AtriCure, Inc.
Form 10-Q
November 13, 2006
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

FORM 10-Q

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the quarterly period ended September 30, 2006

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	**34-1940305**
(State or other jurisdiction of incorporation or organization)	**(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)

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

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

Large Accelerated Filer ¨ Accelerated Filer ¨ Non-accelerated Filer x

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

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

Class	**Outstanding at November 1, 2006**
Common Stock, $.001 par value	12,183,158

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

ATRICURE, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(Unaudited)

	September 30, 2006	December 31, 2005
Assets		
Current assets:		
Cash and cash equivalents	$ 15,816,121	$ 27,432,948
Short-term investments	3,689,367	6,369,234
Accounts receivable, less allowance for doubtful accounts of $287,454 and $261,707 as of September 30, 2006 and December 31, 2005, respectively	6,085,754	4,865,065
Inventories, net	3,249,554	2,135,143
Other current assets	1,460,288	845,330
Total current assets	30,301,084	41,647,720
Property and equipment, net	3,534,343	3,359,549
Long-term investments	2,799,427	
Intangible assets	826,278	986,778
Goodwill	3,840,837	3,840,837
Other assets	199,445	205,531
Total assets	$ 41,501,414	$ 50,040,415
Liabilities and shareholders equity		
Current liabilities:		
Accounts payable	$ 1,546,658	$ 1,243,365
Accrued liabilities	4,253,206	4,131,633
Current maturities of capital lease obligation	26,076	31,753
Current maturities of long-term debt	358,916	338,082
Total current liabilities	6,184,856	5,744,833
Capital lease obligation	20,081	38,855
Long-term debt	773,298	1,045,150
Other liabilities	70,313	28,125
Shareholders equity:		
Common stock, $0.001 par value, 90,000,000 shares authorized as of September 30, 2006 and December 31, 2005; 12,183,158 and 12,086,482 issued and outstanding as of September 30, 2006 and December 31, 2005, respectively	12,180	12,086
Additional paid-in capital	86,193,992	86,107,520
Unearned compensation		(599,591)
Accumulated other comprehensive income	37,794	826
Accumulated deficit	(51,791,100)	(42,337,389)

Total shareholders equity	34,452,866	43,183,452
Total liabilities and shareholders equity	$ 41,501,414	$ 50,040,415

See notes to financial statements.

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ATRICURE, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2006	2005	2006	2005
Revenues	$ 9,358,045	$ 7,169,748	$ 27,643,891	$ 22,397,927
Cost of revenues (a)	1,885,946	2,015,458	5,271,104	5,913,099
Gross profit	7,472,099	5,154,290	22,372,787	16,484,828
Operating expenses:				
Research and development expenses (a)	3,172,286	2,612,977	9,010,950	6,320,371
Selling, general and administrative expenses	7,691,260	6,317,891	23,676,328	16,713,075
Total operating expenses	10,863,546	8,930,868	32,687,278	23,033,446
Loss from operations	(3,391,447)	(3,776,578)	(10,314,491)	(6,548,618)
Preferred stock interest expense		(379,669)		(2,332,254)
Interest expense	(51,218)	(54,141)	(159,215)	(66,372)
Interest income	287,067	161,084	947,364	188,924
Other income		84,868	72,632	84,868
Net loss	$ (3,155,598)	$ (3,964,436)	$ (9,453,710)	$ (8,673,452)
Basic and diluted loss per share	$ (0.26)	$ (0.49)	$ (0.78)	$ (2.18)
Weighted average shares outstanding:				
Basic and diluted	12,148,565	8,151,220	12,121,044	3,981,354

(a) Includes the following expenses resulting from transactions with Enable Medical Corporation prior to the acquisition as of August 10, 2005:

Cost of revenues	*$*	*$ 943,313*	*$*	*$ 4,259,269*
Research and development expenses	*$*	*$ 139,365*	*$*	*$ 1,201,583*

See notes to financial statements.

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ATRICURE, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

	Nine Months Ended September 30,	
	2006	**2005**
Cash flows from operating activities:		
Net loss	$ (9,453,710)	$ (8,673,452)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation	1,167,765	1,006,566
Amortization of intangible assets	160,500	29,722
Amortization of warrants	36,693	24,462
Gain on disposal of equipment	(20,000)	
Stock compensation	649,422	497,898
Preferred stock interest		2,332,254
Changes in assets and liabilities:		
Accounts receivable	(1,220,690)	1,188,002
Inventory	(1,114,411)	(483,136)
Other current assets	(614,958)	(949,167)
Accounts payable	297,803	975,896
Accrued liabilities	66,529	26,280
Other non-current assets and liabilities	96,279	412,420
Net cash used in operating activities	(9,948,778)	(3,612,255)
Cash flows from investing activities:		
Purchases of property & equipment	(1,378,541)	(1,486,948)
Proceeds from sale of property & equipment	20,000	
Purchases of available-for-sale securities	(5,482,883)	
Maturities of available-for-sale securities	5,365,000	
Cash paid for acquisition, net		(6,420,681)
Net cash used in investing activities	(1,476,424)	(7,907,629)
Cash flow from financing activities:		
Proceeds from long-term debt borrowings		1,500,000
Payments on long-term debt	(251,019)	(11,981)
Payments on capital lease obligations	(24,449)	(5,386)
Proceeds from stock offering		43,176,994
Proceeds from stock option exercises and warrants	83,843	21,006
Net cash provided by (used in) financing activities	(191,625)	44,680,633
Net increase (decrease) in cash and cash equivalents	(11,616,827)	33,160,749
Cash and cash equivalents - beginning of period	27,432,948	5,175,177
Cash and cash equivalents - end of period	$ 15,816,121	$ 38,335,926
Supplemental cash flow information:		
Cash paid for income taxes	$ 51,534	$
Cash paid for interest	$ 122,537	$ 27,847

Non-cash investing and financing activities:		
Warrants issued in connection with line of credit	$	$ 216,083
Preferred stock conversion	$	$ 39,109,808
Purchases of property & equipment in accounts payable	$ 5,490	$
Purchases of property & equipment in accrued liabilities	$ 55,043	$

See notes to financial statements.

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ATRICURE, INC.

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) was incorporated in the State of Delaware on October 31, 2000, as a spin-off of Enable Medical Corporation, to focus on the surgical treatment of atrial fibrillation. Atrial fibrillation (AF) is a rapid, irregular quivering of the upper chambers of the heart. The Company sells its medical devices to hospitals and medical clinics both in the United States of America and internationally. International sales were approximately $1.1 million and $0.6 million for the three months ended September 30, 2006 and 2005, respectively, and $3.2 million and $2.1 million for the nine months ended September 30, 2006 and 2005, 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. The accompanying interim financial statements are unaudited, but in the opinion of 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 of America (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, 2005 filed with the Securities and Exchange Commission on March 31, 2006.

Principles of Consolidation The consolidated financial statements include the accounts of the Company and its subsidiary. Intercompany accounts and transactions are eliminated.

Short-Term and Long-Term Investments The Company places its investments primarily in U.S. Government securities, corporate 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.

Inventories, net Inventories are stated at the lower of cost or market using the first-in, first-out (FIFO) cost method and consist of the following:

	September 30, 2006	December 31, 2005
Raw materials	$ 625,891	$ 387,484
Work in process	1,262,112	708,676
Finished goods	1,469,894	1,297,540
Reserve for obsolescence	(108,343)	(258,557)
Inventories, net	$ 3,249,554	$ 2,135,143

Earnings (Loss) Per Share Basic net loss per share is computed by dividing net loss by the weighted average number of common shares outstanding during the period. Since the Company has experienced losses for all periods presented, net loss per share excludes the effect of 1,935,368 and 1,293,490 options outstanding at September 30, 2006 and 2005, respectively, because such options 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. All share and per share amounts reflect the 1-for-3.8 reverse stock split that was effected on July 27, 2005.

