COMPUTER MOTION INC
Form 10-Q
May 15, 2003

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SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended March 31, 2003

Commission File Number 000-22755

COMPUTER MOTION, INC.

(*Exact name of Registrant as specified in its charter*)

Delaware	**77-0458805**
(*State or other jurisdiction of incorporation or organization*)	(*I.R.S. Employer Identification Number*)

130-B Cremona Drive
Goleta, CA 93117

(*Address of principal executive offices*)
(805) 968-9600
(*Registrant s telephone number, including area code*)

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

Indicate by check mark if the Registrant is an accelerated filer (as defined in Exchange Act Rule 12b-2). Yes [ ] No [x]

The number of shares of the Registrant s Common Stock, $.001 par value, as of May 12, 2003 was 21,405,128 shares.

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

COMPUTER MOTION, INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(Amounts in thousands, except per share amounts)
(unaudited)

	Three Months Ended March 31,	
	2003	2002
Revenue	$ 7,011	$ 5,691
Cost of revenue	2,740	2,645
Gross profit	4,271	3,046
Gross profit %	61%	54%
Research & development expense	2,701	2,652
Selling, general & administrative expense	5,693	4,525
Merger expense	544	
Litigation provision	3,039	291
Total operating expense	11,977	7,468
Loss from operations	(7,706)	(4,422)
Interest income	6	12
Interest expense	(132)	(13)
Foreign currency translation loss	(28)	(27)
Other expense	(4)	(2)
Total other income/(expense)	(158)	(30)
Loss before income tax provision	(7,864)	(4,452)
Income tax provision	10	6
Net loss	(7,874)	(4,458)
Dividend to Series B preferred stockholders		4,978
Dividend to Series C / D preferred stockholders	1,375	
Net loss available to common stockholders	$ (9,249)	$ (9,436)
Weighted average common shares outstanding used to compute net loss per share basic and diluted	17,694	14,467
Net loss per share basic and diluted	$ (0.52)	$ (0.65)

See accompanying notes to condensed consolidated financial statements

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COMPUTER MOTION, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(Amounts in thousands, except par value)

	March 31, 2003	December 31, 2002 (1)
ASSETS		
Current assets:		
Cash and cash equivalents	$ 1,269	$ 2,606
Restricted cash	2,298	98
Accounts receivable, net of allowance for doubtful accounts and returns of $1,326 at March 31, 2003 and $781 at December 31, 2002	8,665	6,786
Inventories	7,174	5,866
Other current assets	1,036	1,471
Total current assets	20,442	16,827
Property and equipment:		
Furniture and fixtures	1,899	1,896
Computer equipment	3,128	3,050
Machinery and equipment; (including demo equipment)	7,994	7,419
Accumulated depreciation	(8,141)	(7,398)
Property and equipment, net	4,880	4,967
Other assets	54	56
Total assets	$ 25,376	$ 21,850
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Note payable to stockholder	$	$ 1,000
Bridge loan payable	2,300	
Accounts payable	9,069	3,541
Accrued expenses	8,340	7,953
Deferred revenue	2,649	2,461
Total current liabilities	22,358	14,955
Deferred revenue	1,057	1,226
Other liabilities		18
Total liabilities	23,415	16,199
Series D convertible preferred stock, $.001 par value authorized 10,750 shares, outstanding at 3/31/03 - 8,798 shares	12,755	
Stockholders equity:		
Series C convertible preferred stock, $.001 par value authorized 10,750 shares, authorized 10,500 shares, outstanding 3/31/03 - 0 ; 12/31/02 - 6,299 shares	$	$ 9,017
Series C convertible preferred stock, 1,071 shares subscribed at 12/31/02		1,499
Common stock, $.001 par value, authorized - 50,000 shares; Outstanding 3/31/03 - 19,221; 12/31/2002 - 17,627 shares	19	18
Additional paid-in capital	115,401	112,157
Deferred compensation	(257)	(262)
Accumulated deficit	(125,923)	(116,674)

Other comprehensive loss	(34)	(104)
Total stockholders equity	(10,794)	5,651
Total liabilities & stockholders equity	$ 25,376	$ 21,850

