date of payment shall be excluded; *provided, however,* that if any Credit Extension is repaid on the same day on which it is made, such day shall be included in computing interest on such Credit Extension. In addition, so long as any principal or interest with respect to any Advance is outstanding, Bank shall be entitled to charge Borrower a "float" charge in an amount equal to two (2) Business Days interest, at the interest rate applicable to the Advances, on all Payments received by Bank other than Payments in the form of electronic wire or ACH transfers in immediately available funds. Such float charge is not included in interest for purposes of computing Minimum Monthly Interest (if any) under this Agreement. The float charge for each month shall be payable on the last day of the month. Bank shall not, however, be required to credit Borrower's account for the amount of any item of payment which is unsatisfactory to Bank in its good faith business judgment, and Bank may charge Borrower's Designated Deposit Account for the amount of any item of payment which is returned to Bank unpaid.

**2.4 Fees.** Borrower shall pay to Bank:

(a) **Commitment Fees.** (i) A fully earned, non-refundable commitment fee of \$50,000, on the Effective Date and on each anniversary of the Effective Date, with respect to the Revolving Line, and (ii) a fully earned, non-refundable commitment fee of \$15,000, on the Effective Date, with respect to the Term Loan;

(b) **Letter of Credit Fee.** Bank's customary fees and expenses for the issuance or renewal of Letters of Credit, including, without limitation, a letter of credit fee equal to one and one-half percent (1.50%) per annum of the Dollar Equivalent of the face amount of each Letter of Credit issued, upon the issuance of such Letter of Credit, each anniversary of the issuance during the term of such Letter of Credit, and upon the renewal of such Letter of Credit by Bank;

(c) **Termination Fees.** The termination fees;

(d) **Unused Revolving Line Facility Fee.** A fee (the "**Unused Revolving Line Facility Fee**"), payable monthly, in arrears, on a calendar year basis, in an amount equal to .375% per annum of the average unused portion of the Revolving Line, as reasonably determined by Bank. The used portion of the Revolving Line, for the purposes of this calculation, shall include, without duplication, all outstanding Advances, amounts utilized or reserved in connection with Letters of Credit and for products provided in connection with Cash Management Services and the amount of the outstanding Term Loan. Borrower shall not be entitled to any credit, rebate or repayment of any Unused Revolving Line Facility Fee previously earned by Bank pursuant to this Section notwithstanding any termination of the Agreement or the suspension or termination of Bank's obligation to make loans and advances hereunder;

(e) **Collateral Monitoring Fee.** A collateral monitoring fee of \$1,000 for each month during which the Streamline Period is not in effect for the entire month and of \$500 for each month during which the Streamline Period is in effect for the entire month, payable in arrears on the last day of each month (prorated for any partial month at the beginning and upon termination of this Agreement); and

(f) **Bank Expenses.** All Bank Expenses (including reasonable attorneys' fees and expenses for documentation and negotiation of this Agreement) incurred through and after the Effective Date, when due.

## 2.5 Payments; Application of Payments.

(a) All payments (including prepayments) to be made by Borrower under any Loan Document shall be made in immediately available funds in U.S. Dollars, without setoff or counterclaim, before 12:00 p.m. Pacific time on the date when due. Payments of principal and/or interest received after 12:00 p.m. Pacific time are considered received at the opening of business on the next Business Day. When a payment is due on a day that is not a Business Day, the payment shall be due the next Business Day, and additional fees or interest, as applicable, shall continue to accrue until paid.

(b) All payments with respect to Obligations that are due and payable may be applied to such Obligations in such order and manner as Bank shall determine in its sole discretion. Borrower shall have no right to specify the order or the accounts to which Bank shall allocate or apply any payments required to be made by Borrower to Bank or otherwise received by Bank under this Agreement when any such allocation or application is not specified elsewhere in this Agreement.

## 3 CONDITIONS OF LOANS

**3.1 Conditions Precedent to Initial Credit Extension.** Bank's obligation to make the initial Credit Extension is subject to the condition precedent that Bank shall have received, in form and substance satisfactory to Bank, such documents, and completion of such other matters, as Bank may reasonably deem necessary or appropriate, including, without limitation:

(a) duly executed original signatures to the Loan Documents, including without limitation the Lockbox Agreement;

(b) duly executed original signatures to the Warrant;

(c) [reserved];

(d) Borrower's Operating Documents and a good standing certificate of Borrower certified by the Secretary of State of the State of Delaware as of a date no earlier than thirty (30) days prior to the Effective Date;

(e) the Borrowing Resolutions for Borrower with an original signature of the officer of Borrower making the certifications therein on behalf of the Borrower and with the applicable officer specimen signatures;

(f) duly executed original signature to a payoff letter from National City Bank;

(g) certified copies, dated as of a recent date, of financing statement searches, as Bank shall request, accompanied by written evidence (including any UCC termination statements) that the Liens indicated in any such financing statements either constitute Permitted Liens or have been or, in connection with the initial Credit Extension, will be terminated or released;

(h) the Perfection Certificate of Borrower, together with the duly executed original signatures thereto;

(i) a landlord's consent in favor of Bank for each of the following locations by the respective landlord thereof, together with the duly executed original signatures thereto: 2952 E. Crescentville Road, West Chester, Ohio 45069; 6033 Schumacher Park Drive, West Chester, Ohio 45069; 6209 Centre Park Drive, West Chester, Ohio 45069; 6211 Centre Park Drive, West Chester, Ohio 45069; 6213 Centre Park Drive, West Chester, Ohio 45069; 6215 Centre Park Drive, West Chester, Ohio 45069; and 6345 Centre Park Drive, West Chester, Ohio 45069;

(j) a legal opinion of Borrower's counsel dated as of the Effective Date together with the duly executed original signature thereto;

(k) a copy of Borrower's Investors' Rights Agreement and any amendments thereto;

(l) the insurance policies and/or endorsements required pursuant to Section 6.7 hereof; and

(m) payment of the fees and Bank Expenses then due as specified in Section 2.4 hereof.

**3.2 Conditions Precedent to all Credit Extensions.** Bank's obligations to make each Credit Extension, including the initial Credit Extension, is subject to the following conditions precedent:

(a) except as otherwise provided in Section 3.4(a), timely receipt of an executed Transaction Report;

(b) the representations and warranties in this Agreement shall be true, accurate, and complete in all material respects on the date of the Transaction Report and on the Funding Date of each Credit Extension; provided, however, that such materiality qualifier shall not be applicable to any representations and warranties that already are qualified or modified by materiality in the text thereof; and provided, further that those representations and warranties expressly referring to a specific date shall be true, accurate and complete in all material respects as of such date, and no Event of Default shall have occurred and be continuing or result from the Credit Extension. Each Credit Extension is Borrower's representation and warranty on that date that the representations and warranties in this Agreement remain true, accurate, and complete in all material respects; provided, however, that such materiality qualifier shall not be applicable to any representations and warranties that already are qualified or modified by materiality in the text thereof; and provided, further that those representations and warranties expressly referring to a specific date shall be true, accurate and complete in all material respects as of such date; and

(c) in Bank's reasonable discretion, there has not been a Material Adverse Change.

### **3.3 Covenant to Deliver.**

Borrower agrees to deliver to Bank each item required to be delivered to Bank under this Agreement as a condition precedent to any Credit Extension. Borrower expressly agrees that a Credit Extension made prior to the receipt by Bank of any such item shall not constitute a waiver by Bank of Borrower's obligation to deliver such item, and the making of any Credit Extension in the absence of a required item shall be in Bank's sole discretion.

### **3.4 Procedures for Borrowing.**

(a) Advances. Subject to the prior satisfaction of all other applicable conditions to the making of an Advance set forth in this Agreement, to obtain an Advance (other than Advances under Sections 2.1.2 or 2.1.4), Borrower shall notify Bank (which notice shall be irrevocable) by electronic mail, facsimile, or telephone by 12:00 p.m. Pacific time on the Funding Date of the Advance. Together with such notification, Borrower must promptly deliver to Bank by electronic mail or facsimile a completed Transaction Report executed by a Responsible Officer or his or her designee. Bank shall credit Advances to the Designated Deposit Account. Bank may make Advances under this Agreement based on instructions from a Responsible Officer or his or her designee or without instructions if the Advances are necessary to meet Obligations which have become due. Bank may rely on any telephone notice given by a person whom Bank believes is a Responsible Officer or designee.

(b) Term Loan. Subject to the prior satisfaction of all other applicable conditions to the making of the Term Loan set forth in this Agreement, to obtain the Term Loan, Borrower shall notify Bank (which notice shall be irrevocable) by electronic mail, facsimile, or telephone by 12:00 p.m. Pacific time at least two (2) Business Days prior to the date the Term Loan is to be made. Together with any such electronic or facsimile notification, Borrower shall deliver to Bank by electronic mail or facsimile a completed Payment/Advance Form executed by a Responsible Officer or his or her designee. Bank may rely on any telephone notice given by a person whom Bank believes is a Responsible Officer or designee.

## **4 CREATION OF SECURITY**

**4.1 Grant of Security Interest.** Borrower hereby grants Bank, to secure the payment and performance in full of all of the Obligations, a continuing security interest in, and pledges to Bank, the Collateral, wherever located, whether now owned or hereafter acquired or arising, and all proceeds and products thereof.

**4.2 Priority of Security Interest.** Borrower represents, warrants, and covenants that the security interest granted herein is and shall at all times continue to be a first priority perfected security interest in all the Collateral (subject only to Permitted Liens that, pursuant to the terms hereof, are allowed to have superior priority to Bank's Lien), in each case, to the extent that a security interest in such Collateral can be perfected pursuant to Article 9 or 8 of the Code. If Borrower shall acquire a commercial tort claim, Borrower shall promptly notify Bank in a writing signed by Borrower of the general details thereof and grant to Bank in such writing a security interest therein and in the proceeds thereof, all upon the terms of this Agreement, with such writing to be in form and substance reasonably satisfactory to Bank.

If this Agreement is terminated, Bank's Lien in the Collateral shall continue until the Obligations (other than inchoate indemnity obligations) are repaid in full in cash. Upon payment in full in cash of the Obligations and at such time as Bank's obligation to make Credit Extensions has terminated, Bank shall, at Borrower's sole cost and expense, release its Liens in the Collateral and all rights therein shall revert to Borrower.

**4.3 Authorization to File Financing Statements.** Borrower hereby authorizes Bank to file financing statements, without notice to Borrower, with all appropriate jurisdictions to perfect or protect Bank's interest or rights hereunder, including a notice that any disposition of any Collateral which is not otherwise permitted by the terms hereof, whether by Borrower or any other Person, shall be deemed to violate the rights of Bank under the Code.

## **5 REPRESENTATIONS AND WARRANTIES**

Borrower represents and warrants as follows:

**5.1 Due Organization, Authorization; Power and Authority.** Borrower is duly existing and in good standing as a Registered Organization in its jurisdiction of formation and is qualified and licensed to do business and is in good standing in any jurisdiction in which the conduct of its business or its ownership of property requires that it be qualified except where the failure to do so could not reasonably be expected to have a material adverse effect on Borrower's business. In connection with this Agreement, Borrower has delivered to Bank a completed certificate signed by Borrower, entitled "Perfection Certificate". Borrower represents and warrants to Bank that (a) Borrower's exact legal name is that indicated on the Perfection Certificate and on the signature page hereof; (b) Borrower is an organization of the type and is organized in the jurisdiction set forth in the Perfection Certificate; (c) the Perfection Certificate accurately sets forth Borrower's organizational identification number or accurately states that Borrower has none; (d) the Perfection Certificate accurately sets forth Borrower's place of business, or, if more than one, its chief executive office as well as Borrower's mailing address (if different than its chief executive office); (e) Borrower (and each of its predecessors) has not, in the past five (5) years, changed its jurisdiction of formation, organizational structure or type, or any organizational number assigned by its jurisdiction; and (f) all other information set forth on the Perfection Certificate pertaining to Borrower and each of its Subsidiaries is accurate and complete (it being understood and agreed that Borrower may from time to time update certain information in the Perfection Certificate after the Effective Date to the extent permitted by one or more specific provisions in this Agreement).

The execution, delivery and performance by Borrower of the Loan Documents to which it is a party have been duly authorized, and do not (i) conflict with any of Borrower's organizational documents, (ii) contravene, conflict with, constitute a default under or violate any material Requirement of Law, (iii) contravene, conflict or violate any applicable order, writ, judgment, injunction, decree, determination or award of any Governmental Authority by which Borrower or any of its Subsidiaries or any of their property or assets may be bound or affected, (iv) require any action by, filing, registration, or qualification with, or Governmental Approval from, any Governmental Authority (except such Governmental Approvals which have already been obtained and are in full force and effect and except for filing requirements expressly contemplated by the terms hereof, including the filing of financing statements), or (v) constitute an event of default under any material agreement by which Borrower is bound. Borrower is not in default under any agreement to which it is a party or by which it is bound in which the default could reasonably be expected to have a material adverse effect on Borrower's business.

**5.2 Collateral.** Borrower has good title to, has rights in, and the power to transfer each item of the Collateral upon which it purports to grant a Lien hereunder, free and clear of any and all Liens except Permitted Liens. Borrower has no deposit accounts other than the deposit accounts with Bank, the deposit accounts, if any, described in the Perfection Certificate delivered to Bank in connection herewith, and the deposit accounts with respect to which Borrower is in compliance with the terms of Section 6.8 hereof. The Accounts are bona fide, existing obligations of the Account Debtors.

The Collateral is not in the possession of any third party bailee (such as a warehouse) except as otherwise provided in the Perfection Certificate or as otherwise permitted pursuant to Section 7.2. None of the components of the Collateral shall be maintained at locations other than as provided in the Perfection Certificate or as permitted pursuant to Section 7.2.

Except as otherwise specified in written notice from Borrower to Bank, no material amount of Inventory is other than, in all material respects, of good and marketable quality, free from material defects.

Borrower is the sole owner of the Intellectual Property which it owns or purports to own except for (a) non-exclusive licenses granted to its customers in the ordinary course of business, (b) over-the-counter software that is commercially available to the public, and (c) material Intellectual Property licensed to Borrower and noted on the Perfection Certificate. Each Patent which it owns or purports to own and which is material to Borrower's business is valid and enforceable, and no part of the Intellectual Property which Borrower owns or purports to own and which is material to Borrower's business has been judged invalid or unenforceable, in whole or in part. To the best of Borrower's knowledge, no claim has been made that any part of the Intellectual Property violates the rights of any third party except to the extent such claim would not reasonably be expected to have a material adverse effect on Borrower's business.

Except as noted on the Perfection Certificate and in the Compliance Certificates provided from time to time, Borrower is not a party to, nor is it bound by, any material Restricted License.

### **5.3 Accounts Receivable; Inventory.**

(a) For each Account with respect to which Advances are requested, on the date each Advance is requested and made, such Account shall be an Eligible Account.