Comprehensive Income (Loss) Comprehensive loss consisted of the following:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2006	2005	2006	2005
Net loss	$ (3,155,598)	$ (3,964,436)	$ (9,453,710)	$ (8,673,452)
Unrealized gains on available-for-sale investments	19,891		1,677	
Unrealized gains from foreign currency translation	25,347		35,291	
Comprehensive loss	$ (3,110,360)	$ (3,964,436)	$ (9,416,742)	$ (8,673,452)

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Stock-Based Compensation Expense On January 1, 2006, the Company adopted Statement of Financial Accounting Standards No. 123 (revised 2004), Share-Based Payment, (SFAS 123(R)), which requires the measurement and recognition of compensation expense for all share-based payment awards made to employees and directors, including employee stock options and employee stock purchases related to an employee stock purchase plan, based on estimated fair values. SFAS 123(R) supersedes the Company s previous accounting under Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees (APB 25) for periods beginning in fiscal 2006. In March 2005, the Securities and Exchange Commission issued Staff Accounting Bulletin No. 107 (SAB 107) relating to SFAS 123(R). The Company has applied the provisions of SAB 107 in its adoption of SFAS 123(R).

The Company adopted SFAS 123(R) using the modified prospective transition method. In accordance with the modified prospective transition method, the Company s Consolidated Financial Statements for prior periods have not been restated to reflect, and do not include, the impact of SFAS 123(R). Stock-based compensation expense recognized under SFAS 123(R) for the three and nine months ended September 30, 2006 was $250,288 and $720,980, respectively, on a before and after tax basis, which consisted of stock-based compensation expense related to employee stock options. During the three and nine months ended September 30, 2005, the Company incurred charges for stock compensation for employees for options issued with exercise prices below market value. The Company recorded charges of $66,960 and $192,445, which represent the portion pertaining to the three and nine months ended September 30, 2005, respectively, based on the options vesting requirements.

The following table summarizes the pro forma net loss and loss per share as if the fair value method had been applied for the three and nine months ended September 30, 2005:

(Dollars in thousands)	Three Months Ended September 30, 2005	Nine Months Ended September 30, 2005
Net loss	$ (3,964)	$ (8,673)
Add: Stock-based employee compensation expense included in net loss, net of related tax effect	67	192
Deduct: Stock-based employee compensation expense if the fair value method had been applied, net of related tax effects	(120)	(272)
Pro forma net loss if the fair value method had been applied	$ (4,017)	$ (8,753)
Net loss per common share:		
Basic and diluted-as reported	$ (0.49)	$ (2.18)
Basic and diluted-pro forma	$ (0.49)	$ (2.20)

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. Prior to the adoption of SFAS 123(R), the Company accounted for stock-based awards to employees and directors using the intrinsic value method in accordance with APB 25 as allowed under Statement of Financial Accounting Standards No. 123, Accounting for Stock-Based Compensation (SFAS 123).

Stock-based compensation expense recognized during the period is based on the value of the portion of share-based payment awards that is ultimately expected to vest during the period. Stock-based compensation expense recognized in the Company s Consolidated Statement of Operations for the three and nine months ended September 30, 2006 included compensation expense for share-based payment awards granted prior to, but not yet vested as of, December 31, 2005 based on the grant date fair value estimated in accordance with the pro forma provisions of SFAS 123 and compensation expense for the share-based payment awards granted subsequent to December 31, 2005 based on the grant date fair value estimated in accordance with the provisions of SFAS 123(R). As stock-based compensation expense recognized in the Consolidated Statement of Operations for the three and nine months ended September 30, 2006 is based on awards ultimately expected to vest, it 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. In the Company s pro forma information required under SFAS 123 for the periods prior to fiscal 2006, the Company accounted for forfeitures as they occurred. The cumulative effect of the change in accounting for forfeitures under SFAS 123(R) was not material to the consolidated financial statements.

The Company estimates the fair value of options on 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 expected stock price volatility over the term of the awards and actual and projected employee stock option exercise behaviors.

On November 10, 2005, the Financial Accounting Standards Board (FASB) issued FASB Staff Position No. FAS 123(R)-3 Transition Election Related to Accounting for Tax Effects of Share-Based Payment Awards (the FASB Staff Position). The Company has elected to adopt the alternative transition method provided in the FASB Staff Position for calculating the tax effects of stock-based compensation pursuant to SFAS 123(R). The alternative transition method

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includes simplified methods to establish the beginning balance of the additional paid-in capital pool (APIC pool) related to the tax effects of employee stock-based compensation and to determine the subsequent impact on the APIC pool and Consolidated Statements of Cash Flows of the tax effects of employee stock-based compensation awards that are outstanding upon adoption of SFAS 123(R).

Reclassification Certain amounts in the accompanying financial statements and notes thereto have been reclassified to conform to the current year presentation.

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

Foreign Currency Translation The Company has a foreign sales subsidiary whose functional currency is reported in Euros. Assets and liabilities of this foreign subsidiary reported in the consolidated balance sheets have been translated at the current exchange rates. Revenue and expenses reported in the consolidated statements of operations have been translated at the average exchange rate for the year. Gains and losses on the translation of the Company s foreign subsidiary are reported as Accumulated other comprehensive income (loss) in the consolidated balance sheets.

2. INVESTMENTS

Investments consisted of the following:

	Cost Basis	Unrealized Gains	Unrealized Losses	Fair Value
September 30, 2006				
US Government securities (maturities between 90 days and one year)	$ 2,683,553	$ 6,674	$	$ 2,690,227
Corporate notes (maturities between 90 days and one year)	1,000,251		(1,111)	999,140
Total short-term investments	$ 3,683,804	$ 6,674	$ (1,111)	$ 3,689,367
US Government securities (maturities more than one year)	$ 999,762	$ 868	$	$ 1,000,630
Medium-term notes (maturities more than one year)	1,002,613		(2,193)	1,000,420
Corporate notes (maturities more than one year)	800,112		(1,735)	798,377
Total long-term investments	$ 2,802,487	$ 868	$ (3,928)	$ 2,799,427
Total investments	$ 6,486,291	$ 7,542	$ (5,039)	$ 6,488,794
December 31, 2005				
Commercial paper (maturities between 90 days and one year)	$ 2,428,992	$ 6,119	$	$ 2,435,111
US Government securities (maturities between 90 days and one year)	1,998,467		(2,217)	1,996,250
Corporate notes (maturities between 90 days and one year)	1,940,949		(3,076)	1,937,873
Total short-term investments	$ 6,368,408	$ 6,119	$ (5,293)	$ 6,369,234

The Company has not experienced any significant realized gains or losses on its investments in the periods presented in the statements of operations.

3. ACCRUED LIABILITIES

Accrued liabilities consisted of the following:

	September 30, 2006	December 31, 2005
Accrued commissions	$ 1,099,234	$ 987,599
Accrued bonus	616,645	600,813
Accrued vacation	486,273	469,049
Other accrued liabilities	2,051,054	2,074,172
Total accrued liabilities	$ 4,253,206	$ 4,131,633

4. EQUITY COMPENSATION PLANS

As of September 30, 2006, the Company had two equity compensation plans: the 2001 Stock Option Plan (the 2001 Plan) and the 2005 Equity Incentive Plan (the 2005 Plan). The 2001 plan is no longer used for granting options.

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, stock purchase rights, 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) 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 and 2005 Plans generally expire 10 years from the date of grant (5 years for persons owning more than 10% of the voting power of all classes of stock) and generally vest at a rate of 25% on the first anniversary date and ratably each year or month thereafter. Certain options are exercisable upon grant and the underlying unvested shares are subject to the Company s repurchase right as stated in the applicable plan agreement.

Under the 2005 Plan, 2,576,964 shares of common stock were reserved for issuance as of September 30, 2006. In addition, the shares reserved 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

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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 may determine.

As of September 30, 2006, 3,221,180 shares of the Company s common stock were reserved for issuance under the Company s equity compensation plans.

Activity under the Plans was as follows:

	Stock Options Outstanding		
	Number of Shares Outstanding	Weighted Average Exercise Price	Aggregate Intrinsic Value
Balance at December 31, 2004	1,064,294	$ 1.44	
Granted	688,082	$ 12.67	
Forfeited	(97,188)	$ 3.91	
Exercised	(44,293)	$ 0.95	
Balance at December 31, 2005	1,610,895	$ 6.10	
Granted	647,091	$ 8.58	
Forfeited	(243,394)	$ 9.86	
Exercised	(79,224)	$ 1.06	
Balance at September 30, 2006	1,935,368	$ 6.66	$ 4,635,822
Exercisable- September 30, 2006	841,070		$ 4,223,471

As of September 30, 2006, there were 1,285,812 shares available for future grants under the Plans.