(1) Derived from audited financial statements as of December 31, 2002

See accompanying notes to condensed consolidated financial statements

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COMPUTER MOTION INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)
(unaudited)

	Three Months Ended March 31,	
	2003	2002
Cash Flows from Operating Activities:		
Net loss	$(7,874)	$ (4,458)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and Amortization	748	511
Provision for Doubtful Accounts	100	
Common stock issued for services		1,395
Amortization of Deferred Compensation	5	44
Unexercised MBO Options	34	
Decrease (Increase) in:		
Accounts receivable	(1,979)	779
Inventories	(1,308)	295
Prepaid expenses	435	(160)
Increase (Decrease) in:		
Accounts payable	5,528	(2,974)
Accrued expenses	387	(92)
Other liabilities		(12)
Deferred revenue	19	(233)
Net cash used in operating activities	(3,905)	(4,905)
Cash Flows from Investing Activities:		
Purchase of property and equipment	(659)	(212)
Net cash used in investing activities	(659)	(212)
Cash Flows from Financing Activities:		
Proceeds from bridge loan	2,300	
Payment of dividend	(21)	
Repayment of note payable to stockholder		(900)
Proceeds from note payable Accounts receivable financing		133
Proceeds from preferred stock issuance, net of expenses	861	
Proceeds from common stock issued and warrants exercised, net of repurchases	2,101	10,527
Proceeds from common stock Societe Generale (Equity Line)		508
Proceeds from common stock ESPP plan	44	61
Proceeds from exercise of stock options	90	60
Comprehensive loss and other	52	227
Net cash provided by financing activities	5,427	10,616
Net increase in cash, cash equivalents and restricted cash	863	5,499
Cash, cash equivalents and restricted cash at beginning of period	2,704	1,067
Cash, cash equivalents and restricted cash at end of period	$ 3,567	$ 6,566

See accompanying notes to condensed consolidated financial statements

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COMPUTER MOTION, INC.
Notes to Condensed Consolidated Financial Statements

Note 1. Basis of Presentation

The accompanying unaudited condensed consolidated financial statements of Computer Motion, Inc. (the Company) have been prepared in accordance with generally accepted accounting principles for interim financial information and in accordance with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the financial information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring adjustments) considered necessary for a fair presentation have been included.

The operating results of the interim periods presented are not necessarily indicative of the results expected for the entire fiscal year ending December 31, 2003 or for any other interim period. The accompanying Condensed Consolidated Financial Statements should be read in conjunction with the audited financial statements and notes thereto for the fiscal year ended December 31, 2002 included in the Company s Annual Report on Form 10-K/A, filed with the Securities and Exchange Commission (SEC) on May 12, 2003. As shown in the accompanying consolidated financial statements, the Company continues to incur losses and negative cash flows from operations. At March 31, 2003, the Company had cash and cash equivalents of approximately $3.6 million. The Company is currently consuming cash at a rate of approximately $1.5 million per month. The combination of these factors raises substantial doubt about the Company s ability to continue as a going concern. Management believes that it will be unable to fund its operations for the next twelve months with its current cash and cash equivalents. Management s plans in regard to these items include the following: Obtain cash proceeds under the working capital line of credit with Intuitive Surgical, Inc. (Intuitive Surgical) dated March 6, 2003 (see Note 5); and obtain cash proceeds from the exercise of the Company s Series C Convertible Preferred Stock and other warrants. These plans are intended to enable the Company to continue its operations through March 31, 2004. The Company s need for additional financing will depend upon numerous factors, including, but not limited to, the progress and scope of ongoing research and development projects, the costs of training physicians to become proficient in the use of the Company s products and procedures, the ability to obtain required FDA approvals, the ability to successfully defend itself in any current or future patent litigation and the ability of the Company s customers to obtain medical reimbursement from third party payors.

The Company applies the provisions of Staff Accounting Bulletin No. 101 (SAB 101) when recognizing revenue. SAB 101 states that revenue generally is realized or realizable and earned when all of the following criteria are met: a) persuasive evidence of an arrangement exists, b) delivery has occurred or the services have been rendered, c) the seller s price to the buyer is fixed or determinable, and d) collectibility is reasonably assured.