(b) All statements made and all unpaid balances appearing in all invoices, instruments and other documents evidencing the Eligible Accounts are and shall be true and correct and all such invoices, instruments and other documents, and all of Borrower's Books are genuine and in all respects what they purport to be. If an Event of Default has occurred and is continuing, Bank may notify any Account Debtor owing Borrower money of Bank's security interest in such funds. All sales and other transactions underlying or giving rise to each Eligible Account shall comply in all material respects with all applicable laws and governmental rules and regulations. Borrower has no knowledge of any actual or imminent Insolvency Proceeding of any Account Debtor whose accounts are Eligible Accounts in any Transaction Report. To the best of Borrower's knowledge, all signatures and endorsements on all documents, instruments, and agreements relating to all Eligible Accounts are genuine, and all such documents, instruments and agreements are legally enforceable in accordance with their terms.

**5.4 Litigation.** Except as otherwise specified in the Perfection Certificate or reported pursuant to Section 6.2(k), there are no actions or proceedings pending or, to the knowledge of the Responsible Officers, threatened in writing by or against Borrower or any of its Subsidiaries involving more than \$50,000, individually, or \$250,000 in the aggregate.

**5.5 Financial Statements; Financial Condition.** All consolidated financial statements for Borrower and any of its Subsidiaries delivered to Bank fairly present in all material respects Borrower's consolidated financial condition and Borrower's consolidated results of operations. There has not been any material deterioration in Borrower's consolidated financial condition since the date of the most recent financial statements submitted to Bank.

**5.6 Solvency.** The fair salable value of Borrower's assets (including goodwill minus disposition costs) exceeds the fair value of its liabilities; Borrower is not left with unreasonably small capital after the transactions in this Agreement; and Borrower is able to pay its debts (including trade debts) as they mature.

**5.7 Regulatory Compliance.** Borrower is not an "investment company" or a company "controlled" by an "investment company" under the Investment Company Act of 1940, as amended. Borrower is not engaged as one of its important activities in extending credit for margin stock (under Regulations X, T and U of the Federal

Reserve Board of Governors). Borrower has complied in all material respects with the Federal Fair Labor Standards Act. Neither Borrower nor any of its Subsidiaries is a "holding company" or an "affiliate" of a "holding company" or a "subsidiary company" of a "holding company" as each term is defined and used in the Public Utility Holding Company Act of 2005. Borrower has not violated any laws, ordinances or rules, the violation of which could reasonably be expected to have a material adverse effect on its business. None of Borrower's or any of its Subsidiaries' properties or assets has been used by Borrower or any Subsidiary or, to the best of Borrower's knowledge, by previous Persons, in disposing, producing, storing, treating, or transporting any hazardous substance other than legally. Borrower and each of its Subsidiaries have obtained all consents, approvals and authorizations of, made all declarations or filings with, and given all notices to, all Government Authorities that are necessary to continue their respective businesses as currently conducted, except to the extent the failure to obtain or make any approval or filing could not reasonably be expected to have a material adverse effect on Borrower's or any Subsidiary's business.

**5.8 Subsidiaries; Investments.** Borrower does not own any stock, partnership interest or other equity securities except for Permitted Investments.

**5.9 Tax Returns and Payments; Pension Contributions.**

(a) Except as otherwise permitted by this Section 5.9, Borrower has timely filed all required tax returns and reports, and Borrower has timely paid all foreign, federal, state and local taxes, assessments, deposits and contributions owed by Borrower. Borrower may defer payment of any contested taxes, provided that Borrower (i) in good faith contests its obligation to pay the taxes by appropriate proceedings promptly and diligently instituted and conducted, (ii) notifies Bank in writing of the commencement of, and any material development in, the proceedings, (iii) posts bonds or takes any other steps required to prevent the governmental authority levying such contested taxes from obtaining a Lien upon any of the Collateral that is other than a "Permitted Lien". Borrower is unaware of any claims or adjustments proposed for any of Borrower's prior tax years which could result in additional taxes becoming due and payable by Borrower.

(b) Except as otherwise described on Schedule 5.9, Borrower has paid all amounts necessary to fund all present pension, profit sharing and deferred compensation plans in accordance with their terms, and Borrower has not withdrawn from participation in, and has not permitted partial or complete termination of, or permitted the occurrence of any other event with respect to, any such plan which resulted or could reasonably be expected to result in any liability of Borrower which, when aggregated with all such actual and expected liabilities (including without duplication any liabilities described in Section 6.5(b) or 7.10(c)) other than the liability described on Schedule 5.9, exceeds \$50,000 (including any liability to the Pension Benefit Guaranty Corporation or its successors or any other governmental agency).

**5.10 Use of Proceeds.** Borrower shall use the proceeds of the Credit Extensions solely as working capital and to fund its general business requirements and not for personal, family, household or agricultural purposes.

**5.11 Full Disclosure.** No written representation, warranty or other statement of Borrower in any certificate or written statement given to Bank, as of the date such representation, warranty, or other statement was made, taken together with all such written certificates and written statements given to Bank, contains any untrue statement of a material fact or omits to state a material fact necessary to make the statements contained in the certificates or statements not misleading (it being recognized by Bank that the projections and forecasts provided by Borrower in good faith and based upon reasonable assumptions are not viewed as facts and that actual results during the period or periods covered by such projections and forecasts may differ from the projected or forecasted results).

**5.12 Indebtedness to Officers, Directors or Shareholders.** Borrower is not liable to any officer, director or shareholder of Borrower for any Indebtedness, unless such officer, director or shareholder has subordinated such Indebtedness to all of Borrower's now or hereafter indebtedness to Bank (pursuant to a subordination, intercreditor, or other similar agreement in form and substance satisfactory to Bank entered into between Bank and such officer, director or shareholder), on terms acceptable to Bank.

**5.12 Definition of "Knowledge."** For purposes of the Loan Documents, whenever a representation or warranty is made to Borrower's knowledge or awareness, to the "best of" Borrower's knowledge, or with a similar qualification, knowledge or awareness means the actual knowledge, after reasonable investigation, of the Responsible Officers.

## 6 **AFFIRMATIVE COVENANTS**

Borrower shall do all of the following:

### **6.1 Government Compliance.**

(a) Maintain its and all its Subsidiaries' legal existence and good standing in their respective jurisdictions of formation and maintain qualification in each jurisdiction in which the failure to so qualify would reasonably be expected to have a material adverse effect on Borrower's business or operations. Borrower shall comply, and have each Subsidiary comply, with all laws, ordinances and regulations to which it is subject, noncompliance with which could have a material adverse effect on Borrower's business.

(b) Obtain and maintain all of the Governmental Approvals necessary for the performance by Borrower of its obligations under the Loan Documents to which it is a party and the grant of a security interest to Bank in all of its property. Borrower shall promptly provide to Bank copies of any such obtained Governmental Approvals that Bank shall request.

### **6.2 Financial Statements, Reports, Certificates.** Provide Bank with the following:

(a) a Transaction Report (and any schedules related thereto) (y) weekly and at the time of each request for an Advance if a Streamline Period is not in effect or an Event of Default has occurred and is continuing and (z) within fifteen (15) days after the end of each month if a Streamline Period is in effect and no Event of Default has occurred and is continuing;

(b) within fifteen (15) days after the end of each month, (A) monthly accounts receivable agings, aged by invoice date, (B) monthly accounts payable agings, aged by invoice date, and outstanding or held check registers, if any, and (C) monthly reconciliations of accounts receivable agings (aged by invoice date), transaction reports and general ledger;

(c) as soon as available, but no later than thirty (30) days after the last day of each month, a company prepared consolidated and consolidating balance sheet and income statement covering Borrower's and each of its Subsidiary's operations for such month certified by a Responsible Officer and in a form acceptable to Bank (the "**Monthly Financial Statements**");

(d) within thirty (30) days after the last day of each month and together with the Monthly Financial Statements, a duly completed Compliance Certificate signed by a Responsible Officer, certifying that as of the end of such month Borrower was in full compliance with all of the terms and conditions of this Agreement (subject to any existing Defaults or Events of Default, which Borrower shall describe in the Compliance Certificate), and setting forth calculations showing compliance with the financial covenants set forth in this Agreement and such other information as Bank shall reasonably request, including, without limitation, a statement that at the end of such month there were no held checks;

(e) [Reserved];

(f) prior to the end of each fiscal year of Borrower, (A) annual operating budgets (including income statements, balance sheets and cash flow statements, by month) for the upcoming fiscal year of Borrower, and (B) annual financial projections for the following fiscal year (on a quarterly basis) as approved by Borrower's board of directors, together with any related business forecasts used in the preparation of such annual financial projections; and

(g) as soon as available, and in any event within 120 days following the end of Borrower's fiscal year, audited consolidated financial statements prepared under GAAP, consistently applied, together with an unqualified opinion on the financial statements from an independent certified public accounting firm acceptable to Bank in its reasonable discretion.

(h) [Reserved];

(i) within five (5) days of delivery, copies of all statements, reports and notices made available to Borrower's security holders or to any holders of Subordinated Debt, except to the extent that the foregoing have been filed with the SEC and are publicly available within such time frame;

(j) prompt written notice of (i) any material change in the composition of the Intellectual Property, (ii) the registration of any copyright, including any subsequent ownership right of Borrower in or to any copyright, patent or trademark not shown in the IP Security Agreement, and (iii) Borrower's knowledge of an event that could reasonably be expected to materially and adversely affect the value of the Intellectual Property;

(k) prompt report of any legal action pending or threatened in writing against Borrower or any of its Subsidiaries that could result in damages or costs to Borrower or any of its Subsidiaries of more than Fifty Thousand Dollars (\$50,000), individually, or more than Two Hundred Fifty Thousand Dollars (\$250,000) when aggregated with all other legal actions pending or threatened in writing against Borrower or any of its Subsidiaries that have not previously been disclosed to Bank pursuant to the Perfection Certificate or other written report; and

(l) other financial information reasonably requested by Bank.

### 6.3 Accounts Receivable.

(a) Schedules and Documents Relating to Accounts. Borrower shall deliver to Bank transaction reports and schedules of collections, as provided in Section 6.2, on Bank's standard forms; provided, however, that Borrower's failure to execute and deliver the same shall not affect or limit Bank's Lien and other rights in all of Borrower's Accounts, nor shall Bank's failure to advance or lend against a specific Account affect or limit Bank's Lien and other rights therein. If requested by Bank, Borrower shall furnish Bank with copies (or, at Bank's request, originals) of all contracts, orders, invoices, and other similar documents, and all shipping instructions, delivery receipts, bills of lading, and other evidence of delivery, for any goods the sale or disposition of which gave rise to such Accounts. In addition, Borrower shall deliver to Bank, on its request, the originals of all instruments, chattel paper, security agreements, guarantees and other documents and property evidencing or securing any Accounts, in the same form as received, with all necessary indorsements, and copies of all credit memos.

(b) Disputes. Borrower shall promptly notify Bank of all disputes or claims involving \$50,000 or more that relate to Accounts. Borrower may forgive (completely or partially), compromise, or settle any Account for less than payment in full, or agree to do any of the foregoing so long as (i) Borrower does so in good faith, in a commercially reasonable manner, in the ordinary course of business, in arm's-length transactions, and reports the same to Bank in the regular reports provided to Bank; (ii) no Event of Default has occurred and is continuing; and (iii) after taking into account all such discounts, settlements and forgiveness, no Credit Extension(s) will exceed any limit set forth herein.

(c) Collection of Accounts. Until payment in full in cash of all Advances and all other Obligations relating to the Revolving Line (other than inchoate indemnity obligations) and Bank's obligations to make Advances and any other Credit Extensions relating to the Revolving Line have terminated (provided that Borrower's obligation under this sentence shall not end at a time when any Event of Default exists), Borrower shall be a party to a three party agreement (the "**Lockbox Agreement**") with Bank and a lockbox provider (the "**Lockbox Provider**"). The Lockbox Agreement and Lockbox Provider shall be acceptable to Bank. As soon as reasonably practicable after the Effective Date, Borrower shall use the lockbox address as the payment address on all invoices issued by Borrower and shall direct all its Account Debtors to remit their payments to the lockbox address. The Lockbox Agreement shall provide that the Lockbox Provider shall remit all collections received in the lockbox to Bank. Upon Bank's receipt of such collections, Bank shall apply the same as follows:

- (i) If a Streamline Period is in effect, Bank shall deposit such proceeds into the operating account of Borrower at Bank that is designated by Borrower; and
- (ii) If a Streamline Period is not in effect, Bank shall apply such proceeds to the outstanding Advances, and if all outstanding Advances have been paid in full, Bank shall deposit the remainder into the operating account of Borrower at Bank that is designated by Borrower; and



- (iii) If a Default or Event of Default has occurred and is continuing, without limiting Bank's other rights and remedies, Bank shall have the right to apply such proceeds to the outstanding Obligations in such order as it shall determine in its discretion.

It is understood and agreed by Borrower that this Section does not impose any affirmative duty on Bank to do any act other than to turn over such amounts. Without limitation on the foregoing, whether or not an Event of Default has occurred and is continuing, Borrower shall hold all payments on, and proceeds of, Accounts that Borrower receives, in trust for Bank, and Borrower shall immediately deliver all such payments and proceeds to Bank in their original form, duly endorsed, to be applied to the Obligations pursuant to the terms of Section 9.4 hereof.

(d) **Returns.** Provided no Event of Default has occurred and is continuing, if any Account Debtor returns any Inventory to Borrower, Borrower shall promptly (i) determine the reason for such return, (ii) issue a credit memorandum to the Account Debtor in the appropriate amount, and (iii) provide a copy of such credit memorandum to Bank, upon request from Bank. In the event any attempted return occurs after the occurrence and during the continuance of any Event of Default, Borrower shall hold the returned Inventory in trust for Bank, and immediately notify Bank of the return of the Inventory.

(e) **Verification.** Bank may, from time to time, verify directly with the respective Account Debtors the validity, amount and other matters relating to the Accounts, either in the name of Bank or Bank's agent.

(f) **No Liability.** Bank shall not be responsible or liable for any shortage or discrepancy in, damage to, or loss or destruction of, any goods, the sale or other disposition of which gives rise to an Account, or for any error, act, omission, or delay of any kind occurring in the settlement, failure to settle, collection or failure to collect any Account, or for settling any Account in good faith for less than the full amount thereof, nor shall Bank be deemed to be responsible for any of Borrower's obligations under any contract or agreement giving rise to an Account. Nothing herein shall, however, relieve Bank from liability for its own gross negligence or willful misconduct.

**6.4 Remittance of Proceeds.** Except as otherwise provided in Section 6.3(c), deliver, in kind, all proceeds arising from the disposition of any Collateral to Bank in the original form in which received by Borrower not later than the following Business Day after receipt by Borrower, to be applied to the Obligations (a) prior to an Event of Default, pursuant to the terms of Section 2.5(b) hereof, and (b) after the occurrence and during the continuance of an Event of Default, pursuant to the terms of Section 9.4 hereof; provided that, if no Event of Default has occurred and is continuing, Borrower shall not be obligated to remit to Bank the proceeds of the sale of worn out or obsolete Equipment disposed of by Borrower in good faith in an arm's length transaction for an aggregate purchase price of \$25,000 or less (for all such transactions in any fiscal year). Borrower agrees that it will not commingle proceeds of Collateral with any of Borrower's other funds or property, but will hold such proceeds separate and apart from such other funds and property and in an express trust for Bank. Nothing in this Section limits the restrictions on disposition of Collateral set forth elsewhere in this Agreement.