The total intrinsic value of options exercised during the three months ended September 30, 2006 and 2005 was approximately $222,000 and $17,000, respectively, and was approximately $469,000 and $196,000 during the nine months ended September 30, 2006 and 2005, respectively. Due to the Company s current tax position, no tax benefit was recognized as a result of option exercises for the three and nine months September 30, 2006. Additionally, there was no impact on operating or financing activities in the Company s consolidated statement of cash flows for the three and nine months ended September 30, 2006 as a result of the exercise of stock options, other than the recognition of $46,245 and $83,843, respectively, in cash receipts as a result of stock option exercises.

Additional information regarding stock options outstanding as September 30, 2006 is as follows:

Exercise Prices	Number Outstanding	Weighted Average Remaining Contractual Life (Years)	Exercisable at September 30, 2006
$ 0.57	104,035	4.50	104,035
$ 0.63	52,631	4.50	52,631
$ 1.90	3,684	5.22	3,684
$ 3.80	5,262	5.33	5,262
$ 1.33	388,021	6.01	387,831
$ 1.52	220,457	7.70	176,693
$ 2.09	22,630	7.68	13,175
$ 2.66	10,577	7.85	5,701
$ 3.23	27,940	8.07	15,071
$ 11.29	27,631	8.49	10,488
$ 11.63	16,664	8.52	7,456
$ 12.35	29,599	8.70	10,056
$ 12.00	110,695	8.85	31,920
$ 13.89	105,402	8.96	17,067
$ 12.10	3,944	9.12	
$ 13.18	239,250	9.19	
$ 11.06	92,500	9.36	
$ 9.37	224,700	9.52	
$ 7.99	112,100	4.85	
$ 6.34	137,646	6.09	
	1,935,368		841,070

The exercise price per share of each option is equal to the fair market value of the underlying share on the date of grant. For options granted prior to the Company s initial public offering, the board determined the fair market value based on a multiple of revenue reduced by a factor due to the illiquidity of the options in a private company with no assurances of a public market.

Valuation and Expense Information under FAS 123(R)

On January 1, 2006, the Company adopted SFAS 123(R), which requires the measurement and recognition of compensation expense for all share-based payment awards made to the Company s employees and directors based on fair values. The following table summarizes stock-based compensation expense related to employee stock options under SFAS 123(R), which was allocated as follows:

	Three Months Ended September 30, 2006	Nine Months Ended September 30, 2006
Cost of revenue	$ 10,012	$ 27,904
Research and development	35,040	105,660
Selling, general and administrative	205,236	587,416
Total stock-based compensation expense related to employee stock options	$ 250,288	$ 720,980
Impact on reported basic and diluted loss per share	$ 0.02	$ 0.06

The total compensation expense related to non-vested stock option awards not yet recognized is $3,202,089. The weighted average period over which this compensation expense is expected to be recognized is 3.2 years.

For the three and nine months ended September 30, 2005, the Company incurred a charge for stock compensation for employees for options issued with exercise prices below market value. The Company recorded a charge of $66,960 and $192,445 based on the options vesting requirements for the three and nine months ended September 30, 2005, respectively.

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

	Three months ended September 30,		Nine months ended September 30,	
	2006	2005	2006	2005
Risk free interest rates	1.00% to 4.76%	1.00% to 3.86%	1.00% to 5.14%	1.00% to 3.86%
Expected lives (years)	6	4	6	4
Expected volatility	38.06%	57.00%	38.06%	57.00%
Dividend yield	0.00%	0.00%	0.00%	0.00%

The risk-free interest rate assumption is based upon the U.S. treasury yield curve at the time of grant.

Due to the Company s limited trading history, the Company has chosen to use the simplified method for estimating the expected lives of options as allowed under the Securities and Exchange Commission issued Staff Accounting Bulletin No. 107 (SAB 107). Under this approach, the expected lives were calculated by taking the average of the vesting term and the original contract term.

Due to the Company s limited trading history, the Company used the implied volatility of a group of comparable companies, looking at both short and long-dated options in determining the Company s volatility.

Based on the assumptions noted above, the weighted average estimated fair values of the options granted in the three and nine months ended September 30, 2006 and 2005 were as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2006	2005	2006	2005
Weighted average fair value of options granted	$ 3.25	$ 6.96	$ 3.97	$ 4.97

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. The fair value, 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 with the following weighted average assumptions: contractual life of ten years; volatility of 38.06%; risk-free interest rate ranging from 1% to 5.27% and no dividends during the expected term. The values attributable to these options have been amortized over the service period on a graded vesting method and the vested portion of these options was re-measured at each vesting date.

Stock compensation income (expense) with respect to non-employee awards totaled approximately $69,100 and $(86,000) for the three months ended September 30, 2006 and 2005, respectively, and totaled approximately $71,600 and ($305,000) for the nine months ended September 30, 2006 and 2005, respectively.

5. EXERCISE OF WARRANTS

In August 2006, 17,452 shares of common stock were issued as a result of the cashless exercise of 195,160 warrants with an exercise price of $5.43 and an average fair value of $5.96. These warrants were initially granted in connection with the issuance of a convertible note in 2002. There are no outstanding warrants from this grant as of September 30, 2006.

6. SEGMENT AND GEOGRAPHIC INFORMATION

The Company s system and devices are developed and marketed to a broad base of hospitals in the United States and internationally. Management considers all such sales to be part of a single operating segment in accordance with SFAS No. 131, Disclosure about Segments of an Enterprise and Related Information.

Geographic revenue was as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2006	2005	2006	2005
United States	$ 8,244,919	$ 6,536,376	$ 24,437,497	$ 20,283,763
International	1,113,126	633,372	3,206,394	2,114,164
Total	$ 9,358,045	$ 7,169,748	$ 27,643,891	$ 22,397,927

7. RECENT ACCOUNTING PRONOUNCEMENTS

In February 2006, the FASB issued SFAS No. 155, Accounting for Certain Hybrid Financial Instruments-an amendment of FASB Statements No. 133 and 140 (SFAS 155). SFAS 155 amends SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities and SFAS 140 Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities. The provisions of SFAS 155 are effective for financial instruments acquired, issued, or subject to a remeasurement event occurring after the beginning of an entity s first fiscal year that begins after September 15, 2006. The adoption of SFAS No. 155 is not expected to have a material impact on the Company s financial statements.

In July 2006, the FASB issued FASB Interpretation No. 48 (FIN 48), Accounting for Uncertainty in Income Taxes which prescribes a recognition threshold and measurement process for recording in the financial statements uncertain tax positions taken or expected to be taken in a tax return. Additionally, FIN 48 provides criteria for subsequently recognizing, derecognizing and measuring changes in uncertain tax positions and requires expanded disclosure with respect to the uncertainty of income taxes. The accounting provisions of FIN 48 will be effective for the Company

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beginning January 1, 2007 with the cumulative effect of the change in accounting principle recorded as an adjustment to opening retained earnings. The Company is in the process of determining the effect, if any, the adoption of FIN 48 will have on its financial statements.

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements (SFAS 157), which establishes a framework for measuring fair value and expands disclosures about fair value measurements. The provisions of SFAS 157 will be effective for the Company beginning January 1, 2008. The Company is in the process of determining the effect, if any, the adoption of SFAS 157 will have on its financial statements.

8. AGREEMENT WITH CLEVELAND CLINIC

On July 18, 2006, the Company entered into an Agreement, effective as of June 6, 2005, with The Cleveland Clinic relating to the Company s rights and obligations with respect to the publicly announced grants from the State of Ohio for, among other things, the creation of an Atrial Fibrillation Innovation Center. Pursuant to the terms of the Agreement, the Company is required to supply personnel and materials to accomplish certain research-related activities in connection with the grant and, over a three-year period, the Company will receive up to a total of approximately $0.9 million for personnel and materials and The Cleveland Clinic will acquire up to approximately $2.4 million in capital equipment for the Company s use in support of its performance of the Agreement. Over the same three-year period, the Company is required to expend up to approximately $7.7 million for operating expenses and up to approximately $4.8 million for capital expenses at its facility in support of the Agreement, which amounts the Company believes represent ordinary course expenditures that it would have otherwise anticipated making. Under the terms of the Agreement, the Company may be required to spend up to $2.7 million in the first year, $4.4 million in the second year and $5.4 million in the third year.

The terms of the Agreement specify the division of ownership of intellectual property developed in the performance of the Agreement and provide, among other things, that the Company will own all intellectual property it develops alone and certain intellectual property that is jointly developed and it will have the option to license certain intellectual property that is owned by The Cleveland Clinic and developed in the performance of the Agreement. Additionally, the Agreement terminates on December 6, 2008. However, the Company and The Cleveland Clinic may terminate the Agreement at any time by giving 30 days prior written notice.