The Company recognizes revenue from the sale of products to end-users, including supplies and accessories, once shipment has occurred, as the Company s general terms are FOB shipping point. In those few cases where the customers terms are FOB destination, revenue is not recognized until the Company receives a signed delivery and acceptance certificate, and all of the conditions of SAB 101 as identified above have been met. Revenue is recognized from the performance of services as the services are performed.

The Company recognizes revenue from the sale of products to distributors, including supplies and accessories, once shipment has occurred and all of the conditions of SAB 101 have been met. The Company s distributors do not have rights of return or cancellation. Revenue from distributors, which does not meet all of the requirements of SAB 101, is deferred and recognized upon the sale of the product to the end user.

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Revenues from product sales to financing institutions are not recognized by the Company until a purchase order is received, the product has been shipped and the funding by the financing institution has been approved. The Company recognized revenues from sales to third party financing institutions of $163,000 and $233,000 for the quarters ended March 31, 2003 and 2002, respectively.

Revenues for transactions that include multiple elements such as systems, training, product warranties, instruments, accessory kits and service contracts are allocated to each element based on its relative fair value (or in the absence of fair value, the residual method) and recognized when the revenue recognition criteria have been met for each element. The Company recognizes revenue for delivered elements only when the following criteria are satisfied: (1) undelivered elements are not essential to the functionality of delivered elements, (2) uncertainties regarding customer acceptance are resolved and (3) the fair value for all undelivered elements is known. The Company defers revenue from the sale of extended warranties, product upgrades and other contractual items and recognizes them over the life of the contract, when service is performed or upon shipment to the customer, as applicable. The value allocated to elements in a multiple element arrangement is based on objective evidence of relative fair value of each element.

Shipments of products to be used for demonstration purposes or prototype products used in development programs are reflected as consigned inventory and are included in the property and equipment balance in the accompanying consolidated balance sheets.

The Company records revenue, net of commissions paid to agents, in accordance with Emerging Issues Task Force (EITF) No. 99-19, Reporting Revenue Gross as a Principal versus Net as an Agent.

The Company believes that Statement of Position 97-2, Software Revenue Recognition (SOP 97-2), is not applicable to the sale of the Company s products in accordance with the guidance in paragraphs 2 and 4 of SOP 97-2. The software sold is considered by the Company to be incidental to the products sold and is not a significant focus of the marketing efforts of the Company nor is the software sold separately. In addition, post contract customer support is not sold by the Company in conjunction with the software. As such, the Company does not separately account for the sale of the software.

Note 2. Net Loss Per Share

Statement of Financial Accounting Standard (SFAS) No. 128, Earnings Per Share, requires presentation of both basic and diluted net loss per share in the financial statements. The Company s basic net loss per share is the same as its diluted net loss per share because inclusion of outstanding stock options and warrants in the calculation is antidilutive. Basic and diluted loss per share is calculated by dividing net loss available to common stockholders by the weighted average number of common shares outstanding for the period.

The net loss per share for the quarter ended March 31, 2003 has been adjusted to include the present value of the dividends paid on the shares of the Company s Series C (D) Convertible Preferred Stock of $260,000, the write off of the beneficial conversion feature of such shares of $629,000 and the present value of warrants issued in conjunction with these shares of $486,000. The Company is required to recognize these items as a dividend in the net loss computation for loss per share.

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	Three Months Ended March 31, (Amounts in thousands, except per share amounts) (unaudited)			
	2003		2002	
	Amount	Per share	Amount	Per share
Unaudited per share data basic and diluted:				
Net Loss and net loss per share (Unaudited)	$(7,874)	$(0.45)	$(4,458)	$(0.31)
Present Value of dividend on the Series B Convertible Preferred Stock			(1,193)	(0.08)
Beneficial Conversion feature of the Series B Convertible Preferred Stock			(3,785)	(0.26)
Dividend on Series C / D Convertible Preferred Stock	(260)	(0.01)		
Beneficial Conversion feature of the Series C Convertible Preferred Stock	(629)	(0.03)		
Present Value of Warrants on Series C Convertible Preferred Stock	(486)	(0.03)		
Net loss available to common stockholders and net loss per share	$(9,249)	$(0.52)	$(9,436)	$(0.65)