**6.5 Taxes; Pensions. Taxes; Pensions.** (a) Timely file, and require each of its Subsidiaries to timely file, all required tax returns and reports and timely pay, and require each of its Subsidiaries to timely pay, all foreign, federal, state and local taxes, assessments, deposits and contributions owed by Borrower and each of its Subsidiaries, except for deferred payment of any taxes contested pursuant to the terms of Section 5.9 hereof, and shall deliver to Bank, on demand, appropriate certificates attesting to such payments, and (b) except as otherwise described on Schedule 5.9, pay all amounts necessary to fund all present pension, profit sharing and deferred compensation plans in accordance with their terms, except to the extent that any failure to pay any such amount results in or is reasonably likely to result in any liability of Borrower which, when aggregated with all such actual and expected liabilities (including without duplication any liabilities described in Section 5.9(b) or 7.10(c)) other than the liability described on Schedule 5.9, does not exceed \$50,000.

**6.6 Access to Collateral; Books and Records.** At reasonable times, on three (3) Business Days' notice (provided no notice is required if an Event of Default has occurred and is continuing), Bank, or its agents, shall have the right to inspect the Collateral and the right to audit and copy Borrower's Books. Such inspections or audits shall be conducted no more often than twice in each 12-month period unless an Event of Default has occurred and is continuing. The foregoing inspections and audits shall be at Borrower's expense, and the charge therefor shall be \$750 per person per day (or such higher amount as shall represent Bank's then-current standard charge for

the same), plus reasonable out-of-pocket expenses. In the event Borrower and Bank schedule an audit more than ten (10) days in advance, and Borrower cancels or seeks to reschedule the audit with less than ten (10) days written notice to Bank, then (without limiting any of Bank's rights or remedies), Borrower shall pay Bank a fee of \$1,000 plus any out-of-pocket expenses incurred by Bank to compensate Bank for the anticipated costs and expenses of the cancellation or rescheduling.

**6.7 Insurance.** Keep its business and the Collateral insured for risks and in amounts standard for companies in Borrower's industry and location and as Bank may reasonably request. Insurance policies shall be in a form, with companies, and in amounts that are satisfactory to Bank. All property policies shall have a lender's loss payable endorsement showing Bank as the sole lender loss payee and waive subrogation against Bank. All liability policies shall show, or have endorsements showing, Bank as an additional insured. All policies (or the loss payable and additional insured endorsements) shall provide that the insurer shall give Bank at least twenty (20) days notice before canceling, amending, or declining to renew its policy. At Bank's request, Borrower shall deliver certified copies of policies and evidence of all premium payments. Proceeds payable under any policy shall, at Bank's option, be payable to Bank on account of the Obligations. Notwithstanding the foregoing, (a) so long as no Event of Default has occurred and is continuing, Borrower shall have the option of applying the proceeds of any casualty policy up to Fifty Thousand Dollars (\$50,000) with respect to any loss, but not exceeding One Hundred Thousand Dollars (\$100,000) in the aggregate for all losses under all casualty policies in any one year, toward the replacement or repair of destroyed or damaged property; provided that any such replaced or repaired property (i) shall be of equal or like value as the replaced or repaired Collateral and (ii) shall be deemed Collateral in which Bank has been granted a first priority security interest, and (b) after the occurrence and during the continuance of an Event of Default, all proceeds payable under such casualty policy shall, at the option of Bank, be payable to Bank on account of the Obligations. If Borrower fails to obtain insurance as required under this Section 6.7 or to pay any amount or furnish any required proof of payment to third persons and Bank, Bank may make all or part of such payment or obtain such insurance policies required in this Section 6.7, and take any action under the policies Bank deems prudent.

#### **6.8 Operating Accounts.**

(a) Beginning on the date which is 60 days after the Effective Date, maintain all of its and all of its Subsidiaries' operating and other deposit accounts, securities accounts, and any other accounts at which Borrower or its Subsidiaries maintain funds or investments (including without limitation any Collateral Accounts), which are maintained within the United States (including without limitation such accounts which are maintained with United States branches of foreign institutions), with Bank and Bank's Affiliates. Notwithstanding the foregoing, Borrower may maintain until December 31, 2009 its account number 0985930850 at National City Bank for purpose of continuing to receive deposits of payment items sent to Borrower's pre-existing lockbox, provided that (i) National City Bank and Borrower shall, within 30 days after the Effective Date, agree in writing that the proceeds in such account shall be swept to Bank two times per week and provide Bank with a Control Agreement to perfect Bank's Lien against such account, and (ii) Borrower shall still be required to comply with the terms of Section 6.3(c) hereof.

(b) Without limitation on subsection "a" above, (i) provide Bank five (5) days prior written notice before establishing any Collateral Account at or with any bank or financial institution other than Bank or Bank's Affiliates, and (ii) for each Collateral Account that Borrower at any time maintains within the United States (including without limitation any such account which is maintained with a United States branch of a foreign institution), Borrower shall cause the applicable bank or financial institution (other than Bank) at or with which such Collateral Account is maintained to execute and deliver a Control Agreement or other appropriate instrument with respect to such Collateral Account to perfect Bank's Lien in such Collateral Account in accordance with the terms hereunder. The provisions of "ii" of the previous sentence shall (x) not apply to deposit accounts exclusively used for payroll, payroll taxes and other employee wage and benefit payments to or for the benefit of Borrower's employees and identified to Bank by Borrower as such, (y) not apply to accounts which are being moved to Bank or Bank's Affiliates within the 60 day period provided for in Section 6.8(a) above, and (z) shall be subject to the terms of Section 6.8(a) above with respect to account number 0985930850 at National City Bank.

#### **6.9 Financial Covenants.**

Maintain at all times, to be tested as of the last day of each month, unless otherwise noted, on a consolidated basis with respect to Borrower and its Subsidiaries:

(a) Minimum Adjusted Quick Ratio. An Adjusted Quick Ratio of at least 1.2 to 1.0 provided that Borrower shall only be required to maintain such minimum Adjusted Quick Ratios with respect to months during which there were any Advances outstanding.

(b) **Maximum Capital Expenditures.** Not contract for, purchase or make any expenditure or commitments for capital expenditures in an aggregate amount in excess of \$1,750,000 for Borrower's fiscal year ending December 31, 2009, \$3,400,000 for Borrower's fiscal year ending December 31, 2010, and an amount for each of Borrower's fiscal years ending thereafter as Borrower and Bank shall agree, provided that if Borrower and Bank fail to agree on the amount with respect to any such year, such amount shall be deemed to be \$3,400,000 for such year.

(c) **Minimum Fixed Charge Coverage Ratio.** A Fixed Charge Coverage Ratio for the twelve month period ending April 30, 2009, and for each twelve month period ending on the last day of each month thereafter, of not less than 1.50 to 1.00, provided that Borrower shall only be required to maintain such minimum Fixed Charge Coverage Ratios beginning upon release of the Term Loan-Related Reserve.

(d) **Minimum EBITDA.** Maintain, measured as of the end of each month, EBITDA for the three-month period ending as of the end of such month of at least the following minimum amounts for the months ending during the following periods (amounts in parentheses below represent negative numbers):

<u>Period</u>	<u>Minimum EBITDA</u>
Effective Date through May 31, 2009	\$ (2,280,000)
June 1, 2009 through August 31, 2009	\$ (1,060,000)
September 1, 2009 through November 30, 2009	\$ (100,000)
December 1, 2009 through February 28, 2010	\$ 130,000
March 1, 2010 through May 31, 2010	\$ (1,600,000)
June 1, 2010 through August 31, 2010	\$ (250,000)
September 1, 2010 through November 30, 2010	\$ 50,000
December 1, 2010 through February 28, 2011	\$ 60,000
March 1, 2011 and thereafter	an amount as Borrower and Bank shall agree

#### **6.10 Protection and Registration of Intellectual Property Rights.**

(a) (i) Protect, defend and maintain the validity and enforceability of its Intellectual Property; (ii) promptly advise Bank in writing of material infringements of its Intellectual Property; and (iii) not allow any Intellectual Property material to Borrower's business to be abandoned, forfeited or dedicated to the public without Bank's written consent.

(b) If Borrower (i) obtains any Patent, registered Trademark, registered Copyright, registered mask work, or any pending application for any of the foregoing, whether as owner, licensee or otherwise, or (ii) applies for any Patent or the registration of any Trademark, then Borrower shall provide written notice thereof to Bank as part of the Compliance Certificate required to be provided to Bank pursuant to Section 6.2 with respect to the last month of then current fiscal quarter and shall execute such intellectual property security agreements and other documents and take such other actions as Bank shall request in its good faith business judgment to perfect and maintain a first priority perfected security interest in favor of Bank in such property. If Borrower decides to register any Copyrights or mask works in the United States Copyright Office, Borrower shall: (x) provide Bank with at least fifteen (15) days prior written notice of Borrower's intent to register such Copyrights or mask works together with a

copy of the application it intends to file with the United States Copyright Office (excluding exhibits thereto); (y) execute an intellectual property security agreement and such other documents and take such other actions as Bank may request in its good faith business judgment to perfect and maintain a first priority perfected security interest in favor of Bank in the Copyrights or mask works intended to be registered with the United States Copyright Office; and (z) record such intellectual property security agreement with the United States Copyright Office contemporaneously with filing the Copyright or mask work application(s) with the United States Copyright Office.

(c) Provide written notice to Bank in each Compliance Certificate of any material Restrictive License that Borrower has entered into or become bound by since the period covered by last Compliance Certificate (other than over-the-counter software that is commercially available to the public). Borrower shall take such steps as are commercially reasonable to obtain the consent of, or waiver by, any person whose consent or waiver is necessary for (i) any Restricted License to be deemed "Collateral" and for Bank to have a security interest in it that might otherwise be restricted or prohibited by law or by the terms of any such Restricted License, whether now existing or entered into in the future, and (ii) Bank to have the ability in the event of a liquidation of any Collateral to dispose of such Collateral in accordance with Bank's rights and remedies under this Agreement and the other Loan Documents; provided, however, that the failure to obtain any such consent after taking such commercially reasonable steps shall not limit the ability of Borrower to enter into such license.

**6.11 Litigation Cooperation.** From the date hereof and continuing through the termination of this Agreement, make available to Bank, without expense to Bank, Borrower and its officers, employees and agents and Borrower's books and records (subject to (i) any written agreement binding upon Borrower prohibiting Borrower from disclosing any information of third parties and (ii) attorney-client privilege of Borrower) to the extent that Bank may deem them reasonably necessary to prosecute or defend any third-party suit or proceeding instituted by or against Bank with respect to any Collateral or relating to Borrower.

**6.12 Pledge of Stock of AtriCure Europe B.V.** Within 60 days after the Effective Date, Borrower shall cause Borrower and AtriCure Europe B.V. to enter into a pledge agreement with Bank pledging to Bank shares relating to 65% of the outstanding stock of AtriCure Europe B.V. and cause such agreement to be notarized in accordance with the laws of the Netherlands.

**6.13 Further Assurances.** Execute any further instruments and take further action as Bank reasonably requests to perfect or continue Bank's Lien in the Collateral or to effect the purposes of this Agreement.

## **7 NEGATIVE COVENANTS**

Borrower shall not do any of the following without Bank's prior written consent:

**7.1 Dispositions.** Convey, sell, lease, transfer, assign, or otherwise dispose of (collectively, "**Transfer**"), or permit any of its Subsidiaries to Transfer, all or any part of its business or property, except for Transfers (a) of Inventory (including generators/capital equipment pursuant to leases by Borrower as lessor) in the ordinary course of business, provided that Borrower shall not lease (as lessor) more than \$100,000 book value of Inventory (including generators/capital equipment) per fiscal year and shall not lease any Inventory (including generators/capital equipment that is leased by Borrower as lessor) which is subject to a Lien other than that of Bank or is leased by Borrower as lessee; (b) of worn-out or obsolete Equipment or Intellectual Property that is no longer useful or economically practicable to maintain, provided in each case that no Event of Default has occurred and is continuing; and (c) consisting of Permitted Liens and Permitted Investments.

**7.2 Changes in Business, Management, Control, or Locations of Business or Collateral.** (a) Engage in or permit any of its Subsidiaries to engage in any business other than the businesses currently engaged in by Borrower and such Subsidiary, as applicable, or reasonably related thereto; (b) liquidate or dissolve; or (c) (i) permit the existing Chief Executive Officer or Chief Financial Officer of the Borrower to cease to hold such position unless replaced within thirty (30) days with a person reasonably acceptable to Bank; or (ii) permit or suffer any Change in Control.

Borrower shall not, without at least thirty (30) days prior written notice to Bank: (1) add any new offices or business locations, including warehouses (unless such new offices or business locations contain less than Ten Thousand Dollars (\$10,000) in Borrower's assets or property), (2) change its jurisdiction of organization, (3) change its organizational structure or type, (4) change its legal name, (5) change any organizational number (if any) assigned by its jurisdiction of organization, or (6) maintain any of the Collateral other than at a location of Borrower, pursuant to leases allowed by Section 7.1, or as set forth below in this Section 7.2.

Borrower shall not deliver to any bailee any portion of the Collateral, except that Borrower may deliver (x) Inventory to a bailee for sterilization in an aggregate amount outstanding at any one time for such bailee not exceeding \$500,000 (gross book value), (y) molds to bailees who use the molds to fabricate Inventory for Borrower in an aggregate amount outstanding at any one time for all such bailees not exceeding \$250,000 (gross book value), and (z) other Inventory or Equipment to bailees in an aggregate amount outstanding at any one time for all such bailees not exceeding \$350,000 (gross book value). If Borrower intends to deliver any portion of the Collateral to a bailee in an amount in excess of what is allowed pursuant to the foregoing sentence, Borrower will first receive the written consent of Bank, and such bailee shall execute and deliver a bailee agreement in form and substance reasonably satisfactory to Bank. Borrower may maintain small amounts of "trunk stock" with Borrower's sales representatives and may maintain with any customer of Borrower (y) up to \$150,000 (valued at Borrower's then current standard cost) per customer, at any one time, of Borrower's generators/capital equipment and (z) up to \$50,000 (valued at Borrower's then current standard cost) per customer, at any one time, of Borrower's disposable products on consignment to such customer.

**7.3 Mergers or Acquisitions.** Merge or consolidate, or permit any of its Subsidiaries to merge or consolidate, with any other Person, or acquire, or permit any of its Subsidiaries to acquire, all or substantially all of the capital stock or property of another Person (including, without limitation, by the formation of a Subsidiary). A Subsidiary may merge or consolidate into another Subsidiary.

**7.4 Indebtedness.** Create, incur, assume, or be liable for (a) any Indebtedness, or permit any Subsidiary to do so, other than Permitted Indebtedness, or (b) any Indebtedness to any officer, director or shareholder of Borrower unless such officer, director or shareholder subordinates such Indebtedness to all of Borrower's now or hereafter indebtedness to Bank (pursuant to a subordination, intercreditor, or other similar agreement in form and substance satisfactory to Bank entered into between Bank and such officer, director or shareholder), on terms acceptable to Bank.