9. COMMITMENTS AND CONTINGENCIES

In January 2006 Life Support Technology LST B.V., a former distributor of the Company s products in Europe, filed an action against the Company in Den Bosch, Netherlands and in February 2006 LST also filed an action against the Company s subsidiary, AtriCure Europe, B.V. in The Hague, Netherlands in the Kort Geding (a summary injunction proceeding wherein preliminary relief is demanded). On March 28, 2006, the case against the Company s subsidiary was summarily dismissed. On July 19, 2006, the Company presented an Incidental Statement arguing that the court before which the case is currently pending does not have jurisdiction over the matter and, even if such court should conclude that it does indeed have jurisdiction, such court should stay the proceedings in such case until the case pending in the United States relating to such matter has been decided. The Court has scheduled a hearing on the jurisdictional issue for December 5, 2006.

The Company and LST were party to a distribution agreement, dated January 1, 2004. Each of LST s summonses allege that the Company, on behalf of AtriCure Europe, and LST reached an agreement, which would succeed a January 1, 2004 agreement, pursuant to which LST agreed to continue distributing the Company s products in certain European countries. The summonses allege that, in addition to the value for LST of a continued distributorship, such agreement would have provided an additional $330,000 to LST and its principal, J.L.M. Marinus. The Company believes that neither the Company nor the Company s subsidiary reached such an agreement with LST and that the original distribution agreement with LST was terminated as of December 31, 2005. The Company intends to defend these lawsuits vigorously.

Pursuant to the Company s January 1, 2004 distribution agreement with LST, certain of LST s obligations survive termination of that agreement. Such obligations include, among other things, the timely payment for equipment purchased and the return of all materials (such as marketing literature and sales and promotional materials) supplied by the Company to LST. In March 2006, the Company filed a complaint in Ohio State Court (Butler County, Ohio Court of Common

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Pleas) against LST claiming that LST has not complied with these obligations and the Company is seeking damages which, due to Ohio pleading limitations, are alleged to be more than $25,000 but which, in fact, the Company believes are in an amount in excess of $185,000. On April 21, 2006, LST filed its answer to the Company s complaint and asserted counterclaims that contain similar claims to the claims it made in the action it filed against the Company in the Netherlands, described above. The Company has filed its response to the counterclaims and discovery has been scheduled. Although some discovery requests have been served, no discovery responses have been served yet and no depositions have been conducted.

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 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, 2005 included in our Form 10-K for the year ended December 31, 2005 filed with the Securities and Exchange Commission on March 31, 2006, 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. 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 doe 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 develop, manufacture and sell innovative surgical devices designed to create precise lesions, or scars, in cardiac and soft tissues. Our primary product lines are our AtriCure bipolar ablation systems, which accounted for a total of 98% of our revenues for the nine months ended September 30, 2006 and 2005. Our Isolator bipolar ablation system for open-heart procedures consists of a compact power generator known as an ablation sensing unit, or ASU and several uniquely designed disposable ablation clamps that connect to the ASU, including our new Isolator open clamp that was released in July 2006 and is specifically designed for open surgical procedures. Our Isolator bipolar ablation system for minimally invasive sole-therapy procedures consists of an ASU, a Wolf dissector and several uniquely designed disposable ablation clamps, including two recently developed Isolator endoscopic ablation clamps that are specifically designed for use in minimally invasive procedures. Medical journals have described the adoption by leading cardiothoracic surgeons of our Isolator bipolar ablation system as a standard treatment alternative during open-heart surgical procedures to safely, rapidly and reliably create lesions in cardiac tissue to block the abnormal electrical impulses that cause atrial fibrillation, or AF, a rapid, irregular quivering of the upper chambers of the heart. Cardiothoracic surgeons have used our bipolar ablation systems to treat AF in over 31,000 patients since January 2003. We believe that our Isolator bipolar ablation system for open procedures is currently the market leader in the surgical treatment of AF during open-heart surgical procedures. In addition, surgeons have used our Isolator bipolar ablation system for minimally invasive procedures as a minimally invasive sole-therapy treatment for AF, which is performed on patients who

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are not undergoing a separate open-heart procedure, on over 1,300 patients. We anticipate that substantially all of our sales for the foreseeable future will relate to the AtriCure bipolar ablation systems for the treatment of AF.

Our Isolator Transpolar Pen system, one of our bipolar ablation systems, consists of the ASU, a temporary pacing, sensing and stimulating unit, and a disposable pen-shaped handpiece. In July 2006, our Pen system received FDA 510(k) clearance for temporary pacing, sensing, stimulating, and recording during the evaluation of cardiac arrhythmias in addition to its currently FDA-cleared use for the ablation of cardiac tissues. Our Pen system is the only bipolar radiofrequency device that is cleared for this broad range of indications and allows physicians the capability of identifying potential trigger areas on the heart that could cause cardiac arrhythmias. Additionally, physicians may ablate these targeted cardiac triggers and directly evaluate the effectiveness of the ablation, all with the same device.

In July 2006, we released our new Isolator open clamp, which incorporates many of the design enhancements of our Isolator minimally invasive system. This new open clamp features a design that improves the surgeon s access to key anatomical structures, simplifies the ablation procedure and provides superior tactile feedback to the user.

In September 2006, we expanded our CE Mark indications and received approval to market our Isolator bipolar ablation system for the treatment of cardiac arrhythmias, including atrial fibrillation. Our clamps are the only bipolar radiofrequency clamps that are approved for this indication in the European Union. The expanded European Union indication provides physicians the reassurance that clinical data supporting the AF treatment claims were reviewed and accepted by European regulatory authorities.

From our inception in November 2000 through the first half of 2002, our operations consisted primarily of development-stage activities, including the development of the AtriCure bipolar ablation systems, raising capital, obtaining product clearances, conducting product testing and evaluations, and recruiting personnel. After limited sales of our system in 2002, we commenced the general commercial release of our first bipolar ablation system, our Isolator bipolar ablation system for open procedures, in January 2003.

We currently sell our bipolar ablation systems to customers in the United States primarily through our direct sales force. We also sell our systems outside of the United States, primarily in Asia, Europe, South America, Canada and the Middle East, through distributors who pay us in U.S. dollars, with the exception of Europe. In December 2005, we formed AtriCure Europe BV, our wholly-owned subsidiary incorporated in the Netherlands that distributes and sells our products throughout Europe to customers who pay us in Euros. Our sales outside of the United States constituted approximately 11.6% and 9.4% of our revenues for the nine months ended September 30, 2006 and 2005, respectively. We expect international sales to be relatively constant as a percentage of sales for the foreseeable future. We had a total of 166 employees as of September 30, 2006.

Our future growth will depend on our ability to generate sales of the AtriCure bipolar ablation systems through increasing acceptance by the medical community of our systems as standard treatment alternatives for the surgical treatment of AF. Acceptance of our bipolar ablation systems is dependent upon, among other factors, awareness and education of the medical community about the surgical treatment of AF, in general, and the safety and effectiveness of the AtriCure bipolar ablation systems, in particular.

Our bipolar ablation systems for open-heart and minimally invasive procedures have been cleared by the FDA for the ablation and coagulation of soft tissues during general and thoracic surgical procedures, but neither of these systems has been cleared nor approved in the United States for the ablation of cardiac tissue. We have received FDA clearance for our Pen system for cardiac tissue ablation and for temporary pacing, sensing, stimulating and recording during the evaluation of cardiac arrhythmias. As such, we may promote our Pen system to doctors and provide education and training on the use of this system for those uses. However, other than the Pen s use for cardiac tissue ablation and temporary pacing, sensing and stimulating during the evaluation of cardiac arrhythmias, we do not believe that any of our AtriCure bipolar ablation systems are currently being used for their FDA-cleared indications and, accordingly, substantially all of our revenue is currently generated through the non-FDA-approved, or off-label, use of our systems for the treatment of AF. None of our bipolar ablation systems have been approved by the FDA for the treatment of AF. While the FDA does not prevent doctors from using a product on an off-label basis, we cannot legally market a product for an off-label use. Because the AtriCure bipolar ablation systems are currently our only significant products, the sustainability of our current operations,

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as well as our future viability, is dependent upon the continuation of sales of our systems. We believe that sole-therapy minimally invasive treatment for AF represents the largest growth opportunity for us. If this market fails to develop, or the AtriCure bipolar ablation systems are not widely adopted for use in this market, we may not achieve greater revenue or become profitable. In order to establish the minimally invasive sole-therapy AF treatment market, the current referral practices of physicians must change.