Note 3. Inventories

Inventories, which include materials, labor and overhead, are stated at the lower of cost or market. The Company uses the first-in, first-out (FIFO) method to value inventories. The components of inventories are as follows:

	(Amounts in thousands)	
	March 31, 2003	December 31, 2002
Raw materials	$4,486	$3,531
Work in process	760	900
Finished goods	1,928	1,435
Total inventories	$7,174	$5,866

Note 4. Employee Option Plans

The Company s employee stock purchase savings plan allows participating employees to purchase, through payroll deductions, shares of common stock at 85% of the fair market value at specified dates. Under the terms of the plan, 400,000 shares of common stock have been reserved for purchase by plan participants. Purchases are made bi-annually on January 1 and July 1 for the previous six-month period.

The Company maintains a management by objectives program under which non-executive employees may receive up to 10% of their base salary as a bonus if certain objectives are met. During 2002, the Company suspended cash payments for bonuses earned under this plan and issued options to purchase common stock at an exercise price of $.00. The number of shares issued to each employee is determined by the amount of their

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bonus divided by the fair market value of the Company s common stock on the date of grant. The Company recognized $125,000 in compensation expense for the full fair market value of options granted during the quarter ended March 31, 2003.

Under SFAS No. 123, Accounting for Stock-Based Compensation, the Company has elected to account for stock-based compensation using the intrinsic value method prescribed in Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees and related accounting interpretations.

Accordingly, no compensation expense has been recognized related to the granting of stock options, except as noted above. If compensation expense related to stock options was determined based upon their grant date fair value consistent with the methodology prescribed under SFAS No. 123 the Company s net loss and net loss per share would have been increased by $1,060,000 ($.06 per share), and $1,143,000 ($.08 per share) for the quarters ended March 31, 2003 and 2002, respectively. The fair market value of the warrants and stock options at the grant date was estimated using the Black-Scholes valuation model with the following weighted average assumptions:

	Q1 '03	Q1 '02
Expected life (years)	7.0	7.0
Interest rate	3.5%	3.8%
Volatility	214.0%	185.0%
Dividend yield	0.0%	0.0%

Note 5. Loan and Security Agreements

On February 13, 2003, the Company entered into a Loan and Security Agreement with Agility Capital, LLC, for a short-term bridge loan in the aggregate principal amount of $2,300,000. Interest on the loan will accrue at a rate of 9% per annum and is payable monthly. In connection with the bridge loan, the Company issued a warrant to purchase up to an aggregate of 500,000 shares of the Company s common stock at an exercise price of $.97 per share. The Company valued the warrants using the Black-Scholes option pricing model. The fair value of the warrants was recorded as a debt issuance cost and was recorded as deferred interest expense and additional paid-in capital in accordance with APB 14. The deferred interest expense is being amortized to interest expense over the life of the loan.

In connection with the proposed merger involving Intuitive Surgical (see Note 10), Computer Motion and Intuitive Surgical have entered into a Loan and Security Agreement, under which Intuitive Surgical has agreed to provide a short-term secured bridge loan of up to $7.3 million. The loan will terminate and all outstanding amounts will become due and payable 120 days following termination of the merger agreement (the Maturity Date). Under the terms of the Loan and Security Agreement, the Company is required to pay off the Loan and Security Agreement with Agility Capital, LLC, with its initial borrowings. Interest on the loan will accrue at a rate of 8% per annum and will be payable on the Maturity Date. At March 31, 2003 no funds had been borrowed against this secured bridge loan.

Note 6. Series D Convertible Preferred Stock

As set forth in the purchase agreement signed in connection with the Series C Financing, Mr. Duggan (or his affiliates or designees) agreed to purchase an aggregate amount of Series C stock totaling $1,999,200, $999,600 of which was paid by the conversion of an outstanding promissory note from the Company to Mr. Duggan. Following the receipt of stockholder approval on January 27, 2003, Mr. Duggan and his designees purchased an additional $999,600 of Series C Convertible Preferred Stock.