**7.5 Encumbrance.** Create, incur, allow, or suffer any Lien on any of its property, or assign or convey any right to receive income, including the sale of any Accounts, or permit any of its Subsidiaries to do so, except for Permitted Liens, or permit any Collateral not to be subject to the first priority security interest granted herein, or enter into any agreement, document, instrument or other arrangement (except with or in favor of Bank) with any Person which directly or indirectly prohibits or has the effect of prohibiting Borrower or any Subsidiary from assigning, mortgaging, pledging, granting a security interest in or upon, or encumbering any of Borrower's or any Subsidiary's Intellectual Property, except as is otherwise permitted in the definition of "Permitted Liens" herein.

**7.6 Maintenance of Collateral Accounts.** Maintain any Collateral Account except pursuant to the terms of Section 6.8(b) hereof.

**7.7 Distributions; Investments.** (a) Pay any dividends or make any distribution or payment or redeem, retire or purchase any capital stock provided that (i) Borrower may convert any of its convertible securities into other securities pursuant to the terms of such convertible securities or otherwise in exchange thereof, (ii) Borrower may pay dividends solely in common stock; (iii) Borrower may repurchase the stock of former employees or consultants pursuant to stock repurchase agreements so long as an Event of Default does not exist at the time of such repurchase and would not exist after giving effect to such repurchase, provided such repurchase does not exceed in the aggregate of One Hundred Thousand Dollars (\$100,000) per fiscal year; and (iv) Borrower may institute a stock repurchase program pursuant to which it repurchases outstanding shares of Borrower's common stock so long as an Event of Default does not exist at the time of any such repurchase and would not exist after giving effect to such repurchase and provided that the aggregate of all such repurchases does not exceed \$500,000; or (b) directly or indirectly make any Investment other than Permitted Investments, or permit any of its Subsidiaries to do so.

**7.8 Transactions with Affiliates.** Directly or indirectly enter into or permit to exist any material transaction with any Affiliate of Borrower, except for transactions that are in the ordinary course of Borrower's business, upon fair and reasonable terms that are no less favorable to Borrower than would be obtained in an arm's length transaction with a non-affiliated Person.

**7.9 Subordinated Debt.** (a) Make or permit any payment on any Subordinated Debt, except under the terms of the subordination, intercreditor, or other similar agreement to which such Subordinated Debt is subject, or (b) amend any provision in any document relating to the Subordinated Debt which would increase the amount thereof or the amount of any permitted payments thereunder or adversely affect the subordination thereof to Obligations owed to Bank.

**7.10 Compliance.** (a) Become an “investment company” or a company controlled by an “investment company”, under the Investment Company Act of 1940, as amended, or undertake as one of its important activities extending credit to purchase or carry margin stock (as defined in Regulation U of the Board of Governors of the Federal Reserve System), or use the proceeds of any Credit Extension for that purpose; (b) fail to comply with the Federal Fair Labor Standards Act or violate any other law or regulation, if the violation could reasonably be expected to have a material adverse effect on Borrower’s business, or permit any of its Subsidiaries to do so; (c) fail to meet the minimum funding requirements of ERISA, permit a Reportable Event or Prohibited Transaction, as defined in ERISA, to occur, or withdraw or permit any Subsidiary to withdraw from participation in, permit partial or complete termination of, or (except as has already occurred and is described on Schedule 5.9 hereto) permit the occurrence of any other event with respect to, any present pension, profit sharing and deferred compensation plan which results or could reasonably be expected to result in any liability of Borrower which, when aggregated with all such actual and expected liabilities (including without duplication any liabilities described in Section 5.9(b) or 6.5(b)) other than the liability described on Schedule 5.9, exceeds \$50,000 (including any liability to the Pension Benefit Guaranty Corporation or its successors or any other governmental agency).

**7.11 Schedule 5.9 Liability.** Become liable for in an amount greater than \$300,000 in connection with the matter described on Schedule 5.9.

## **8 EVENTS OF DEFAULT**

Any one of the following shall constitute an event of default (an “**Event of Default**”) under this Agreement:

**8.1 Payment Default.** Borrower fails to (a) make any payment of principal or interest on any Credit Extension on its due date, or (b) pay any other Obligations within three (3) Business Days after such Obligations are due and payable (which three (3) Business Day cure period shall not apply to payments due on the Revolving Line Maturity Date or the Term Loan Maturity Date). During the cure period, the failure to make or pay any payment specified under clause (a) or (b) hereunder is not an Event of Default (but no Credit Extension will be made during the cure period);

### **8.2 Covenant Default.**

(a) Borrower fails or neglects to perform any obligation in Sections 6.2, 6.5, 6.6, 6.7, 6.8, 6.9, 6.10(c) or violates any covenant in Section 7; or

(b) Borrower fails or neglects to perform, keep, or observe any other term, provision, condition, covenant or agreement contained in this Agreement or any Loan Documents, and as to any default (other than those specified in this Section 8) under such other term, provision, condition, covenant or agreement that can be cured, has failed to cure the default within ten (10) days after the occurrence thereof; provided, however, that if the default cannot by its nature be cured within the ten (10) day period or cannot after diligent attempts by Borrower be cured within such ten (10) day period, and such default is likely to be cured within a reasonable time, then Borrower shall have an additional period (which shall not in any case exceed thirty (30) days) to attempt to cure such default, and within such reasonable time period the failure to cure the default shall not be deemed an Event of Default (but no Credit Extensions shall be made during such cure period). Cure periods provided under this section shall not apply, among other things, to financial covenants or any other covenants set forth in clause (a) above;

**8.3 Material Adverse Change.** A Material Adverse Change occurs;

**8.4 Attachment; Levy; Restraint on Business.**

(a) (i) The service of process seeking to attach, by trustee or similar process, any funds of Borrower or of any entity under the control of Borrower (including a Subsidiary) on deposit or otherwise maintained with Bank or any Bank Affiliate, or (ii) a notice of lien or levy is filed against any of Borrower's assets by any government agency, and the same under subclauses (i) and (ii) hereof are not, within ten (10) days after the occurrence thereof, discharged or stayed (whether through the posting of a bond or otherwise); provided, however, no Credit Extensions shall be made during any ten (10) day cure period; or

(b) (i) any material portion of Borrower's assets is attached, seized, levied on, or comes into possession of a trustee or receiver, or (ii) any court order enjoins, restrains, or prevents Borrower from conducting any material part of its business;

**8.5 Insolvency.** (a) Borrower is unable to pay its debts (including trade debts) as they become due or otherwise becomes insolvent; (b) Borrower begins an Insolvency Proceeding; or (c) an Insolvency Proceeding is begun against Borrower and not dismissed or stayed within forty-five (45) days (but no Credit Extensions shall be made while of any of the conditions described in clause (a) exist and/or until any Insolvency Proceeding is dismissed);

**8.6 Other Agreements.** There is, under any agreement to which Borrower or any Guarantor is a party with a third party or parties, (a) any default resulting in a right by such third party or parties, whether or not exercised, to accelerate the maturity of any Indebtedness in an amount individually or in the aggregate in excess of One Hundred Thousand Dollars (\$100,000); (b) any default by Borrower or Guarantor which (without limitation on the generality of Section 8.3) constitutes a Material Adverse Change; or (c) any default by Guarantor, the result of which could have a material adverse effect on such Guarantor's business;

**8.7 Judgments.** One or more final judgments, orders, or decrees for the payment of money in an amount, individually or in the aggregate, of at least One Hundred Thousand Dollars (\$100,000) (not covered by independent third-party insurance as to which liability has been accepted by such insurance carrier) shall be rendered against Borrower and the same are not, within ten (10) days after the entry thereof, discharged or execution thereof stayed or bonded pending appeal, or such judgments are not discharged prior to the expiration of any such stay (provided that no Credit Extensions will be made prior to the discharge, stay, or bonding of such judgment, order, or decree);

**8.8 Misrepresentations.** Borrower or any Person acting for Borrower makes any representation, warranty, or other statement now or later in this Agreement, any Loan Document or in any writing delivered to Bank or to induce Bank to enter this Agreement or any Loan Document, and such representation, warranty, or other statement is incorrect in any material respect when made; or

**8.9 Subordinated Debt.** Any document, instrument, or agreement evidencing any Subordinated Debt shall for any reason be revoked or invalidated or otherwise cease to be in full force and effect; any Person shall be in breach thereof or contest in any manner the validity or enforceability thereof or deny that it has any further liability or obligation thereunder; a default or breach occurs under any agreement between Borrower and any creditor of Borrower that signed a subordination, intercreditor, or other similar agreement with Bank, or any creditor that has signed such an agreement with Bank breaches any terms of such agreement; or the Obligations shall for any reason be subordinated or shall not have the priority contemplated by this Agreement or any such subordination, intercreditor, or other similar agreement.

## **9 BANK'S RIGHTS AND REMEDIES**

**9.1 Rights and Remedies.** If an Event of Default has occurred and is continuing, Bank may, without notice or demand, do any or all of the following:

(a) declare all Obligations immediately due and payable (but if an Event of Default described in Section 8.5 occurs all Obligations are immediately due and payable without any action by Bank);

(b) stop advancing money or extending credit for Borrower's benefit under this Agreement or under any other agreement between Borrower and Bank;

(c) demand that Borrower (i) deposit cash with Bank in an amount equal to 105% of the Dollar Equivalent of the aggregate face amount of all Letters of Credit remaining undrawn (plus all interest, fees, and costs due or to become due in connection therewith (as estimated by Bank in its good faith business judgment)), to secure all of the Obligations relating to such Letters of Credit, as collateral security for the repayment of any future drawings under such Letters of Credit, and Borrower shall forthwith deposit and pay such amounts, and (ii) pay in advance all letter of credit fees scheduled to be paid or payable over the remaining term of any Letters of Credit;

(d) [Reserved];

(e) verify the amounts of, demand payment of and performance under, and collect any Accounts and General Intangibles, and settle or adjust disputes and claims directly with Account Debtors for amounts on terms and in any order that Bank considers advisable, and notify any Person owing Borrower money of Bank's security interest in such funds;

(f) make any payments and do any acts it considers necessary or reasonable to protect the Collateral and/or its security interest in the Collateral. Borrower shall assemble the Collateral if Bank requests and make it available as Bank designates. Bank may enter premises where the Collateral is located, take and maintain possession of any part of the Collateral, and pay, purchase, contest, or compromise any Lien which appears to be prior or superior to its security interest and pay all expenses incurred. Borrower grants Bank a license to enter and occupy any of its premises, without charge, to exercise any of Bank's rights or remedies;

(g) apply to the Obligations any (i) balances and deposits of Borrower it holds, or (ii) any amount held by Bank owing to or for the credit or the account of Borrower;

(h) ship, reclaim, recover, store, finish, maintain, repair, prepare for sale, advertise for sale, and sell the Collateral. Bank is hereby granted a non-exclusive, royalty-free license or other right to use, without charge, Borrower's labels, Patents, Copyrights, mask works, rights of use of any name, trade secrets, trade names, Trademarks, and advertising matter, or any similar property as it pertains to the Collateral, in completing production of, advertising for sale, and selling any Collateral and, in connection with Bank's exercise of its rights under this Section, Borrower's rights under all licenses and all franchise agreements inure to Bank's benefit;

(i) place a "hold" on any account maintained with Bank and/or deliver a notice of exclusive control, any entitlement order, or other directions or instructions pursuant to any Control Agreement or similar agreements providing control of any Collateral;

(j) demand and receive possession of Borrower's Books; and

(k) exercise all rights and remedies available to Bank under the Loan Documents or at law or equity, including all remedies provided under the Code (including disposal of the Collateral pursuant to the terms thereof).

**9.2 Power of Attorney.** Borrower hereby irrevocably appoints Bank as its lawful attorney-in-fact, exercisable upon the occurrence and during the continuance of an Event of Default, to: (a) endorse Borrower's name on any checks or other forms of payment or security; (b) sign Borrower's name on any invoice or bill of lading for any Account or drafts against Account Debtors; (c) settle and adjust disputes and claims about the Accounts directly with Account Debtors, for amounts and on terms Bank determines reasonable; (d) make, settle, and adjust all claims under Borrower's insurance policies; (e) pay, contest or settle any Lien, charge, encumbrance, security interest, and adverse claim in or to the Collateral, or any judgment based thereon, or otherwise take any action to terminate or discharge the same; and (f) transfer the Collateral into the name of Bank or a third party as the Code permits. Borrower hereby appoints Bank as its lawful attorney-in-fact to sign Borrower's name on any documents necessary to perfect or continue the perfection of Bank's security interest in the Collateral regardless of whether an Event of Default has occurred until all Obligations have been satisfied in full and Bank is under no further obligation to make Credit Extensions hereunder. Bank's foregoing appointment as Borrower's attorney in fact, and all of Bank's rights and powers, coupled with an interest, are irrevocable until all Obligations have been fully repaid and performed and Bank's obligation to provide Credit Extensions terminates.



**9.3 Protective Payments.** If Borrower fails to obtain the insurance called for by Section 6.7 or fails to pay any premium thereon or fails to pay any other amount which Borrower is obligated to pay under this Agreement or any other Loan Document, Bank may obtain such insurance or make such payment, and all amounts so paid by Bank are Bank Expenses and immediately due and payable, bearing interest at the then highest rate applicable to the Obligations, and secured by the Collateral. Bank will make reasonable efforts to provide Borrower with notice of Bank obtaining such insurance at the time it is obtained or within a reasonable time thereafter. No payments by Bank are deemed an agreement to make similar payments in the future or Bank's waiver of any Event of Default.

**9.4 Application of Payments and Proceeds.** If an Event of Default has occurred and is continuing, Bank may apply any funds in its possession, whether from Borrower account balances, payments, proceeds realized as the result of any collection of Accounts or other disposition of the Collateral, or otherwise, to the Obligations in such order as Bank shall determine in its sole discretion. Any surplus shall be paid to Borrower by credit to the Designated Deposit Account or to other Persons legally entitled thereto; Borrower shall remain liable to Bank for any deficiency. If Bank, in its good faith business judgment, directly or indirectly enters into a deferred payment or other credit transaction with any purchaser at any sale of Collateral, Bank shall have the option, exercisable at any time, of either reducing the Obligations by the principal amount of the purchase price or deferring the reduction of the Obligations until the actual receipt by Bank of cash therefor.

**9.5 Bank's Liability for Collateral.** So long as Bank complies with reasonable banking practices regarding the safekeeping of the Collateral in the possession or under the control of Bank, Bank shall not be liable or responsible for: (a) the safekeeping of the Collateral; (b) any loss or damage to the Collateral; (c) any diminution in the value of the Collateral; or (d) any act or default of any carrier, warehouseman, bailee, or other Person. Borrower bears all risk of loss, damage or destruction of the Collateral.