After conducting necessary on-going clinical trials, we intend to seek FDA approval as early as 2010 for the use of one or more of our systems to treat AF, which we view as our market opportunity. If lack of FDA clearance or approval of our systems for the treatment of AF were to prevent sales of our systems, not only would we no longer receive revenue from the sale of our systems, but we also would require significant financing to conduct clinical trials and to sustain our operations until such time as sales could resume. We cannot assure you that we can obtain these FDA approvals, that we would have, or could raise, sufficient financial resources to sustain our operations pending FDA approval, or that, if and when the required approvals are obtained, there will be a market for any of our bipolar ablation systems.

We understand that Randall Wolf, M.D., one of our key consultants who has conducted clinical studies on the use of our systems to treat AF and published articles relating to such studies, received a warning letter from the FDA, dated September 28, 2006, regarding certain objectionable conditions observed during the FDA inspection conducted at his clinical site from April 19, 2006 to May 22, 2006. Following the inspection of Dr. Wolf, in June of this year, the FDA conducted a Bioresearch Monitoring Inspection of the conduct of our FDA-regulated clinical trials and a Quality Systems Inspection of the manufacture of our products. The FDA informed us that it was inspecting us for cause, based on articles that had appeared in The Wall Street Journal during December 2005 and February 2006 that related to, among other things, Dr. Wolf s relationship to us. At the close of these inspections and in subsequent communications, the FDA advised us that it would not be issuing us a Form 483 documenting formal inspectional observations. We received a final Establishment Inspection Report from the FDA on November 9, 2006. The report included two recommendations for continuous improvements, which were brought to our attention during the inspection and were implemented and reviewed by the close of the inspection.

We are continuing to develop the AtriCure Cosgrove-Gillinov Clip, which is designed to exclude the left atrial appendage, the small appendage that is attached to the left atrium, during surgical procedures and which may also be used to provide an option for high risk patients as a stand-alone left atrial appendage exclusion procedure following catheter ablation or pacemaker implantation. The left atrial appendage is considered by many physicians to be the source of blood clots which may cause a high percentage of AF-related strokes. We have decided to delay, until the first quarter of 2007, the filing with the FDA of a 510(k) application for the AtriCure Cosgrove-Gillinov Clip for an indication that includes left atrial appendage exclusion in order to further our preclinical support for the submission. Accordingly, we anticipate a limited release of the clip in the United States for use during open-heart and minimally invasive sole therapy procedures during the second half of 2007, subject to FDA review and clearance.

Our costs and expenses consist of cost of revenue, research and development expenses and selling, general and administrative expenses. Cost of revenue consists 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 trials. We are conducting the FDA-approved RESTORE-SR clinical trial relating to the use of the Isolator bipolar ablation system for procedures to treat AF during open-heart surgery. A total of 36 patients have been enrolled in the clinical trial as of September 30, 2006, approximately 16% of the patients required for this multicenter, 226-patient clinical trial. We are also conducting the FDA-approved RESTORE-SR II clinical study to evaluate the feasibility of using our Isolator minimally invasive bipolar ablation system as a minimally invasive sole-therapy treatment for AF. This feasibility study has completed enrollment and treatment of the necessary 25 patients at 5 leading US centers as of May 31, 2006. Selling, general and administrative expenses consist principally of costs associated with our sales, marketing and administrative functions, accounting and legal fees and educational grants to medical institutions.

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Results of Operations

Three months ended September 30, 2006 compared to September 30, 2005

The following table sets forth, for the periods indicated, our results of operations expressed as dollar amounts (in thousands) and as percentages of total revenue:

	Three Months Ended September 30,			
	2006		2005	
(Dollars in thousands)	Amount	% of Revenue	Amount	% of Revenue
Revenues	$ 9,358	100%	$ 7,170	100%
Cost of revenues	1,886	20%	2,015	28%
Gross profit	7,472	80%	5,155	72%
Operating expenses:				
Research and development expenses	3,172	34%	2,613	37%
Selling, general and administrative expenses	7,691	82%	6,318	88%
Total operating expenses	10,863	116%	8,931	125%
Loss from operations	(3,391)	(36%)	(3,776)	(53%)
Preferred stock interest expense		0%	(380)	(5%)
Interest income, net	236	2%	107	2%
Other income		0%	85	1%
Net loss	$ (3,155)	(34%)	$ (3,964)	(55%)

Revenues. Total revenue increased approximately $2.2 million, or 31%, from approximately $7.2 million for the three months ended September 30, 2005 to approximately $9.4 million for the three months ended September 30, 2006. The increase was attributable to an increase of approximately 31% in the total number of disposable products sold domestically and internationally. This volume increase in disposable products sold contributed approximately $2.5 million to the increase in revenues. While the average domestic selling price of our disposable ablation clamps increased slightly for the three months ended September 30, 2006 over the three months ended September 30, 2005, the increase in lower-priced international units sold as a percentage of total units sold resulted in a marginal decline in our overall average selling prices for the three months ended September 30, 2006 over the three months ended September 30, 2005. This marginal decline in our worldwide average selling prices partially offset the overall revenue increase by approximately $0.3 million.

Cost of revenues. Cost of revenues decreased approximately $0.1 million, from approximately $2.0 million for the three months ended September 30, 2005 to approximately $1.9 million for the three months ended September 30, 2006 due to the approximately 32% decrease in our average cost per disposable unit in the three months ended September 30, 2006 as compared to the three months ended September 30, 2005. The decrease in our average cost per unit is a direct result of our third quarter 2005 acquisition of Enable Medical Corporation (Enable), the manufacturer of our disposable products, partially offset by an increase in the total number of units sold. As a percentage of revenue, cost of revenue declined from approximately 28% for the three months ended September 30, 2005 to approximately 20% for the three months ended September 30, 2006.

Research and development expenses. Research and development expenses increased approximately $0.6 million, from approximately $2.6 million for the three months ended September 30, 2005 to approximately $3.2 million for the three months ended September 30, 2006. The increase was primarily attributable to the addition of 21 full-time research and development personnel, including 13 former Enable employees and the expansion of our clinical research activities. As a percentage of total revenue, research and development expenses decreased from approximately 37% for the three months ended September 30, 2005 to approximately 34% for the three months ended September 30, 2006. Research and development expenses are expected to continue to increase in absolute dollars for the remainder of 2006.

Selling, general and administrative expenses. Selling, general and administrative expenses increased approximately $1.4 million, from approximately $6.3 million for the three months ended September 30, 2005 to approximately $7.7 million for the three months ended September 30, 2006. The increase was primarily attributable to increases in headcount-related charges of approximately $0.7 million, increased marketing expenses of approximately $0.3 million, increases in unrestricted grants and training expenditures of approximately $0.1 million and increases in general corporate expenditures of approximately $0.3 million. The increase in headcount-related charges was primarily attributable to the expansion of our sales and marketing organizations. As a percentage of total revenue, selling, general and administrative expenses decreased from approximately 88% for the three months ended September 30, 2005 to approximately 82% for the three months ended September 30, 2006. Selling, general and administrative costs are expected to continue to increase in absolute dollars for the remainder of 2006 as a result of increased costs associated with sales and marketing efforts and the increase in costs associated with being a public company.

Preferred stock interest expense. Preferred stock interest expense decreased to zero from approximately $0.4 million for the three months ended September 30, 2005. The decrease was attributable to the conversion of all shares of preferred stock into common stock upon the closing of our initial public offering on August 10, 2005.

Interest income, net. Interest income, net increased approximately $129,000, from approximately $107,000 for the three months ended September 30, 2005 to approximately $236,000 for the three months ended September 30, 2006, due to the increase in cash, cash equivalents and investments resulting from the proceeds of our August 2005 initial public offering.