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In accordance with the Certificate of Designations and the Side Agreement, the shares of Series C Convertible Preferred Stock bear a cumulative dividend at a rate of 12% per annum until January 31, 2003, and 8% per annum thereafter. In the event shares of Series C Convertible Preferred Stock are not converted or redeemed in accordance with the Certificate of Designations by October 31, 2004, the cumulative dividend rate will be adjusted upward to 12% per annum thereafter. Dividends on the Series C-1 Convertible Preferred Stock may be paid by the Company, at its option, through the issuance of shares of Common Stock or in cash, and dividends on the Series C-2 Convertible Preferred Stock may only be paid in cash.

In accordance with the Certificate of Designations, in the event the Company proposes to enter into a Change of Control Transaction (as defined below) and if not previously converted, the holders of shares of Series C Convertible Preferred Stock may elect to convert such shares of Series C Convertible Preferred Stock into a number of common shares equal to 135% of the amount into which such shares of Series C Convertible Preferred Stock would otherwise be convertible.

On March 6, 2003, all holders of Series C Convertible Preferred Stock agreed to exchange their shares for newly issued shares of Series D Convertible Preferred Stock. The terms of the Series D Convertible Preferred Stock eliminated certain provisions that were contained in the terms of the Series C Convertible Preferred Stock that could have restricted the ability of the Company to enter into the merger agreement with Intuitive Surgical. The shares of the Series D Convertible Preferred Stock will convert into shares of common stock immediately prior to the consummation of the merger described above. Pursuant to the terms of the Exchange Agreement, in the event the Company does not consummate the merger by September 30, 2003, the Company will file its Certificate of Designations Setting Forth the Preferences, Rights and Limitations of the Series E Convertible Preferred Stock with the Secretary of State of Delaware, and, thereupon outstanding shares of Series D-1 Convertible Preferred Stock and Series D-2 Convertible Preferred Stock will be exchanged for share of a like number of Series E-1 Convertible Preferred Stock and Series E-2 Convertible Preferred Stock. As an inducement to the holders of shares of Series C Convertible Preferred Stock to enter into the Exchange Agreement, the Company has agreed to lower the exercise price of all outstanding Series C-1 warrants and Series C-2 warrants to $1.50 per share, provided that such holders exercise such warrants prior to 10 days following the mailing of a proxy statement relating to the Company s meeting of stockholders to approve the merger. The Company accounted for the reduction of the exercise price as a significant modification and a new measurement date. The Company valued the warrants using the option pricing model as of March 6, 2003, the date of the repricing, noting the fair value was less than the original value of the warrants as calculated on the issuance date during the fourth quarter of 2002. As such, no additional expense was recorded for the warrants as of the date of the conversion.

Note 7. Segments of Business

The Company adopted SFAS No. 131, Disclosures about Segments of an Enterprise and Related Information. SFAS 131 establishes standards for reporting information regarding operating segments in annual financial statements and requires selected information for those segments to be presented in interim financial reports issued to stockholders. SFAS 131 also establishes standards for related disclosures about products and services and geographic areas. Operating segments are identified as components of an enterprise about which separate discrete financial information is available for evaluation by the chief operating decision maker, or decision making group, in making decisions how to allocate resources and assess performance. The Company s chief decision making group, as defined under SFAS 131, is the Executive Staff. To date, the Executive Staff has viewed the Company s operations as principally one market: proprietary robotic and computerized surgical systems for the medical device industry. Sales by product lines within this market are as follows:

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Revenue by product line for the three months ended

(Amounts in thousands)

	Mar. 31, 2003	Dec. 31, 2002	Mar. 31, 2002
ZEUS surgical systems	$ 2,521	$ 3,159	$ 2,384
AESOP surgical systems	1,865	2,173	932
SOCRATES telementoring systems	242	338	320
HERMES (systems, development, and supplies)	1,014	1,680	1,111
Grant revenue	240	129	88
Recurring revenue	1,129	1,343	856
	$ 7,011	$ 8,822	$ 5,691

Units sold by product line for the three months ended

	Mar. 31, 2003	Dec. 31, 2002	Mar. 31, 2002
ZEUS surgical systems	3	4	4
ZEUS surgical systems upgrades	2	3	3
AESOP surgical systems	21	31	14
SOCRATES telementoring systems	3	4	4

For the three months ended
(Amounts in thousands)