**9.6 No Waiver; Remedies Cumulative.** Bank's failure, at any time or times, to require strict performance by Borrower of any provision of this Agreement or any other Loan Document shall not waive, affect, or diminish any right of Bank thereafter to demand strict performance and compliance herewith or therewith. No waiver hereunder shall be effective unless signed by the party granting the waiver and then is only effective for the specific instance and purpose for which it is given. Bank's rights and remedies under this Agreement and the other Loan Documents are cumulative. Bank has all rights and remedies provided under the Code, by law, or in equity. Bank's exercise of one right or remedy is not an election and shall not preclude Bank from exercising any other remedy under this Agreement or other remedy available at law or in equity, and Bank's waiver of any Event of Default is not a continuing waiver. Bank's delay in exercising any remedy is not a waiver, election, or acquiescence.

**9.7 Demand Waiver.** Borrower waives demand, notice of default or dishonor, notice of payment and nonpayment, notice of any default, nonpayment at maturity, release, compromise, settlement, extension, or renewal of accounts, documents, instruments, chattel paper, and guarantees held by Bank on which Borrower is liable.

## **10 NOTICES**

All notices, consents, requests, approvals, demands, or other communication by any party to this Agreement or any other Loan Document must be in writing and shall be deemed to have been validly served, given, or delivered: (a) upon the earlier of actual receipt and three (3) Business Days after deposit in the U.S. mail, first class, registered or certified mail return receipt requested, with proper postage prepaid; (b) upon transmission, when sent by electronic mail or facsimile transmission; (c) one (1) Business Day after deposit with a reputable overnight courier with all charges prepaid; or (d) when delivered, if hand-delivered by messenger, all of which shall be addressed to the party to be notified and sent to the address, facsimile number, or email address indicated below. Bank or Borrower may change its mailing or electronic mail address or facsimile number by giving the other party written notice thereof in accordance with the terms of this Section 10.

If to Borrower: AtriCure, Inc.  
6033 Schumacher Park Drive  
West Chester, Ohio 45069  
Attn: Julie A. Piton  
Fax: (513) 644-1315  
Email: [jpiton@atricure.com](mailto:jpiton@atricure.com)

If to Bank: Silicon Valley Bank  
230 West Monroe, Suite 720  
Chicago, IL 60606  
Attn: Janice Galbavy  
Fax: (312) 704-1532  
Email: [Jgalbavy@svb.com](mailto:Jgalbavy@svb.com)

## **11 CHOICE OF LAW, VENUE, JURY TRIAL WAIVER AND JUDICIAL REFERENCE**

California law governs the Loan Documents without regard to principles of conflicts of law. Borrower and Bank each submit to the exclusive jurisdiction of the State and Federal courts in Santa Clara County, California; provided, however, that nothing in this Agreement shall be deemed to operate to preclude Bank from bringing suit or taking other legal action in any other jurisdiction to realize on the Collateral or any other security for the Obligations, or to enforce a judgment or other court order in favor of Bank. Borrower expressly submits and consents in advance to such jurisdiction in any action or suit commenced in any such court, and Borrower hereby waives any objection that it may have based upon lack of personal jurisdiction, improper venue, or forum non conveniens and hereby consents to the granting of such legal or equitable relief as is deemed appropriate by such court. Borrower hereby waives personal service of the summons, complaints, and other process issued in such action or suit and agrees that service of such summons, complaints, and other process may be made by registered or certified mail addressed to Borrower at the address set forth in, or subsequently provided by Borrower in accordance with, Section 10 of this Agreement and that service so made shall be deemed completed upon the earlier to occur of Borrower's actual receipt thereof or three (3) days after deposit in the U.S. mails, proper postage prepaid.

**TO THE FULLEST EXTENT PERMITTED BY APPLICABLE LAW, BORROWER AND BANK EACH WAIVE THEIR RIGHT TO A JURY TRIAL OF ANY CLAIM OR CAUSE OF ACTION ARISING OUT OF OR BASED UPON THIS AGREEMENT, THE LOAN DOCUMENTS OR ANY CONTEMPLATED TRANSACTION, INCLUDING CONTRACT, TORT, BREACH OF DUTY AND ALL OTHER CLAIMS. THIS WAIVER IS A MATERIAL INDUCEMENT FOR BOTH PARTIES TO ENTER INTO THIS AGREEMENT. EACH PARTY HAS REVIEWED THIS WAIVER WITH ITS COUNSEL.**

WITHOUT INTENDING IN ANY WAY TO LIMIT THE PARTIES' AGREEMENT TO WAIVE THEIR RESPECTIVE RIGHT TO A TRIAL BY JURY, if the above waiver of the right to a trial by jury is not enforceable, the parties hereto agree that any and all disputes or controversies of any nature between them arising at any time shall be decided by a reference to a private judge, mutually selected by the parties (or, if they cannot agree, by the Presiding Judge of the Santa Clara County, California Superior Court) appointed in accordance with California Code of Civil Procedure Section 638 (or pursuant to comparable provisions of federal law if the dispute falls within the exclusive jurisdiction of the federal courts), sitting without a jury, in Santa Clara County, California; and the parties hereby submit to the jurisdiction of such court. The reference proceedings shall be conducted pursuant to and in accordance with the provisions of California Code of Civil Procedure §§ 638 through 645.1, inclusive. The private judge shall have the power, among others, to grant provisional relief, including without limitation, entering temporary restraining orders, issuing preliminary and permanent injunctions and appointing receivers. All such proceedings shall be closed to the public and confidential and all records relating thereto shall be permanently sealed. If during the course of any dispute, a party desires to seek provisional relief, but a judge has not been appointed at that point pursuant to the judicial reference procedures, then such party may apply to the Santa Clara County, California Superior Court for such relief. The proceeding before the private judge shall be conducted in the same manner as it would be before a court under the rules of evidence applicable to judicial proceedings. The parties shall be entitled to discovery which shall be conducted in the same manner as it would be before a court under the rules of discovery applicable to judicial proceedings. The private judge shall oversee discovery and may enforce all discovery rules and orders applicable to judicial proceedings in the same manner as a trial court judge. The parties agree that the selected or appointed private judge shall have the power to decide all issues in the action

or proceeding, whether of fact or of law, and shall report a statement of decision thereon pursuant to California Code of Civil Procedure § 644(a). Nothing in this paragraph shall limit the right of any party at any time to exercise self-help remedies, foreclose against collateral, or obtain provisional remedies. The private judge shall also determine all issues relating to the applicability, interpretation, and enforceability of this paragraph.

## **12 GENERAL PROVISIONS**

**12.1 Termination Prior to Revolving Line Maturity Date.** This Agreement may be terminated prior to the Revolving Line Maturity Date by Borrower, effective three (3) Business Days after written notice of termination is given to Bank. Notwithstanding any such termination, Bank's lien and security interest in the Collateral and all of Bank's rights and remedies under this Agreement shall continue until Borrower fully satisfies its Obligations. If such termination is at Borrower's election or at Bank's election due to the occurrence and continuance of an Event of Default or if any of the Obligations become due and payable as a result of an Event of Default (including without limitation becoming due and payable as a result of an Insolvency Proceeding), Borrower shall pay to Bank, in addition to the payment of any other expenses or fees then-owing, a termination fee in an amount equal to 3.0% of the Net Maximum Dollar Amount if termination occurs on or before the first anniversary of the Effective Date, and 2.0% of the Net Maximum Dollar Amount if termination occurs after the first anniversary of the Effective Date and on or before the second anniversary of the Effective Date, and 1.0% of the Net Maximum Dollar Amount if termination occurs after the second anniversary of the Effective Date and before the Revolving Line Maturity Date; provided that no termination fee shall be charged if the credit facility hereunder is replaced with a new facility from another division of Bank.

**12.2 Successors and Assigns.** This Agreement binds and is for the benefit of the successors and permitted assigns of each party. Borrower may not assign this Agreement or any rights or obligations under it without Bank's prior written consent (which may be granted or withheld in Bank's discretion). Bank has the right, without the consent of or notice to Borrower, to sell, transfer, assign, negotiate, or grant participation in all or any part of, or any interest in, Bank's obligations, rights, and benefits under this Agreement and the other Loan Documents. Notwithstanding the foregoing, prior to the occurrence of an Event of Default, Bank shall not assign any interest in the Loan Documents to an operating company which is a direct competitor of Borrower.

**12.3 Indemnification.** Borrower agrees to indemnify, defend and hold Bank and its directors, officers, employees, agents, attorneys, or any other Person affiliated with or representing Bank (each, an "**Indemnified Person**") harmless against: (a) all obligations, demands, claims, and liabilities (collectively, "**Claims**") claimed or asserted by any other party in connection with the transactions contemplated by the Loan Documents; and (b) all losses or expenses (including Bank Expenses) in any way suffered, incurred, or paid by such Indemnified Person as a result of, following from, consequential to, or arising from transactions between Bank and Borrower (including reasonable attorneys' fees and expenses), except for Claims and/or losses directly caused by such Indemnified Person's gross negligence or willful misconduct.

**12.4 Time of Essence.** Time is of the essence for the performance of all Obligations in this Agreement.

**12.5 Severability of Provisions.** Each provision of this Agreement is severable from every other provision in determining the enforceability of any provision.

**12.6 Correction of Loan Documents.** Bank may correct patent errors and fill in any blanks in the Loan Documents consistent with the agreement of the parties so long as Bank provides Borrower with written notice of such correction and allows Borrower at least ten (10) days to object to such correction. In the event of such objection, such correction shall not be made except by an amendment signed by both Bank and Borrower.

**12.7 Amendments in Writing; Waiver; Integration.** No purported amendment or modification of any Loan Document, or waiver, discharge or termination of any obligation under any Loan Document, shall be enforceable or admissible unless, and only to the extent, expressly set forth in a writing signed by the party against which enforcement or admission is sought. Without limiting the generality of the foregoing, no oral promise or statement, nor any action, inaction, delay, failure to require performance or course of conduct shall operate as, or evidence, an amendment, supplement or waiver or have any other effect on any Loan Document. Any waiver granted shall be limited to the specific circumstance expressly described in it, and shall not apply to any subsequent or other circumstance, whether similar or dissimilar, or give rise to, or evidence, any obligation or commitment to

grant any further waiver. The Loan Documents represent the entire agreement about this subject matter and supersede prior negotiations or agreements. All prior agreements, understandings, representations, warranties, and negotiations between the parties about the subject matter of the Loan Documents merge into the Loan Documents.

**12.8 Counterparts.** This Agreement may be executed in any number of counterparts and by different parties on separate counterparts, each of which, when executed and delivered, is an original, and all taken together, constitute one Agreement.

**12.9 Survival.** All covenants, representations and warranties made in this Agreement continue in full force until this Agreement has terminated pursuant to its terms and all Obligations (other than inchoate indemnity obligations and any other obligations which, by their terms, are to survive the termination of this Agreement) have been satisfied. The obligation of Borrower in Section 12.3 to indemnify Bank shall survive until the statutes of limitation with respect to all Claims, losses and expenses for which such indemnity is given shall have run.

**12.10 Confidentiality.** In handling any confidential information, Bank shall exercise the same degree of care that it exercises for its own proprietary information, but disclosure of information may be made: (a) to Bank's Subsidiaries or Affiliates; (b) to prospective transferees or purchasers of any interest in the Credit Extensions (provided, however, Bank shall use its best efforts to obtain any prospective transferee's or purchaser's agreement to the terms of this provision); (c) as required by law, regulation, subpoena, or other order; (d) to Bank's regulators or as otherwise required in connection with Bank's examination or audit; (e) as Bank considers appropriate in exercising remedies under the Loan Documents; and (f) to third-party service providers of Bank so long as such service providers have executed a confidentiality agreement with Bank with terms no less restrictive than those contained herein. Confidential information does not include information that is either: (i) in the public domain (other than as a result of a disclosure by Bank) or in Bank's possession when disclosed to Bank, or becomes part of the public domain after disclosure to Bank; or (ii) disclosed to Bank by a third party, if Bank does not know that the third party is prohibited from disclosing the information.

Bank may use confidential information for the development of databases, reporting purposes, and market analysis so long as such confidential information is aggregated and anonymized prior to distribution unless otherwise expressly permitted by Borrower. The provisions of this Section 12.10 shall survive the termination of this Agreement.

**12.11 Attorneys' Fees, Costs and Expenses.** In any action or proceeding between Borrower and Bank arising out of or relating to the Loan Documents, the prevailing party shall be entitled to recover its reasonable attorneys' fees and other costs and expenses incurred, in addition to any other relief to which it may be entitled.

**12.12 Electronic Execution of Documents.** The words "execution," "signed," "signature" and words of like import in any Loan Document shall be deemed to include electronic signatures or the keeping of records in electronic form, each of which shall be of the same legal effect, validity and enforceability as a manually executed signature or the use of a paper-based recordkeeping systems, as the case may be, to the extent and as provided for in any applicable law, including, without limitation, any state law based on the Uniform Electronic Transactions Act.

**12.13 Captions.** The headings used in this Agreement are for convenience only and shall not affect the interpretation of this Agreement.

**12.14 Construction of Agreement.** The parties mutually acknowledge that they and their attorneys have participated in the preparation and negotiation of this Agreement. In cases of uncertainty this Agreement shall be construed without regard to which of the parties caused the uncertainty to exist.

**12.15 Relationship.** The relationship of the parties to this Agreement is determined solely by the provisions of this Agreement. The parties do not intend to create any agency, partnership, joint venture, trust, fiduciary or other relationship with duties or incidents different from those of parties to an arm's-length contract.

**12.16 Third Parties.** Nothing in this Agreement, whether express or implied, is intended to: (a) confer any benefits, rights or remedies under or by reason of this Agreement on any persons other than the express parties to it and their respective permitted successors and assigns; (b) relieve or discharge the obligation or liability of any person not an express party to this Agreement; or (c) give any person not an express party to this Agreement any right of subrogation or action against any party to this Agreement.

### 13 DEFINITIONS

**13.1 Definitions.** As used in the Loan Documents, the word “shall” is mandatory, the word “may” is permissive, the word “or” is not exclusive, the words “includes” and “including” are not limiting, the singular includes the plural, and numbers denoting amounts that are set off in brackets are negative. As used in this Agreement, the following capitalized terms have the following meanings:

“**Account**” is any “account” as defined in the Code with such additions to such term as may hereafter be made, and includes, without limitation, all accounts receivable and other sums owing to Borrower.

“**Account Debtor**” is any “account debtor” as defined in the Code with such additions to such term as may hereafter be made.

“**Adjusted Quick Ratio**” is the ratio of (a) Borrower’s unrestricted cash and unrestricted Cash Equivalents held with Bank and Bank’s Affiliates plus Borrower’s Eligible Accounts, divided by (b) Borrower’s Current Liabilities (including any amounts used for Cash Management Services and the face amount of outstanding Letters of Credit (including drawn but unreimbursed Letters of Credit)) minus the current portion of Deferred Revenue. (For purposes of clarity, the parties acknowledge that Borrower’s cash or Cash Equivalents shall not be considered to be restricted by reason of the fact that they are subject to Bank’s Lien.)

“**Advance**” or “**Advances**” means an advance (or advances) under the Revolving Line.