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Nine months ended September 30, 2006 compared to September 30, 2005

The following table sets forth, for the periods indicated, our results of operations expressed as dollar amounts (in thousands) and as percentages of total revenue:

	Nine Months Ended September 30,			
	2006		2005	
(Dollars in thousands)	Amount	% of Revenue	Amount	% of Revenue
Revenues	$ 27,644	100%	$ 22,398	100%
Cost of revenues	5,271	19%	5,913	26%
Gross profit	22,373	81%	16,485	74%
Operating expenses:				
Research and development expenses	9,011	32%	6,320	28%
Selling, general and administrative expenses	23,676	86%	16,713	75%
Total operating expenses	32,687	118%	23,033	103%
Loss from operations	(10,314)	(37%)	(6,548)	(29%)
Preferred stock interest expense		0%	(2,332)	(10%)
Interest income, net	788	3%	122	0%
Other income	72	0%	85	0%
Net loss	$ (9,454)	(34%)	$ (8,673)	(39%)

Revenues. Total revenue increased approximately $5.2 million, or 23%, from approximately $22.4 million for the nine months ended September 30, 2005 to approximately $27.6 million for the nine months ended September 30, 2006. The increase was attributable to an increase of approximately 26% in the total number of disposable products sold domestically and internationally. This volume increase in disposable products sold contributed approximately $6.0 million to the increase in revenues. While the average domestic selling price of our disposable ablation clamps increased for the nine months ended September 30, 2006 over the nine months ended September 30, 2005, the increase in lower-priced international units sold as a percentage of total units sold resulted in a decline in our overall average selling prices for the nine months ended September 30, 2006 over the nine months ended September 30, 2005. The decline in our worldwide average selling prices partially offset the overall revenue increase by approximately $0.8 million.

Cost of revenues. Cost of revenues decreased approximately $0.6 million, from approximately $5.9 million for the nine months ended September 30, 2005 to approximately $5.3 million for the nine months ended September 30, 2006 due to the approximately 35% decrease in our average cost per unit in the nine months ended September 30, 2006 as compared to the nine months ended September 30, 2005. The decrease in our average cost per unit is a direct result of our third quarter 2005 acquisition of Enable, the manufacturer of our disposable products, partially offset by an increase in the total number of units sold. As a percentage of revenue, cost of revenue declined from approximately 26% for the nine months ended September 30, 2005 to approximately 19% for the nine months ended September 30, 2006.

Research and development expenses. Research and development expenses increased approximately $2.7 million, from approximately $6.3 million for the nine months ended September 30, 2005 to approximately $9.0 million for the nine months ended September 30, 2006. The increase was primarily attributable to the addition of 21 full-time research and development personnel, including 13 former Enable employees, the expansion of our product development activities to increase our product offerings, and the expansion of our clinical trial activities. Our product development activities include projects to extend and improve the AtriCure bipolar ablation systems, develop our new left atrial appendage exclusion device, create new enabling devices and ablation tools and research for new technologies. As a percentage of total revenue, research and development expenses increased from approximately 28% for the nine months ended September 30, 2005 to approximately 32% for the nine months ended September 30, 2006. We anticipate a continued increase in absolute dollars in overall research and development spending for the remainder of 2006.

Selling, general and administrative expenses. Selling, general and administrative expenses increased approximately $7.0 million, from approximately $16.7 million for the nine months ended September 30, 2005 to approximately $23.7 million for the nine months ended September 30, 2006. The increase was primarily attributable to increases in headcount-related charges of approximately $4.0 million, increased marketing expenditures of approximately $0.7 million, increases in unrestricted grants and training expenditures of approximately $0.3 million and increases in other general corporate expenditures of approximately $2.0 million. The increase in headcount-related charges was primarily attributable to the acquisition of Enable and the expansion of our sales and marketing organizations. As a percentage of total revenue, selling, general and administrative expenses increased from approximately 75% for the nine months ended September 30, 2005 to approximately 86% for the nine months ended September 30, 2006. Selling, general and administrative costs are expected to continue to increase in absolute dollars for the remainder of 2006 as a result of increased costs associated with sales and marketing efforts and the increase in costs associated with being a public company.

Preferred stock interest expense. Preferred stock interest expense decreased to zero from approximately $2.3 million for the nine months ended September 30, 2005. The decrease was attributable to the conversion of all shares of preferred stock into common stock upon the closing of our initial public offering on August 10, 2005.

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Interest income, net. Interest income, net increased approximately $0.7 million, from approximately $0.1 million for the nine months ended September 30, 2005 to approximately $0.8 million for the nine months ended September 30, 2006, due to the increase in cash, cash equivalents and investments resulting from the proceeds of our August 2005 initial public offering.

Liquidity and Capital Resources

Prior to our initial public offering, we financed our operations primarily through private sales of preferred stock, with aggregate net proceeds of approximately $21.3 million of cash, excluding the conversion of approximately $4.7 million of promissory notes.

In August 2005, we completed an initial public offering in which we received net proceeds, after deducting underwriting discounts, commissions and offering expenses, of approximately $43.2 million from our sale and issuance of an aggregate of 4,150,000 shares of common stock, including 150,000 shares sold by us as part of the underwriters over-allotment option.

As of September 30, 2006, we had cash, cash equivalents and short-term investments of approximately $19.5 million, long-term investments of approximately $2.8 million and short-term and long-term debt of approximately $1.1 million. We had working capital of approximately $24.1 million and an accumulated deficit of approximately $51.8 million as of September 30, 2006.

Cash flows used in operating activities. Net cash used in operations was approximately $9.9 million for the nine months ended September 30, 2006 and $3.6 million for the nine months ended September 30, 2005. For the nine months ended September 30, 2006, the increase in net cash used in operating activities was attributable primarily to the net loss of approximately $9.5 million and increases in accounts receivable, inventory and other current assets of approximately $1.2 million, $1.1 million and $0.6 million, respectively, which increased as revenues increased. Those increases were partially offset by adjustments for depreciation and amortization of approximately $1.4 million and non-cash charges related to stock-based compensation of approximately $0.6 million and increases in payables, accrued liabilities and other non-current assets and liabilities of approximately $0.5 million due to our increase in operating expenses. Net cash used in operations for the nine months ended September 30, 2005 was primarily attributable to a net loss of approximately $8.7 million and increases in other current assets and inventory of approximately $0.9 million and $0.5 million, respectively, partially offset by preferred stock interest of approximately $2.3 million, depreciation and amortization of approximately $1.1 million, non-cash charges related to stock-based compensation of approximately $0.5 million, a decrease of approximately $1.2 million in accounts receivable, increases in payables and accrued liabilities of approximately $1.0 million and an increase in other non-current assets and liabilities of approximately $0.4 million.

Cash flows used in investing activities. Net cash used in investing activities was approximately $1.5 million for the nine months ended September 30, 2006 and $7.9 million for the nine months ended September 30, 2005. For each of these periods, cash used in investing activities reflected purchases of property and equipment and, for the nine months ended September 30, 2006, the purchases and maturities of approximately $0.1 million of investments and, for the nine months ended September 30, 2005, the net purchase price paid for the acquisition of Enable of approximately $6.4 million.

Cash flows used in and provided by financing activities. Cash flows used in financing activities were approximately $0.2 million for the nine months ended September 30, 2006 and cash flows provided by financing activities were approximately $44.7 for the nine months ended September 30, 2005. For the nine months ended September 30, 2006, cash flows used in financing activities reflected payments made on our debt and lease obligations partially offset by proceeds from exercises of stock options. For the nine months ended September 30, 2005, net cash provided by financing activities was attributable to the proceeds from the issuance of common stock related to our initial public offering, borrowings under our Lighthouse credit facility and the proceeds from stock option and warrant exercises.

Credit facility. We entered into a $5.0 million credit facility on March 8, 2005 with Lighthouse Capital Partners V, L.P. for working capital requirements. Outstanding borrowings under the facility bear interest at the prime rate plus 1.75% and our ability to draw down funds under this facility terminated upon our initial public offering. Under the terms of the facility, we are required to pay any monthly installments of interest only through August 2005 and monthly installments of principal and interest thereafter, in addition to a fee due at maturity on September 1, 2009 equal to 15% of the aggregate amount borrowed under the credit facility, with prepayment in whole allowed at any time without penalty. As

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of September 30, 2006, there was approximately $1.2 million outstanding under this facility, including approximately $0.1 million for the fee due at maturity.

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 relating to changes in regulatory policies or laws that affect our operations and costs of filing, prosecuting, defending and enforcing our intellectual property rights. We expect to increase capital expenditures consistently with our anticipated growth in research and development, manufacturing, infrastructure and personnel.