	Mar. 31, 2003	Dec. 31, 2002	Mar. 31, 2002
Canada	$ 58	$ 81	$ 316
Europe and the Middle East	1,061	362	630
Asia	659	846	63
South America & Mexico	522	122	10
	$ 2,300	$ 1,411	$ 1,019

Note 8. Litigation

On May 10, 2000, the Company filed a lawsuit in United States District Court alleging that Intuitive Surgical s *da Vinci* surgical robot system infringes on its United States Patent Nos. 5,524,180, 5,878,193, 5,762,458, 6,001,108, 5,815,640, 5,907,664 and 5,855,583. Subsequently, Computer Motion s complaint was amended to add allegations that Intuitive Surgical s *da Vinci* surgical robot infringed three additional Computer Motion patents United States Patent Nos. 6,244,809, 6,102,850 and 6,063,095. These patents concern methods and devices for conducting various aspects of robotic surgery. Intuitive Surgical has served an Answer and Counterclaim alleging non-infringement of each patent-in-suit, patent invalidity and unenforceability. Discovery is still underway. The parties have filed cross motions for summary judgment on the issue of patent infringement relating to the 108, 664, 809, and 850 patents. The Court recently granted Intuitive Surgical s motion for summary judgment of non-infringement relating to the 850 patent. The Court also recently granted the Company s motion for partial summary judgment relating to the 809 patent. The Court has not ruled on any of the remaining motions at this time. Pursuant to the merger agreement with Intuitive Surgical, Computer Motion and Intuitive Surgical filed on March 10, 2003, stipulations to stay this litigation until August 31, 2003, subject to the stay being lifted if the merger agreement is terminated, or subject to this case being dismissed upon consummation of the transactions contemplated by the merger agreement.

On or about December 7 and 8, 2000, the United States Patent and Trademark Office (USPTO) granted three of Intuitive Surgical s petitions for a declaration of an interference relating to the Company s 5,878,193, 5,907,664, and 5,855,583 patents. On March 30, 2002, the three judge

panel of the Board of Patent Interferences issued decision orders on the parties preliminary motions. The Board granted the Company s motion on Interference No. 104,643 and issued an order for Intuitive to show cause why judgment should not

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be entered against Intuitive on this interference. The Board denied the Company s motion on the Interference No. 104,644 and entered judgment against the Company. The Board denied the Company s motions on the Interference No. 104,645, deferred decision on two of Intuitive Surgical s motions, and granted-in-part, denied-in-part and deferred-in-part on one of Intuitive Surgical s motions. The Board s decision on Interference No. 104,645 invalidated some of the parties claims, affirmed some of Intuitive Surgical s claims and provided for further proceedings related to two of the Company s claims and is therefore not final. On July 25, 2002, Computer Motion filed a civil action seeking review of the two adverse decisions in the United States District Court for the District of California.

Pursuant to the merger agreement with Intuitive Surgical, Computer Motion and Intuitive Surgical filed on March 10, 2003, stipulations to stay this litigation until August 31, 2003, subject to the stay being lifted if the merger agreement is terminated, or subject to this case being dismissed upon consummation of the transactions contemplated by the merger agreement.

On February 21, 2001, Brookhill-Wilk filed suit against the Company alleging that its ZEUS surgical system infringed upon Brookhill-Wilk s United States Patent Nos. 5,217,003 and 5,368,015. Brookhill-Wilk s complaint seeks damages, attorneys fees and increased damages alleging willful patent infringement. On March 21, 2001, the Company served its Answer and Counterclaim alleging non-infringement of each patent-in-suit, patent invalidity and unenforceability. On November 8, 2001, the United States District Court for the Southern District of New York in the co-pending Brookhill-Wilk v. Intuitive Surgical, Inc., Civil Action No. 00-CV-6599 (NRB), issued an order interpreting the claims of Brookhill-Wilk s Patent No. 5,217,003 in a way that the Company believes excludes current applications of the Company s ZEUS surgical system. In light of this decision, on November 13, 2001, the parties to Brookhill Wilk v. Computer Motion, Inc. agreed to dismiss the case without prejudice. On March 25, 2002, Judge Alvin K. Hellerstein dismissed the case without prejudice.