“**Affiliate**” is, with respect to any Person, each other Person that owns or controls directly or indirectly the Person, any Person that controls or is controlled by or is under common control with the Person, and each of that Person’s senior executive officers, directors, partners and, for any Person that is a limited liability company, that Person’s managers and members.

“**Agreement**” is defined in the preamble hereof.

“**Availability Amount**” is (a) the lesser of (i) the Net Maximum Dollar Amount or (ii) the amount available under the Borrowing Base, minus, without duplication, (b) the aggregate Dollar Equivalent amount of all outstanding Letters of Credit (including drawn but unreimbursed Letters of Credit), minus, without duplication, (c) any amounts being used for Cash Management Services, and minus, without duplication, (d) the outstanding principal balance of any Advances.

“**Bank**” is defined in the preamble hereof.

“**Bank Expenses**” are all audit fees and expenses, costs, and expenses (including reasonable attorneys’ fees and expenses) for preparing, amending, negotiating, administering, defending and enforcing the Loan Documents (including, without limitation, those incurred in connection with appeals or Insolvency Proceedings) or otherwise incurred with respect to Borrower or any Guarantor.

“**Base Rate**” is the greater of the Prime Rate or 4.0% per annum.

“**Borrower**” is defined in the preamble hereof

“**Borrower’s Books**” are all Borrower’s books and records including ledgers, federal and state tax returns, records regarding Borrower’s assets or liabilities, the Collateral, business operations or financial condition, and all computer programs or storage or any equipment containing such information.

“**Borrowing Base**” is 80% of Eligible Accounts, as determined by Bank from Borrower’s most recent Transaction Report, less the Term Loan-Related Reserve; provided, however, that Bank may decrease the foregoing percentage in its good faith business judgment based on events, conditions, contingencies, or risks which, as determined by Bank, may adversely affect Collateral.

**“Borrowing Resolutions”** are the Bank’s form of Corporate Borrowing Certificate (with such revisions thereto as Bank and Borrower shall agree), completed and signed by the applicable officers of Borrower.

**“Business Day”** is any day that is not a Saturday, Sunday or a day on which Bank is closed.

**“Cash Equivalents”** means (a) marketable direct obligations issued or unconditionally guaranteed by the United States or any agency or any State thereof having maturities of not more than one (1) year from the date of acquisition; (b) commercial paper maturing no more than one (1) year after its creation and having the highest rating from either Standard & Poor’s Ratings Group or Moody’s Investors Service, Inc.; (c) Bank’s certificates of deposit issued maturing no more than one (1) year after issue; and (d) money market funds at least ninety-five percent (95%) of the assets of which constitute Cash Equivalents of the kinds described in clauses (a) through (c) of this definition.

**“Cash Management Services”** is defined in Section 2.1.4.

**“Change in Control”** means any event, transaction, or occurrence as a result of which (a) any “person” (as such term is defined in Sections 3(a)(9) and 13(d)(3) of the Exchange Act), other than a trustee or other fiduciary holding securities under an employee benefit plan of Borrower, is or becomes a beneficial owner (within the meaning Rule 13d-3 promulgated under the Exchange Act), directly or indirectly, of securities of Borrower, representing twenty-five percent (25%) or more of the combined voting power of Borrower’s then outstanding securities.

**“Code”** is the Uniform Commercial Code, as the same may, from time to time, be enacted and in effect in the State of California; provided, that, to the extent that the Code is used to define any term herein or in any Loan Document and such term is defined differently in different Articles or Divisions of the Code, the definition of such term contained in Article or Division 9 shall govern; provided further, that in the event that, by reason of mandatory provisions of law, any or all of the attachment, perfection, or priority of, or remedies with respect to, Bank’s Lien on any Collateral is governed by the Uniform Commercial Code in effect in a jurisdiction other than the State of California, the term **“Code”** shall mean the Uniform Commercial Code as enacted and in effect in such other jurisdiction solely for purposes of the provisions thereof relating to such attachment, perfection, priority, or remedies and for purposes of definitions relating to such provisions.

**“Collateral”** is any and all properties, rights and assets of Borrower described on Exhibit A.

**“Collateral Account”** is any Deposit Account, Securities Account, or Commodity Account.

**“Commodity Account”** is any “commodity account” as defined in the Code with such additions to such term as may hereafter be made.

**“Compliance Certificate”** is that certain certificate in the form attached hereto as Exhibit B.

**“Contingent Obligation”** is, for any Person, any direct or indirect liability, contingent or not, of that Person for (a) any indebtedness, lease, dividend, letter of credit or other obligation of another such as an obligation, in each case, directly or indirectly guaranteed, endorsed, co-made, discounted or sold with recourse by that Person, or for which that Person is directly or indirectly liable; (b) any obligations for undrawn letters of credit for the account of that Person; and (c) all obligations from any interest rate, currency or commodity swap agreement, interest rate cap or collar agreement, or other agreement or arrangement designated to protect a Person against fluctuation in interest rates, currency exchange rates or commodity prices; but “Contingent Obligation” does not include endorsements in the ordinary course of business. The amount of a Contingent Obligation is the stated or determined amount of the primary obligation for which the Contingent Obligation is made or, if not determinable, the maximum reasonably anticipated liability for it determined by the Person in good faith; but the amount may not exceed the maximum of the obligations under any guarantee or other support arrangement.

**“Control Agreement”** is any control agreement entered into among the depository institution at which Borrower maintains a Deposit Account or the securities intermediary or commodity intermediary at which Borrower maintains a Securities Account or a Commodity Account, Borrower, and Bank pursuant to which Bank obtains control (within the meaning of the Code) over such Deposit Account, Securities Account, or Commodity Account.

“**Copyrights**” are any and all copyright rights, copyright applications, copyright registrations and like protections in each work or authorship and derivative work thereof, whether published or unpublished and whether or not the same also constitutes a trade secret.

“**Credit Extension**” is any Advance, Letter of Credit, amount utilized for Cash Management Services, Term Loan, or any other extension of credit by Bank for Borrower’s benefit.

“**Current Assets**” are amounts that under GAAP should be included on that date as current assets on Borrower’s consolidated balance sheet.

“**Current Liabilities**” are all obligations and liabilities of Borrower to Bank (regardless of when they mature), plus, without duplication, the aggregate amount of Borrower’s Total Liabilities that mature within one (1) year.

“**Default**” means any event which with notice or passage of time or both, would constitute an Event of Default.

“**Default Rate**” is defined in Section 2.3(b).

“**Deferred Revenue**” is all amounts received or invoiced in advance of performance under contracts and not yet recognized as revenue.

“**Deposit Account**” is any “deposit account” as defined in the Code with such additions to such term as may hereafter be made.

“**Designated Deposit Account**” is Borrower’s deposit account, account number 3300640389, maintained with Bank.

“**Dollars,**” “**dollars**” or use of the sign “**\$**” means only lawful money of the United States and not any other currency, regardless of whether that currency uses the “**\$**” sign to denote its currency or may be readily converted into lawful money of the United States.

“**Dollar Equivalent**” is, at any time, (a) with respect to any amount denominated in Dollars, such amount, and (b) with respect to any amount denominated in a Foreign Currency, the equivalent amount therefor in Dollars as determined by Bank at such time on the basis of the then-prevailing rate of exchange in San Francisco, California, for sales of the Foreign Currency for transfer to the country issuing such Foreign Currency.

“**Domestic Subsidiary**” means a Subsidiary organized under the laws of the United States or any state or territory thereof or the District of Columbia.

“**EBITDA**” shall mean (a) Net Income, plus (b) Interest Expense, plus (c) to the extent deducted in the calculation of Net Income, depreciation expense and amortization expense, plus (d) to the extent deducted in the calculation of Net Income, income tax expense, plus (e) to the extent deducted in the calculation of Net Income, non-cash charges including non-cash equity compensation.

“**Effective Date**” is defined in the preamble hereof.

“**Eligible Accounts**” means Accounts which arise in the ordinary course of Borrower’s business that meet all Borrower’s representations and warranties in Section 5.3. Bank reserves the right upon prior written notice to Borrower at any time after the Effective Date to adjust any of the criteria set forth below and to establish new criteria in its good faith business judgment. Unless Bank otherwise agrees in writing, Eligible Accounts shall not include:

(a) Accounts that the Account Debtor has not paid within ninety (90) days of invoice date regardless of invoice payment period terms;

- (b) Accounts owing from an Account Debtor, fifty percent (50%) or more of whose Accounts have not been paid within ninety (90) days of invoice date;
- (c) Accounts owing from an Account Debtor which does not have its principal place of business in the United States or Canada;
- (d) Accounts billed and/or payable outside of the United States;
- (e) Accounts owing from an Account Debtor to the extent that Borrower is indebted or obligated in any manner to the Account Debtor (as creditor, lessor, supplier or otherwise - sometimes called "contra" accounts, accounts payable, customer deposits or credit accounts), with the exception of customary credits, adjustments and/or discounts given to an Account Debtor by Borrower in the ordinary course of its business;
- (f) Accounts for which the Account Debtor is Borrower's Affiliate, officer, employee, or agent;
- (g) Accounts with credit balances over ninety (90) days from invoice date;
- (h) Accounts owing from an Account Debtor, including Affiliates, whose total obligations to Borrower exceed twenty-five percent (25%) of all Accounts, for the amounts that exceed that percentage, unless Bank approves in writing;
- (i) Accounts owing from an Account Debtor which is a United States government entity or any department, agency, or instrumentality thereof unless Borrower has assigned its payment rights to Bank and the assignment has been acknowledged under the Federal Assignment of Claims Act of 1940, as amended;
- (j) Accounts for demonstration or promotional equipment, or in which goods are consigned, or sold on a "sale guaranteed", "sale or return", "sale on approval", or other terms if Account Debtor's payment may be conditional;
- (k) Accounts owing from an Account Debtor that has not been invoiced or where goods or services have not yet been rendered to the Account Debtor (sometimes called memo billings or pre-billings);
- (l) Accounts subject to contractual arrangements between Borrower and an Account Debtor where payments shall be scheduled or due according to completion or fulfillment requirements where the Account Debtor has a right of offset for damages suffered as a result of Borrower's failure to perform in accordance with the contract (sometimes called contracts accounts receivable, progress billings, milestone billings, or fulfillment contracts);
- (m) Accounts owing from an Account Debtor the amount of which may be subject to withholding based on the Account Debtor's satisfaction of Borrower's complete performance (but only to the extent of the amount withheld; sometimes called retainage billings);
- (n) Accounts subject to trust provisions, subrogation rights of a bonding company, or a statutory trust;
- (o) Accounts owing from an Account Debtor that has been invoiced for goods that have not been shipped to the Account Debtor unless Bank, Borrower, and the Account Debtor have entered into an agreement acceptable to Bank in its sole discretion wherein the Account Debtor acknowledges that (i) it has title to and has ownership of the goods wherever located, (ii) a bona fide sale of the goods has occurred, and (iii) it owes payment for such goods in accordance with invoices from Borrower (sometimes called "bill and hold" accounts);
- (p) Accounts owing from an Account Debtor with respect to which Borrower has received Deferred Revenue (but only to the extent of such Deferred Revenue);
- (q) Accounts for which the Account Debtor has not been invoiced;
- (r) Accounts that represent non-trade receivables or that are derived by means other than in the ordinary course of Borrower's business;



(s) Accounts for which Borrower has permitted Account Debtor's payment to extend beyond 90 days;

(t) Accounts subject to chargebacks or others payment deductions taken by an Account Debtor (but only to the extent of the chargebacks or deductions);

(u) Accounts in which the Account Debtor disputes liability or makes any claim (but only up to the disputed or claimed amount), or if the Account Debtor is subject to an Insolvency Proceeding, or becomes insolvent, or goes out of business; and

(v) Accounts for which Bank in its good faith business judgment determines collection to be doubtful.

**"Equipment"** is all "equipment" as defined in the Code with such additions to such term as may hereafter be made, and includes without limitation all machinery, fixtures, goods, vehicles (including motor vehicles and trailers), and any interest in any of the foregoing.

**"ERISA"** is the Employee Retirement Income Security Act of 1974, and its regulations.

**"Event of Default"** is defined in Section 8.

**"Exchange Act"** is the Securities Exchange Act of 1934, as amended.

**"Fixed Charge Coverage Ratio"** means a ratio of (a) EBITDA, minus cash income taxes paid, and minus unfinanced capital expenditures, to (b) current portion of long term debt, plus cash Interest Expense paid.

**"Foreign Currency"** means lawful money of a country other than the United States.

**"Foreign Subsidiary"** means any Subsidiary which is not a Domestic Subsidiary.

**"Funding Date"** is any date on which a Credit Extension is made to or for the account of Borrower which shall be a Business Day.

**"GAAP"** is generally accepted accounting principles set forth in the opinions and pronouncements of the Accounting Principles Board of the American Institute of Certified Public Accountants and statements and pronouncements of the Financial Accounting Standards Board or in such other statements by such other Person as may be approved by a significant segment of the accounting profession, which are applicable to the circumstances as of the date of determination.

**"General Intangibles"** is all "general intangibles" as defined in the Code in effect on the date hereof with such additions to such term as may hereafter be made, and includes without limitation, all Intellectual Property, claims, income and other tax refunds, security and other deposits, payment intangibles, contract rights, options to purchase or sell real or personal property, rights in all litigation presently or hereafter pending (whether in contract, tort or otherwise), insurance policies (including without limitation key man, property damage, and business interruption insurance), payments of insurance and rights to payment of any kind.

**"Governmental Approval"** is any consent, authorization, approval, order, license, franchise, permit, certificate, accreditation, registration, filing or notice, of, issued by, from or to, or other act by or in respect of, any Governmental Authority.

**"Governmental Authority"** is any nation or government, any state or other political subdivision thereof, any agency, authority, instrumentality, regulatory body, court, central bank or other entity exercising executive, legislative, judicial, taxing, regulatory or administrative functions of or pertaining to government, any securities exchange and any self-regulatory organization.

**"Guarantor"** is any present or future guarantor of the Obligations.

**“Indebtedness”** is (a) indebtedness for borrowed money or the deferred price of property or services, such as reimbursement and other obligations for surety bonds and letters of credit, (b) obligations evidenced by notes, bonds, debentures or similar instruments, (c) capital lease obligations, and (d) Contingent Obligations.

**“Indemnified Person”** is defined in Section 12.3.

**“Initial Audit”** is Bank’s inspection of Borrower’s Accounts, the other Collateral, and Borrower’s Books, with results satisfactory to Bank in its sole and absolute discretion.

**“Insolvency Proceeding”** is any proceeding by or against any Person under the United States Bankruptcy Code, or any other bankruptcy or insolvency law, including assignments for the benefit of creditors, compositions, extensions generally with its creditors, or proceedings seeking reorganization, arrangement, or other relief.

**“Intellectual Property”** means all of Borrower’s right, title, and interest in and to the following:

(a) its Copyrights, Trademarks and Patents;

(b) any and all trade secrets and trade secret rights, including, without limitation, any rights to unpatented inventions, know-how, operating manuals;

(c) any and all source code;

(d) any and all design rights which may be available to a Borrower;

(e) any and all claims for damages by way of past, present and future infringement of any of the foregoing, with the right, but not the obligation, to sue for and collect such damages for said use or infringement of the Intellectual Property rights identified above; and

(f) all amendments, renewals and extensions of any of the Copyrights, Trademarks or Patents.