We believe that our current cash and cash equivalents 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 or obtain a credit facility. 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. Additional financing may not be available at all, or in amounts or terms acceptable to us. If we are unable to obtain this additional financing, we may be required to reduce the scope of our planned research and development and sales and marketing efforts.

Contractual Obligations and Commitments

On July 18, 2006, we entered into an Agreement, effective as of June 6, 2005, with The Cleveland Clinic relating to our rights and obligations with respect to the publicly announced grants from the State of Ohio for, among other things, the creation of the Atrial Fibrillation Innovation Center. Pursuant to the terms of the Agreement, we are required to supply personnel and materials to accomplish certain research-related activities in connection with the grant and, over a three-year period, we will receive up to a total of approximately $0.9 million for personnel and materials and The Cleveland Clinic will acquire up to approximately $2.4 million in capital equipment for our use in support of our performance of the Agreement. Over the same three-year period, we are required to expend up to approximately $7.7 million for operating expenses and up to approximately $4.8 million for capital expenses at our facility in support of the Agreement, which amounts we believe represent ordinary course expenditures that we would have otherwise anticipated making. Under the terms of the agreement, we may be required to spend up to $2.7 million in the first year, $4.4 million in the second year and $5.4 million in the third year. The Agreement terminates on December 6, 2008. However, we and The Cleveland Clinic may terminate the Agreement at any time by giving 30 days prior written notice.

Off-Balance-Sheet Arrangements

As of September 30, 2006, we did not have any off-balance-sheet arrangements.

Seasonality

During the third quarter, we typically experience a decline in sales that we attribute to the elective nature of the procedures in which our products are typically used, which we believe arises from fewer people choosing to undergo elective procedures during the summer months.

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 of America. The preparation of financial statements requires management to make estimates and judgments that affect the reported amounts of assets and liabilities, revenue 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 accounts receivable, inventories and stock-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.

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We believe the following critical accounting policies affect our more significant judgments and estimates used in the preparation of our financial statements.

Stock-Based Compensation. On January 1, 2006, we adopted Statement of Financial Accounting Standards No. 123 (revised 2004), Share-Based Payment, (SFAS 123(R)), which requires the measurement and recognition of compensation expense for all share-based payment awards made to employees and directors, including employee stock options and employee stock purchases related to an employee stock purchase plan, based on estimated fair values. Stock-based compensation expense recognized under SFAS 123(R) for the three and nine months ended September 30, 2006 was $250,288 and $720,980, respectively, on a before and after tax basis, which consisted of stock-based compensation expense related to employee stock options. During the three and nine months ended September 30, 2005, we incurred charges for stock compensation for employees for options issued with exercise prices below market value. We recorded charges of approximately $66,960 and $192,445, which represent the portion pertaining to the three and nine months ended September 30, 2005, respectively, based on the options vesting requirements. See Note 4 to the Notes to Consolidated Financial Statements for additional information.

We estimate the fair value of options on date of grant using the Black-Scholes option-pricing model. Our determination of fair value of share-based payment awards on the date of grant using an option-pricing model is affected by our stock price, as well as assumptions regarding a number of highly complex and subjective variables. These variables include, but are not limited to, our expected stock price volatility over the term of the awards, and actual and projected employee stock option exercise behaviors. Due to our limited trading history, we used the implied volatility of a group of comparable companies, looking at both short and long-dated options in determining our volatility. The weighted-average estimated fair value of options granted during the three and nine months ended September 30, 2006 was $3.25 and $3.97, respectively, and during the three and nine months ended September 30, 2005 was $6.96 and $4.97, respectively, using the Black-Scholes model with the following assumptions:

	Three months ended September 30,		Nine months ended September 30,	
	2006	2005	2006	2005
Risk free interest rates	1.00% to 4.76%	1.00% to 3.86%	1.00% to 5.14%	1.00% to 3.86%
Expected lives (years)	6	4	6	4
Expected volatility	38.06%	57.00%	38.06%	57.00%
Dividend yield	0.00%	0.00%	0.00%	0.00%

The risk-free interest rate assumption is based upon the U.S. treasury yield curve at the time of grant.

Due to our limited trading history, we have chosen to use the simplified method for estimating the expected lives of options as allowed under the Securities and Exchange Commission issued Staff Accounting Bulletin No. 107. Under this approach, the expected lives were calculated by taking the average of the vesting term and the original contract term.

If factors change and we employ different assumptions in the application of SFAS 123(R) in future periods, the compensation expense that we record under SFAS 123(R) may differ significantly from what we have recorded in the current period.

Revenue Recognition. Revenue is generated primarily from the sale of our disposable Isolator bipolar ablation clamps, the Isolator Transpolar pen and the Wolf dissector. Pursuant to our standard sales terms, revenue is recognized when title to the goods and risk of loss transfer to customers and there are no remaining obligations that will affect the customer s final acceptance of the sale. Our standard sales terms define the transfer of title and risk of loss to occur upon shipment to the respective customer. We maintain no post-shipping obligations to the recipients of the products. No installation, calibration or testing of this equipment is performed by us subsequent to shipment to the customer in order to render it operational. Product revenue includes shipping revenue of approximately $63,000 and $31,000 for the three months ended September 30, 2006 and 2005, respectively and $169,000 and $99,000 for the nine months ended September 30, 2006 and 2005, respectively. Cost of freight is included in cost of goods sold. We sell our products through a direct and indirect sales force and through AtriCure Europe, B.V., our wholly-owned subsidiary incorporated in the Netherlands. Sales terms are consistent for both end-users and distributors, with terms generally not exceeding 120 days. Customers and distributors generally have no right of return.

We comply with 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. We recognize revenue when all of the following

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criteria are met: persuasive evidence that an arrangement exists; delivery of the products or services has occurred; the selling price is fixed or determinable; and collectibility is reasonably assured.

Allowance for Uncollectible Accounts Receivable. We periodically and systematically evaluate the collectibility of accounts receivable and determine the appropriate reserve for doubtful accounts. In determining the amount of the reserve, we consider historical credit losses, the past due status of the receivables, and other customer-specific information, and any other relevant factors or considerations.

Inventory Valuation. Inventories are stated at the lower of cost or market using the first-in, first-out, or FIFO, cost method and consist of raw materials, work in process and finished goods. Reserves are estimated 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 the product is destroyed. We review inventory on hand at least quarterly and record 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. Our industry is characterized by rapid product development and frequent new product introductions. Uncertain timing of product approvals, variability in product launch strategies, product recalls and variation in product utilization all impact the estimates related to excess and obsolete inventory.

Deferred Tax Asset Valuation Allowance. Our estimate for the valuation allowance for deferred tax assets requires us to make significant estimates and judgments about our future operating results. Our ability to realize the deferred tax assets depends on our 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 our operating results on which the establishment of a valuation allowance is based involve significant estimates regarding future demand for our products, competitive conditions, product development efforts, approvals of regulatory agencies, and product cost. If actual results differ from these projections, or if our expectations of future results change, it may be necessary to adjust the valuation allowance.

Recent Accounting Pronouncements

In February 2006, the FASB issued SFAS No. 155, Accounting for Certain Hybrid Financial Instruments-an amendment of FASB Statements No. 133 and 140. This Standard amends SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities and SFAS 140 Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities. The provisions of this Standard are effective for financial instruments acquired, issued, or subject to a remeasurement event occurring after the beginning of an entity s first fiscal year that begins after September 15, 2006. The adoption of SFAS No. 155 is not expected to have a material impact on our financial statements.

In July 2006, the FASB issued FASB Interpretation No. 48 (FIN 48), Accounting for Uncertainty in Income Taxes which prescribes a recognition threshold and measurement process for recording in the financial statements uncertain tax positions taken or expected to be taken in a tax return. Additionally, FIN 48 provides criteria for subsequently recognizing, derecognizing and measuring changes in uncertain tax positions and requires expanded disclosure with respect to the uncertainty of income taxes. The accounting provisions of FIN 48 will be effective for us beginning January 1, 2007 with the cumulative effect of the change in accounting principle recorded as an adjustment to opening retained earnings. We are in the process of determining the effect, if any, the adoption of FIN 48 will have on our financial statements.

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements (SFAS 157), which establishes a framework for measuring fair value and expands disclosures about fair value measurements. The provisions of SFAS 157 will be effective for us beginning January 1, 2008. We are in the process of determining the effect, if any, the adoption of SFAS 157 will have on our financial statements.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

We do not utilize derivative financial instruments, derivative commodity instruments or other market risk sensitive instruments, positions or transactions. We are exposed to various market risks, which are potential losses arising from adverse changes in market rates and prices, such as foreign exchange fluctuations and interest rates.