On March 30, 2001, Intuitive Surgical and IBM Corporation filed suit alleging that the Company s AESOP, ZEUS and HERMES products infringe United States Patent No. 6,201,984, which was issued on March 13, 2001. The complaint seeks damages, a preliminary injunction, a permanent injunction, and costs and attorneys fees. The claims are directed to a surgical system employing voice recognition for control of a surgical instrument. Each of the asserted claims are limited to a surgical system employing voice recognition for control of a surgical robot and literally read on the Company s current AESOP product and the Company s ZEUS and HERMES products to the extent they are used with AESOP. A jury trial has been held on the issues of patent invalidity due to lack of enablement and failure to disclose the best mode in addition to damages. The Company s defense of unenforceability due to prosecution laches was tried before the District Court Judge. The jury returned a verdict finding IBM s United States Patent No. 6,201,984 valid, and finding Intuitive was damaged in an amount of $4.4 million. At December 31, 2002, the Company recorded a $4.4 million litigation provision for this related jury verdict. Prior to the jury s verdict, the Court ruled that the Company had not willfully infringed the patent. On December 10, 2002, the Court rendered an adverse decision on the Company s prosecution laches defense and on December 11, 2002, issued a judgment in Intuitive Surgical s and IBM s favor based upon the earlier jury verdict and the Court s December 10, 2002 ruling. Pursuant to the merger agreement with Intuitive, Computer Motion and Intuitive Surgical filed on March 10, 2003, stipulations to stay this litigation until August 31, 2003, subject to the stay being lifted if the merger agreement is terminated, or subject to this case being dismissed upon consummation of the transactions contemplated by the merger agreement.

The Company believes that all of its major product lines could be affected by this litigation. The patents subject to this litigation are an integral part of the technology incorporated in the Company s AESOP, ZEUS and HERMES product lines which together accounted for approximately 77% of its revenues for the quarter ended March 31, 2003. If the stay is lifted and the Company loses the suit brought by Intuitive

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Surgical and IBM or loses any patent infringement suit refiled by Brookhill-Wilk v. Intuitive Surgical, Inc., the Company may be prevented from selling its products as currently configured without first obtaining a license to the disputed technology from the successful party or modifying the product. Obtaining a license could be expensive, or could require that the Company license to the successful party some of its own proprietary technology, either of which result could seriously harm the Company s business. In the event that a successful party is unwilling to grant the Company a license, the Company will be required to stop selling its products that are found to infringe the successful party s patents unless the Company can redesign them so they do not infringe these patents, which the Company may be unable to do. Whether or not the Company is successful in these lawsuits, in the even the stay is lifted, the litigation could consume substantial amounts of the Company s financial and managerial resources. Further, because of the substantial amount of discovery often involved in connection with this type of litigation, there is a risk that some of the Company s confidential information could be compromised by disclosure during the discovery process.

Note 9. Recent Accounting Pronouncements

In December 2002, the Financial Accounting Standards Board (FASB) issued SFAS No. 148. Statement 148 amends FASB Statement No. 123, *Accounting for Stock-Based Compensation*, to provide alternative methods of transition to Statement 123 s fair value method of accounting for stock-based employee compensation. Statement 148 also amends the disclosure provisions of Statement 123 and APB Opinion No. 28, *Interim Financial Reporting*, to require disclosure in the summary of significant accounting policies of the effects of an entity s accounting policy with respect to stock-based employee compensation on reported net income and earnings per share in annual and interim financial statements. While the Statement does not amend Statement 123 to require companies to account for employee stock options using the fair value method, the disclosure provisions of Statement 148 are applicable to all companies with stock-based employee compensation, regardless of whether they account for that compensation using the fair value method of Statement 123 or the intrinsic value method of Opinion 25. The Company adopted the disclosure requirements of SFAS No. 148 in fiscal 2002. The Company did not adopt the fair value method of accounting for stock-based compensation and as such the adoption of SFAS No. 148 did not have a material impact on the Company s results of operations or its financial position.

Emerging Issues Task Force (EITF) No. 00-21, Revenue Arrangements with Multiple Deliverables, addresses how to determine whether an arrangement involving multiple deliverables contains more than one unit of accounting. This EITF also addresses how arrangement consideration should be measured and allocated to the separate units of accounting in the arrangement. As the Company s current practice is consistent with the provisions of EITF 00-21, the Company does not expect that the adoption of EITF 00-21 will have a material impact on its results of operations or its financial condition.