**“Interest Expense”** means for any fiscal period, interest expense (whether cash or non-cash) determined in accordance with GAAP for the relevant period ending on such date, including, in any event, interest expense with respect to any Credit Extension and other Indebtedness of Borrower and its Subsidiaries, including, without limitation or duplication, all commissions, discounts, or related amortization and other fees and charges with respect to letters of credit and bankers’ acceptance financing and the net costs associated with interest rate swap, cap, and similar arrangements, and the interest portion of any deferred payment obligation (including leases of all types).

**“Inventory”** is all “inventory” as defined in the Code in effect on the date hereof with such additions to such term as may hereafter be made, and includes without limitation all merchandise, raw materials, parts, supplies, packing and shipping materials, work in process and finished products, including without limitation such inventory as is temporarily out of Borrower’s custody or possession or in transit and including any returned goods and any documents of title representing any of the above.

**“Investment”** is any beneficial ownership interest in any Person (including stock, partnership interest or other securities), and any loan, advance or capital contribution to any Person.

**“IP Agreement”** is that certain Intellectual Property Security Agreement executed and delivered by Borrower to Bank entered into on or about the date hereof.

**“Letter of Credit”** means a standby letter of credit issued by Bank or another institution based upon an application, guarantee, indemnity or similar agreement on the part of Bank as set forth in Section 2.1.2.

**“Letter of Credit Application”** is defined in Section 2.1.2(b).

**“Lien”** is a claim, mortgage, deed of trust, levy, charge, pledge, security interest or other encumbrance of any kind, whether voluntarily incurred or arising by operation of law or otherwise against any property.

**“Loan Documents”** are, collectively, this Agreement, the Warrant, the Perfection Certificate, the IP Agreement, any note, or notes or guaranties executed by Borrower or any Guarantor, and any other present or future agreement between Borrower any Guarantor and/or for the benefit of Bank in connection with this Agreement, all as amended, restated, or otherwise modified.

**“Make-Whole Event Date”** shall mean (a) in the case of a Voluntary Term Loan Prepayment, the date of such prepayment, and (b) in the case of all or a portion of the Term Loan becoming due and payable according to the terms hereof because of the occurrence and continuance of an Event of Default, the date such amount of the Term Loan has become due and payable according to the terms hereof.

**“Make-Whole Premium”** is an amount equal to 3% of the Term Loan Amount if the Make-Whole Event Date occurs on or before the first anniversary of the Effective Date; 2% of the Term Loan Amount if the Make-Whole Event Date occurs after the first anniversary of the Effective Date but on or before the second anniversary of the Effective Date; 1% of Term Loan Amount if the Make-Whole Event Date occurs after the second anniversary of the Effective Date but before the Term Loan Maturity Date.

**“Material Adverse Change”** is (a) a material impairment in the perfection or priority of Bank’s Lien in the Collateral or in the value of such Collateral; (b) a material adverse change in the business, operations, or condition (financial or otherwise) of Borrower; or (c) a material impairment of the prospect of repayment of any portion of the Obligations.

**“Maximum Dollar Amount”** is \$10,000,000.

**“Minimum Cash Condition”** is the condition that, as of the date on which it is tested, Borrower have an aggregate of unrestricted cash and Cash Equivalents held at Bank and Bank’s Affiliates of greater than the sum of (a) the outstanding principal amount of any Advances (including any amounts used for Cash Management Services), plus (b) the face amount of any outstanding Letters of Credit (including drawn but unreimbursed Letters of Credit), plus (c) the amount outstanding under the Term Loan.

**“Monthly Financial Statements”** is defined in Section 6.2(c).

**“Net Income”** means, as calculated on a consolidated basis for Borrower and its Subsidiaries for any period as at any date of determination, the net profit (or loss), after provision for taxes, of Borrower and its Subsidiaries for such period taken as a single accounting period.

**“Net Maximum Dollar Amount”** is, as of any date, the Maximum Dollar Amount less the amount outstanding under the Term Loan on such date.

**“Obligations”** are Borrower’s obligations to pay when due any debts, principal, interest, Bank Expenses and other amounts Borrower owes Bank now or later, whether under this Agreement, the Loan Documents, or otherwise, including, without limitation, all obligations relating to letters of credit (including reimbursement obligations for drawn and undrawn letters of credit), cash management services, and foreign exchange contracts, if any, and including interest accruing after Insolvency Proceedings begin and debts, liabilities, or obligations of Borrower assigned to Bank, and to perform Borrower’s duties under the Loan Documents.

**“Operating Documents”** are, for any Person, such Person’s formation documents, as certified with the Secretary of State of such Person’s state of formation on a date that is no earlier than 30 days prior to the Effective Date, and, (a) if such Person is a corporation, its bylaws in current form, (b) if such Person is a limited liability company, its limited liability company agreement (or similar agreement), and (c) if such Person is a partnership, its partnership agreement (or similar agreement), each of the foregoing with all current amendments or modifications thereto.

**“Overadvance”** is defined in Section 2.2.

**“Patents”** means all patents, patent applications and like protections including without limitation improvements, divisions, continuations, renewals, reissues, extensions and continuations-in-part of the same.

**“Payment”** means all checks, wire transfers and other items of payment received by Bank (including proceeds of Accounts and payment of the Obligations in full) for credit to Borrower’s outstanding Credit Extensions or, if the balance of the Credit Extensions has been reduced to zero, for credit to its deposit accounts.

**“Perfection Certificate”** is defined in Section 5.1.

**“Permitted Indebtedness”** is:

- (a) Borrower’s Indebtedness to Bank under this Agreement and the other Loan Documents;
- (b) Indebtedness existing on the Effective Date and shown on the Perfection Certificate;
- (c) Subordinated Debt;
- (d) unsecured Indebtedness to trade creditors incurred in the ordinary course of business;
- (e) Indebtedness incurred as a result of endorsing negotiable instruments received in the ordinary course of business;
- (f) Indebtedness secured by Liens permitted under clauses (a) and (c) of the definition of “Permitted Liens” hereunder;

(g) Indebtedness of Borrower to any Subsidiary, and Contingent Obligations of any Subsidiary with respect to obligations of Borrower (provided that the primary obligations are not prohibited hereby), and Indebtedness of Subsidiaries to Borrower that, when aggregated with Investments of Borrower in Subsidiaries that are permitted pursuant to the definition of “Permitted Investments” hereunder, does not exceed Seven Million Dollars (\$7,000,000) in the aggregate for all Subsidiaries (net of repayments by the Subsidiaries to Borrower), and Indebtedness of any Subsidiary to any other Subsidiary, and Contingent Obligations of any Subsidiary with respect to obligations of any other Subsidiary (provided that the primary obligations are not prohibited hereby);

(h) Indebtedness under hedging obligations with respect to interest rates, foreign currency exchange rates or commodity prices, in each case not entered into for speculative purposes, and in an aggregate notational value at any time outstanding not exceeding an amount equal to one-half (1/2) of the then outstanding principal balance of the Term Loan;

(i) other Indebtedness of Foreign Subsidiaries not otherwise permitted under this definition in an aggregate amount not exceeding \$250,000 at any time outstanding (for purposes of clarity, the parties acknowledge that this is Permitted Indebtedness of Foreign Subsidiaries and not Permitted Indebtedness of Borrower);

(j) other Indebtedness not otherwise permitted by Section 7.4 not exceeding \$250,000 in the aggregate outstanding at any time;

(k) Contingent Obligations of Borrower relating to, and not exceeding the amount of, the Indebtedness of any Subsidiary allowed pursuant to clause (i) above; and

(l) extensions, refinancings, modifications, amendments and restatements of any items of Permitted Indebtedness (a) and (b) above, provided that the principal amount thereof is not increased or the terms thereof are not modified to impose more burdensome terms upon Borrower or its Subsidiary, as the case may be.

**“Permitted Investments”** are:

(a) Investments (including, without limitation, Subsidiaries) existing on the Effective Date and shown on the Perfection Certificate;

(b) (i) Investments consisting of Cash Equivalents, and (ii) Investments approved by Borrower’s Board of Directors or otherwise pursuant to a Board-approved investment policy;

(c) Investments consisting of the endorsement of negotiable instruments for deposit or collection or similar transactions in the ordinary course of Borrower;

(d) Investments consisting of deposit accounts in which Bank has a perfected security interest;

(e) Investments accepted in connection with Transfers permitted by Section 7.1;

(f) Investments (i) by Borrower in Subsidiaries that, when aggregated with Indebtedness of Subsidiaries to Borrower that is permitted pursuant to the definition of "Permitted Indebtedness" hereunder, do not exceed Seven Million Dollars (\$7,000,000) (or the Dollar equivalent thereof) in the aggregate for all Subsidiaries (net of repayments by the Subsidiaries to Borrower) and (ii) by Subsidiaries in Borrower;

(g) Investments consisting of (i) travel advances and employee relocation loans and other employee loans and advances in the ordinary course of business, and (ii) loans to employees, officers or directors relating to the purchase of equity securities of Borrower or its Subsidiaries pursuant to employee stock purchase plans or agreements approved by Borrower's Board of Directors;

(h) Investments (including debt obligations) received in connection with the bankruptcy or reorganization of customers or suppliers and in settlement of delinquent obligations of, and other disputes with, customers or suppliers arising in the ordinary course of business;

(i) Investments consisting of notes receivable of, or prepaid royalties and other credit extensions, to customers and suppliers who are not Affiliates, in the ordinary course of business; provided that this paragraph (i) shall not apply to Investments of Borrower in any Subsidiary;

(j) Investments consisting of hedging obligations permitted by clause (h) of the definition of "Permitted Indebtedness" hereunder; and

(k) other Investments not otherwise permitted by Section 7.7 not exceeding \$100,000 in the aggregate outstanding at any time.

**"Permitted Liens" are:**

(a) Liens existing on the Effective Date and shown on the Perfection Certificate or arising under this Agreement and the other Loan Documents;

(b) Liens for taxes, fees, assessments or other government charges or levies, either (i) not due and payable or (ii) being contested in good faith and for which Borrower maintains adequate reserves on its Books, provided that no notice of any such Lien has been filed or recorded under the Internal Revenue Code of 1986, as amended, and the Treasury Regulations adopted thereunder;

(c) purchase money Liens or capital leases (for which Borrower is the lessee) (i) on Equipment acquired or held by Borrower incurred for financing the acquisition of the Equipment securing no more than \$500,000 in the aggregate amount outstanding, or (ii) existing on Equipment when acquired, if the Lien is confined to the property and improvements and the proceeds of the Equipment;

(d) Liens of carriers, warehousemen, suppliers, or other Persons that are possessory in nature arising in the ordinary course of business so long as such Liens attach only to Inventory, securing liabilities in the aggregate amount not to exceed Fifty Thousand Dollars (\$50,000) and which are not delinquent or remain payable without penalty or which are being contested in good faith and by appropriate proceedings which proceedings have the effect of preventing the forfeiture or sale of the property subject thereto;

(e) Liens to secure payment of workers' compensation, employment insurance, old-age pensions, social security and other like obligations incurred in the ordinary course of business (other than Liens imposed by ERISA);

(f) Liens incurred in the extension, renewal or refinancing of the indebtedness secured by Liens described in (a) through (c), but any extension, renewal or replacement Lien must be limited to the property encumbered by the existing Lien and the principal amount of the indebtedness may not increase;

(g) leases or subleases of real property granted in the ordinary course of Borrower's business (or, if referring to another Person, in the ordinary course of such Person's business), and leases, subleases, non-exclusive licenses or sublicenses of personal property (other than Intellectual Property) granted in the ordinary course of Borrower's business (or, if referring to another Person, in the ordinary course of such Person's business), if the leases, subleases, licenses and sublicenses do not prohibit granting Bank a security interest therein;

(h) non-exclusive license of Intellectual Property granted to third parties in the ordinary course of business;

(i) Liens arising from attachments or judgments, orders, or decrees in circumstances not constituting an Event of Default under Sections 8.4 and 8.7;

(j) Liens in favor of other financial institutions arising in connection with (i) Borrower's foreign deposit and/or foreign securities accounts held at such institutions outside of the United States, and (ii) any Collateral Account of Borrower that is allowed to be maintained with such institution under the terms of this Agreement provided that the Lien only secures Borrower's obligations to the institution for fees and expenses related to the maintenance of the account or for standard banking charges to the account (e.g. for bounced checks) and that the Bank has a perfected security interest in the amounts held in the Collateral Account;

(k) easements, rights-of-way, restrictions (including zoning restrictions), covenants, licenses, encroachments, protrusions and other similar charges or encumbrances, and minor title deficiencies, on or with respect to any real property, in each case whether now or hereafter in existence; and

(l) Liens securing Indebtedness permitted under clause (i) of the definition of "Permitted Indebtedness" hereunder, provided that none of the property subject to such Liens constitutes Collateral.

**"Person"** is any individual, sole proprietorship, partnership, limited liability company, joint venture, company, trust, unincorporated organization, association, corporation, institution, public benefit corporation, firm, joint stock company, estate, entity or government agency.

**"Prime Rate"** is Bank's most recently announced "prime rate," even if it is not Bank's lowest rate.

**"Registered Organization"** is any "registered organization" as defined in the Code with such additions to such term as may hereafter be made

**"Requirement of Law"** is as to any Person, the organizational or governing documents of such Person, and any law (statutory or common), treaty, rule or regulation or determination of an arbitrator or a court or other Governmental Authority, in each case applicable to or binding upon such Person or any of its property or to which such Person or any of its property is subject.

**"Reserves"** means, as of any date of determination, such amounts as Bank may from time to time establish and revise in its good faith business judgment, reducing the amount of Advances and other financial accommodations which would otherwise be available to Borrower (a) to reflect events, conditions, contingencies or risks which, as determined by Bank in its good faith business judgment, do or may adversely affect (i) the Collateral or any other property which is security for the Obligations or its value (including without limitation any increase in delinquencies of Accounts), (ii) the assets, business or prospects of Borrower or any Guarantor, or (iii) the security interests and other rights of Bank in the Collateral (including the enforceability, perfection and priority thereof); or (b) to reflect Bank's good faith belief that any collateral report or financial information furnished by or on behalf of Borrower or any Guarantor to Bank is or may have been incomplete, inaccurate or misleading in any material respect; or (c) in respect of any state of facts which Bank determines in good faith constitutes an Event of Default or may, with notice or passage of time or both, constitute an Event of Default.

**“Responsible Officer”** is any of the Chief Executive Officer, President, Chief Financial Officer and Director of Finance.

**“Restricted License”** is any material license or other agreement with respect to which Borrower is the licensee (a) that prohibits or otherwise restricts Borrower from granting a security interest in Borrower’s interest in such license or agreement or any other property, or (b) for which a default under or termination of could interfere with the Bank’s right to sell any Collateral.