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For the nine months ended September 30, 2006, products sold by AtriCure Europe BV accounted for approximately 4.9% of our sales. Since such sales were denominated in Euros, we have exposure to exchange rate fluctuations between the Euro and the U.S. dollar. To date, the effect of the foreign exchange rate fluctuations on our financial results has not been material.

For sales denominated in Euros, if there is an increase in the rate at which Euros are exchanged for U.S. dollars, it will require more Euros to equal a specified amount of U.S. dollars than before the rate increase. In such cases and if we price our products in Euros, we will receive less in U.S. dollars than we did before the rate increase went into effect. If we price our products in U.S. dollars and competitors price their products in Euros, an increase in the relative strength of the U.S. dollar could result in our price not being competitive in a market where business is transacted in the Euro.

Although approximately 95.1% of our sales and purchases are currently denominated in U.S. dollars, future fluctuations in the value of the U.S. dollar may affect the price competitiveness of our products outside the United States.

We invest our excess cash primarily in U.S. government securities, corporate bonds and commercial paper. Accordingly, we believe that, while the instruments we hold are subject to changes in the financial standing of the issuer of such securities, we are not subject to any material risks arising from changes in interest rates, foreign currency exchange rates, commodity prices, equity prices or other market changes that affect market risk sensitive instruments.

Item 4. Controls and Procedures

Disclosure Controls and Procedures

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

As required by SEC Rule 13a-15(b), an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rule 13a-15(e) and Rule 15d-15(e) under the Securities Exchange Act of 1934) as of the end of the period covered by this report was carried out under the supervision and with the participation of our management, including our chief executive officer. Based on that evaluation, our chief executive officer has concluded that our disclosure controls and procedures are effective at the reasonable assurance level to ensure that material information relating to us, is made known to them, particularly during the period in which this report was prepared, in order to allow timely decisions regarding required disclosure.

Changes in Internal Control Over Financial Reporting

During the nine-month period ended September 30, 2006, there has not occurred any change in our internal control over financial reporting (as defined in Rule 13a-15(f) and Rule 15d-15(f) under the Securities Exchange Act of 1934) that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting. However, as previously announced, during the third quarter of 2006, our Vice President and Chief Financial Officer resigned. We believe that the resignation was in no way related to our internal controls, financial statements, financial performance or financial condition. All of the control processes formerly performed by our Chief Financial Officer were transitioned to and performed by other individuals, including our Chief Executive Officer. Until a successor is named, our President and Chief Executive Officer will continue to work with our controller to manage our finances and all finance functions will report directly to our President and Chief Executive Officer.

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PART II. OTHER INFORMATION

Item 1. Legal Proceedings

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

Life Support Technology LST B.V.

In January 2006 Life Support Technology LST B.V., a former distributor of our products in Europe, filed an action against us in Den Bosch, Netherlands and in February 2006 LST also filed an action against our subsidiary, AtriCure Europe, B.V. in The Hague, Netherlands in the Kort Geding (a summary injunction proceeding wherein preliminary relief is demanded). On March 28, 2006, the case against our subsidiary was summarily dismissed. On July 19, 2006, we presented an Incidental Statement arguing that the court before which the case is currently pending does not have jurisdiction over the matter and, even if such court should conclude that it does indeed have jurisdiction, such court should stay the proceedings in such case until the case pending in the United States relating to such matter has been decided. The Court has scheduled a hearing on the jurisdictional issue for December 5, 2006.

We and LST were party to a distribution agreement, dated January 1, 2004. Each of LST s summonses allege that we, on behalf of AtriCure Europe, and LST reached an agreement, which would succeed a January 1, 2004 agreement, pursuant to which LST agreed to continue distributing our products in certain European countries. The summonses allege that, in addition to the value for LST of a continued distributorship, such agreement would have provided an additional $330,000 to LST and its principal, J.L.M. Marinus. We believe that neither we nor our subsidiary reached such an agreement with LST and that the original distribution agreement with LST was terminated as of December 31, 2005. We intend to defend these lawsuits vigorously.

Pursuant to our January 1, 2004 distribution agreement with LST, certain of LST s obligations survive termination of that agreement. Such obligations include, among other things, the timely payment for equipment purchased and the return of all materials (such as marketing literature and sales and promotional materials) supplied by us to LST. In March 2006, we filed a complaint in Ohio State Court (Butler County, Ohio Court of Common Pleas) against LST claiming that LST has not complied with these obligations and we are seeking damages which, due to Ohio pleading limitations, are alleged to be more than $25,000 but which, in fact, we believe are in an amount in excess of $185,000. On April 21, 2006, LST filed its answer to our complaint and asserted counterclaims that contain similar claims to the claims it made in the action it filed against us in the Netherlands, described above. We have filed our response to the counterclaims and discovery has been scheduled. Although some discovery requests have been served, no discovery responses have been served yet and no depositions have been conducted.

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, you should carefully consider the factors discussed in Part I, Item 1A. Risk Factors in our Form 10-K for the year ended December 31, 2005, all of which could materially affect our business, financial condition or future results. These described risks 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.

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

(a) Unregistered Sales of Equity Securities

None.

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(b) Initial Public Offering and Use of Proceeds from the Sale of Registered Securities

We registered the initial public offering of our common stock, par value $.001 per share, on a Registration Statement on Form S-1, as amended (Registration No. 333-124197), which was declared effective on August 4, 2005. On August 10, 2005, we consummated an initial public offering of 4.6 million shares of our common stock at $12.00 per share, which included the underwriters exercise of their over-allotment option on August 9, 2005 to purchase 600,000 shares of our common stock, of which 450,000 shares were sold by selling shareholders and 150,000 shares were sold by us. Gross proceeds from the offering were $49.8 million. We did not receive any proceeds from the sale of the 450,000 shares of common stock that were sold by selling shareholders. Net proceeds to us from the offering, after deducting underwriting discounts and commissions of approximately $3.5 million and offering expenses of approximately $3.1 million, were approximately $43.2 million.

During the nine months ended September 30, 2006, we spent approximately $0.6 million of the proceeds from the offering toward our obligations under a development and license agreement, approximately $1.4 million for the purchase of property and equipment, approximately $0.1 million on the net purchases and maturities of investment securities, approximately $0.3 million on payments on long-term debt and approximately $9.2 million on other research and development activities and selling, general and administrative expenditures. Pending use of the remaining net proceeds of the offering, we intend to invest such proceeds in a variety of capital preservation investments, including short-term, investment-grade, interest-bearing instruments. The use of proceeds does not represent a material change from the use of proceeds described in the prospectus relating to the Registration Statement.

No offering expenses were paid directly or indirectly to any of our directors or officers (or their associates) or persons owning ten percent or more of our equity securities or to any other affiliates except for payments made to Epstein, Becker & Green P.C., our corporate counsel, for legal fees and expenses incurred in connection with the offering. Theodore L. Polin, our corporate secretary, is a shareholder of Epstein, Becker & Green P.C. Other than those legal fees and expenses, all offering expenses were paid directly to third parties who were not our directors or officers (or their associates), persons owning ten percent or more of our equity securities or any other affiliate.

(c) Repurchases of Equity Securities

None.

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

None.

Item 5. Other Information

We recently announced that Michael D. Hooven, our co-founder and Chief Technology Officer, will resign as an executive officer and serve as a consultant. In his consultant role, Mr. Hooven will focus on early-stage innovative product concepts for use by electrophysiologists. Mr. Hooven will continue to serve as a director of AtriCure and provide support to our product development efforts and the management of our intellectual property portfolio. We anticipate that under this consulting agreement, Mr. Hooven will be able to develop these early-stage concepts, while also being able to pursue his long-established entrepreneurial endeavors outside of our business.

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Item 6. Exhibits

Exhibit

No.	Description
10.1*	Agreement, dated as of July 18, 2006, by and between AtriCure, Inc. and The Cleveland Clinic.
31.1	Rule 13a-14(a) Certification of Chief Executive Officer and Principal 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 and Principal Financial Officer, as adopted, pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

* Incorporated by reference to the Exhibit bearing the same number to the Company s Current Report on Form 8-K filed on July 20, 2006.

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SIGNATURE

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: November 13, 2006

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

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