**“Revolving Line”** is an Advance or Advances in an aggregate amount equal to the Net Maximum Dollar Amount.

**“Revolving Line Maturity Date”** is April 30, 2012.

**“SEC”** shall mean the Securities and Exchange Commission, any successor thereto, and any analogous Governmental Authority.

**“Securities Account”** is any “securities account” as defined in the Code with such additions to such term as may hereafter be made.

**“Streamline Period”** is defined in Section 2.1.1(b).

**“Streamline Requirements”** are all of the following: (a) no Default or Event of Default exists and (b) Borrower meets the Minimum Cash Condition.

**“Subordinated Debt”** is indebtedness incurred by Borrower subordinated to all of Borrower’s now or hereafter indebtedness to Bank (pursuant to a subordination, intercreditor, or other similar agreement in form and substance satisfactory to Bank entered into between Bank and the other creditor), on terms acceptable to Bank.

**“Subsidiary”** is, as to any Person, a corporation, partnership, limited liability company or other entity of which shares of stock or other ownership interests having ordinary voting power (other than stock or such other ownership interests having such power only by reason of the happening of a contingency) to elect a majority of the board of directors or other managers of such corporation, partnership or other entity are at the time owned, or the management of which is otherwise controlled, directly or indirectly through one or more intermediaries, or both, by such Person. Unless the context otherwise requires, each reference to a Subsidiary herein shall be a reference to a Subsidiary of Borrower.

**“Term Loan”** is defined in Section 2.1.5(a).

**“Term Loan Amount”** is defined in Section 2.1.5(a).

**“Term Loan Maturity Date”** is defined in Section 2.1.5(b).

**“Term Loan-Related Reserve”** is, as of any date, an amount equal to one-half (1/2) of the amount outstanding under the Term Loan on such date; provided that the Term Loan-Related Reserve will be deemed to be zero on and after the date that Borrower has maintained a Fixed Charge Coverage Ratio of at least 1.5 to 1.0 for at least four consecutive fiscal quarters.

**“Total Liabilities”** is on any day, obligations that should, under GAAP, be classified as liabilities on Borrower’s consolidated balance sheet, including all Indebtedness and current portion of Subordinated Debt permitted by Bank to be paid by Borrower, but excluding all other Subordinated Debt.

**“Trademarks”** means any trademark and servicemark rights, whether registered or not, applications to register and registrations of the same and like protections, and the entire goodwill of the business of Borrower connected with and symbolized by such trademarks.

**“Transaction Report”** is that certain report of transactions and schedule of collections in the form provided by Bank to Borrower prior to the date hereof.

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“**Transfer**” is defined in Section 7.1.

“**Unused Revolving Line Facility Fee**” is defined in Section 2.4(d).

“**Voluntary Term Loan Prepayment**” is defined in Section 2.1.5(d).

“**Warrant**” is that certain Warrant to Purchase Stock of substantially even date executed by Borrower in favor of Bank.

[Signature page follows.]



**IN WITNESS WHEREOF**, the parties hereto have caused this Agreement to be executed as of the Effective Date.

BORROWER:

ATRICURE, INC.

By /s/ Julie A. Piton  
Name: Julie A. Piton  
Title: Vice President, Finance and Administration and  
Chief Financial Officer

BANK:

SILICON VALLEY BANK

By /s/ Janice Galbavy  
Name: Janice Galbavy  
Title: Relationship Manager  
Effective Date: May 1, 2009

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**EXHIBIT A**

Collateral Description

The Collateral consists of all of Borrower's right, title and interest in and to the following personal property:

All goods, Accounts (including health-care receivables), Equipment, Inventory, contract rights or rights to payment of money, leases, license agreements, franchise agreements, General Intangibles, commercial tort claims, documents, instruments (including any promissory notes), chattel paper (whether tangible or electronic), cash, deposit accounts, fixtures, letters of credit rights (whether or not the letter of credit is evidenced by a writing), securities, and all other investment property, supporting obligations, and financial assets, whether now owned or hereafter acquired, wherever located; and

all Borrower's Books relating to the foregoing, and any and all claims, rights and interests in any of the above and all substitutions for, additions, attachments, accessories, accessions and improvements to and replacements, products, proceeds and insurance proceeds of any or all of the foregoing.

Notwithstanding the foregoing, the Collateral does not include more than 65% of the presently existing and hereafter arising issued and outstanding shares of capital stock owned by Borrower of any Foreign Subsidiary which shares entitle the holder thereof to vote for directors or any other matter.

**EXHIBIT B**

**COMPLIANCE CERTIFICATE**

TO: SILICON VALLEY BANK  
FROM: ATRICURE, INC.

Date: \_\_\_\_\_

The undersigned authorized officer of AtriCure, Inc. ("Borrower") certifies that under the terms and conditions of the Loan and Security Agreement between Borrower and Bank (the "Agreement"):

(1) Borrower is in complete compliance for the period ending \_\_\_\_\_ with all required covenants except as noted below; (2) there are no Events of Default; (3) all representations and warranties in the Agreement are true and correct in all material respects on this date except as noted below; provided, however, that such materiality qualifier shall not be applicable to any representations and warranties that already are qualified or modified by materiality in the text thereof; and provided, further that those representations and warranties expressly referring to a specific date shall be true, accurate and complete in all material respects as of such date; (4) Borrower, and each of its Subsidiaries, has timely filed all required tax returns and reports, and Borrower has timely paid all foreign, federal, state and local taxes, assessments, deposits and contributions owed by Borrower except as otherwise permitted pursuant to the terms of Section 5.9 of the Agreement; and (5) no Liens have been levied or claims made against Borrower or any of its Subsidiaries relating to unpaid employee payroll or benefits of which Borrower has not previously provided written notification to Bank.

Attached are the required documents supporting the certification. The undersigned certifies that these are prepared in accordance with GAAP consistently applied from one period to the next except as explained in an accompanying letter or footnotes. The undersigned acknowledges that no borrowings may be requested at any time or date of determination that Borrower is not in compliance with any of the terms of the Agreement, and that compliance is determined not just at the date this certificate is delivered. Capitalized terms used but not otherwise defined herein shall have the meanings given them in the Agreement.

**Please indicate compliance status by circling Yes/No under "Complies" column.**

<u>Reporting Covenant</u>	<u>Required</u>	<u>Complies</u>	
Transaction Reports	Non-Streamline=Weekly; Streamline= monthly within 15 days	Yes	No
Monthly payable & receivable items, check registers, general ledger, & reconciliations	Monthly within 15 days	Yes	No
Monthly financial statements with Compliance Certificate	Monthly within 30 days	Yes	No
Annual financial statement (CPA Audited)	FYE within 120 days	Yes	No
Annual budgets and projections	Prior to FYE	Yes	No

<u>Financial Covenants</u>	<u>Required</u>	<u>Actual</u>	<u>Complies</u>	
Maintain on a Monthly Basis:				
Minimum Adjusted Quick Ratio (when required)	1.2:1.0	_____:1.0	Yes	No
Maximum Capital Expenditures	*	\$ _____	Yes	No
Minimum Fixed Charge Coverage Ratio (when required)	1.5:1.0	_____:1.0	Yes	No
Minimum EBITDA	*	\$ _____	Yes	No

\* See Loan Agreement

	Performance Pricing	Applies	
Adjusted Quick Ratio: greater or equal to 2 to 1	First Tier Rate	Yes	No
greater or equal to 1.5 to 1, but less than 2 to 1	Second Tier Rate	Yes	No
Less than 1.5 to 1, or Event of Default exists	Regular Rate	Yes	No
	<b>Streamline Requirement</b>		
Minimum Cash Condition	See Loan Agreement	Yes	No

Borrower is party to, or bound by, the following material Restricted Licenses that were not previously noted in the Perfection Certificate or a prior Compliance Certificate: \_\_\_\_\_.

Borrower intends to register the following copyrights or mask works with the United States Copyright Office that were not previously noted in a prior Compliance Certificate: \_\_\_\_\_.

Borrower has (i) obtained the following Patents, registered Trademarks, registered Copyrights, registered mask work, or any pending application for any of the foregoing, whether as owner, licensee or otherwise, and (ii) applied for the following Patents and the registration of the following Trademarks; in each case, that were not previously noted in the Perfection Certificate or a prior Compliance Certificate (to be reported on as part of the Compliance Certificate due following the last month of each fiscal quarter): \_\_\_\_\_.

The following financial covenant analyses and information set forth in Schedule 1 attached hereto are true and accurate as of the date of this Certificate.

The following are the exceptions with respect to the certification above: (If no exceptions exist, state "No exceptions to note.")

\_\_\_\_\_  
 \_\_\_\_\_  
 \_\_\_\_\_

ATRICURE, INC.

**BANK USE ONLY**

By: \_\_\_\_\_  
 Name: \_\_\_\_\_  
 Title: \_\_\_\_\_

Received by: \_\_\_\_\_  
 AUTHORIZED SIGNER

Date: \_\_\_\_\_

Verified: \_\_\_\_\_  
 AUTHORIZED SIGNER

Date: \_\_\_\_\_

Compliance Status:    Yes    No

**Schedule 1 to Compliance Certificate**

**Financial Covenants of Borrower**

In the event of a conflict between this Schedule and the Loan Agreement, the terms of the Loan Agreement shall govern.

Dated: \_\_\_\_\_

**I. Minimum Adjusted Quick Ratio (Section 6.9(a))**

Required: at least 1.20:1.00 (required with respect to months during which Advances were outstanding)

Actual:

- A. Borrower's unrestricted cash (and Cash Equivalents) held with Bank and its Affiliates \$ \_\_\_\_\_
- B. Borrower's Eligible Accounts \$ \_\_\_\_\_
- C. Line A plus line B \$ \_\_\_\_\_
- D. Borrower's Current Liabilities (including any amounts used for Cash Management Services and the face amount of outstanding Letters of Credit (including drawn but unreimbursed Letters of Credit)) \$ \_\_\_\_\_
- E. The current portion of Deferred Revenue
- F. Line D minus line E
- G. Adjusted Quick Ratio (line C divided by line F) \_\_\_\_\_:

Is line G greater than or equal to 1.20:1.00?

\_\_\_\_\_ No, not in compliance

\_\_\_\_\_ Yes, in compliance

**II. Maximum Capital Expenditures (Section 6.9(b))**

Required: not to exceed per fiscal year the limits provided for in Section 6.9(b) of the Loan Agreement

Actual:

- A. Capital expenditure limit provided for in Section 6.9(b) \$ \_\_\_\_\_
- B. Capital expenditures for fiscal year \$ \_\_\_\_\_
- C. Line A minus line B \$ \_\_\_\_\_

Is line C greater than or equal to zero?

\_\_\_\_\_ No, not in compliance

\_\_\_\_\_ Yes, in compliance

**III. Minimum Fixed Charge Coverage Ratio (Section 6.9(c))**

Required: not less than 1.50:1.00 (required upon release of the Term Loan-Related Reserve)

Actual:

A. EBITDA (as defined in the Loan Agreement)	\$ _____
B. Cash income taxes paid	\$ _____
C. Unfinanced capital expenditures	\$ _____
D. Line A minus line B minus line C	\$ _____
E. Current portion of long term debt	\$ _____
F. Cash interest expense	\$ _____
G. Line E plus line F	\$ _____
H. Fixed Charge Coverage Ratio (line D divided by line G)	_____:____

Is line H greater than or equal to 1.50:1.00?

No, not in compliance

Yes, in compliance

**IV. Minimum EBITDA (Section 6.9(d))**

Required: equal to or greater than the amounts set forth in Section 6.9(d) of the Loan Agreement

Actual:

A. EBITDA (as defined in the Loan Agreement)	\$ _____
B. Minimum required per Section 6.9(d)	\$ _____
C. Line A minus line B	\$ _____

Is line C greater than or equal to zero?

No, not in compliance

Yes, in compliance

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**SCHEDULE 5.9**

Pension Plans

The Borrower has prepared and submitted to the Internal Revenue Service a report for the period January 31, 2002 through December 31, 2008 detailing certain non-compliance under Borrower's 401(k) plan, including as a result of improper calculations of compensation under the plan documents, errors in properly calculating required "matching" contributions to be made by the Borrower and improper exclusion of certain employees from participation in the plan. The Borrower has also submitted an amendment to the plan which is effective January 1, 2009.

**CERTIFICATION OF CHIEF EXECUTIVE OFFICER  
PURSUANT TO  
SECTION 13(a) OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934  
AS ADOPTED PURSUANT TO  
SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002**

I, David J. Drachman, certify that:

1. I have reviewed this quarterly report on Form 10-Q of AtriCure, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - a. designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b. designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c. evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d. disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - a. all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b. any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 10, 2009

By: /s/ David J. Drachman  
David J. Drachman  
President and Chief Executive Officer  
(Principal Executive Officer)



**CERTIFICATION OF CHIEF FINANCIAL OFFICER  
PURSUANT TO  
SECTION 13(a) OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934  
AS ADOPTED PURSUANT TO  
SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002**

I, Julie A. Piton, certify that:

1. I have reviewed this quarterly report on Form 10-Q of AtriCure, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - a. designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b. designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c. evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d. disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - a. all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b. any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 10, 2009

By: /s/ Julie A. Piton

Julie A. Piton  
Vice President, Finance and Administration and Chief  
Financial Officer  
(Principal Accounting and Financial Officer)

**CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350,  
AS ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the quarterly report of AtriCure, Inc. (the "Company") on Form 10-Q for the quarter ended June 30, 2009 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, David J. Drachman, President and Chief Executive Officer of the Company, certify, pursuant to Rule 13a-14(b) and Section 1350 of Chapter 63 of Title 18 of the United States Code, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

1. The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: August 10, 2009

By: /s/ David J. Drachman  
David J. Drachman  
President and Chief Executive Officer  
(Principal Executive Officer)

A signed original of this written statement or other document authenticating, acknowledging, or otherwise adopting the signature that appears in typed form within the electronic version of this written statement has been provided to AtriCure, Inc. and will be retained by AtriCure, Inc. and furnished to the Securities and Exchange Commission or its staff upon request.

The foregoing certification is being furnished solely pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (Subsections (a) and (b) of Section 1350, Chapter 63 of Title 18, United States Code) and is not being filed as part of the report or as a separate disclosure document.

**CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350,  
AS ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the quarterly report of AtriCure, Inc. (the "Company") on Form 10-Q for the quarter ended June 30, 2009 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Julie A. Piton, Vice President and Chief Financial Officer of the Company, certify, pursuant to Rule 13a-14(b) and Section 1350 of Chapter 63 of Title 18 of the United States Code, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

1. The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: August 10, 2009

By: /s/ Julie A. Piton

Julie A. Piton

Vice President, Finance and Administration and Chief  
Financial Officer

(Principal Accounting and Financial Officer)

A signed original of this written statement or other document authenticating, acknowledging, or otherwise adopting the signature that appears in typed form within the electronic version of this written statement has been provided to AtriCure, Inc. and will be retained by AtriCure, Inc. and furnished to the Securities and Exchange Commission or its staff upon request.

The foregoing certification is being furnished solely pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (Subsections (a) and (b) of Section 1350, Chapter 63 of Title 18, United States Code) and is not being filed as part of the report or as a separate disclosure document.