Note 10. Agreement and Plan of Merger

On March 7, 2003, the Company entered into an Agreement and Plan of Merger with Intuitive Surgical, Inc. At the effective time of the merger, Intuitive Merger Corporation, Inc., formerly known as Iron Acquisition Corporation, a newly formed subsidiary of Intuitive Surgical, Inc., will be merged with and into Computer Motion, Inc., with Computer Motion, Inc. surviving the merger and continuing as a wholly owned subsidiary of Intuitive Surgical. Upon completion of the merger, each share of Computer Motion common stock will be converted into the right to receive a fraction of a share of Intuitive Surgical common stock. The fraction of a share of Intuitive Surgical common stock to be issued with respect to each share of Computer Motion common stock will be determined by a formula described in the merger agreement. Based on the capitalization of Intuitive Surgical and Computer Motion and the market price of Computer Motion common stock as of the date of this report and assuming that the merger is completed on June 30, 2003, the Company estimates that the exchange ratio will be approximately 0.52. The exchange ratio will be adjusted proportionately in the event that the proposed reverse split of Intuitive Surgical s common stock is approved by

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Intuitive Surgical s stockholders and implemented by Intuitive Surgical s board of directors.

The final exchange ratio will be calculated based on the total number of fully diluted shares outstanding for Intuitive Surgical and Computer Motion immediately prior to the effective time of the merger. The number of Computer Motion s fully diluted shares will vary based on the number of shares of Computer Motion common stock into which Computer Motion s Series D Convertible Preferred Stock will be convertible and the number of shares of Computer Motion common stock which may be issued to pay accrued dividends on the Series D Convertible Preferred Stock upon conversion. All shares of Computer Motion Series D Convertible Preferred Stock will convert into shares of Computer Motion common stock immediately prior to the effective time of the merger. Under the terms of the Series D Convertible Preferred Stock, in the event that the average of the closing bid prices of Computer Motion s common stock for the 20 consecutive trading days ending 15 days prior to the Computer Motion special meeting is below $1.86 per share, the conversion ratio for Computer Motion s Series D Convertible Preferred Stock could increase. As a result, the exchange ratio in the merger may decrease and, therefore, Computer Motion common stockholders would receive a lesser number of Intuitive Surgical shares, and Computer Motion preferred stockholders would receive a greater number of Intuitive Surgical shares, in the merger. Computer Motion stockholders will receive cash in lieu of any fractional shares of Intuitive Surgical common stock.

In connection with the proposed merger, Computer Motion and Intuitive Surgical have entered into a Loan and Security Agreement, under which Intuitive Surgical has agreed to provide a short-term secured bridge loan of up to $7.3 million. The loan will terminate and all outstanding amounts will become due and payable 120 days following termination of the merger agreement (the Maturity Date). Interest on the loan will accrue at a rate of 8% per annum and will be payable on the Maturity Date.

Additionally, pursuant to the merger agreement, Computer Motion and Intuitive Surgical filed stipulations on March 10, 2003 to immediately stay all pending litigation proceedings between them until August 31, 2003, subject to the stay being lifted if the merger agreement is terminated, or subject to the cases being dismissed upon consummation of the transaction contemplated by the merger agreement.

ITEM 2. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

This quarterly report on Form 10-Q contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. These forward-looking statements involve risks and uncertainties. The Company s actual results may differ materially from those projected in the forward-looking statements due to factors that include, but are not limited to, the risks discussed herein under the heading Risk Factors That May Affect Future Results.

OVERVIEW

Computer Motion, Inc. develops and markets proprietary robotic and computerized surgical systems that are intended to enhance a surgeon s performance and centralize and simplify the surgeon s control of the operating room (OR). The Company s products consist of the AESOP, HERMES, SOCRATES and ZEUS products. The Company believes that its products will provide surgeons with the precision and dexterity necessary to perform complex, minimally invasive surgical (MIS) procedures, as well as enable surgeons to control critical devices in the OR through simple verbal commands. The Company believes that its products will broaden the scope and increase the effectiveness of minimally invasive surgery, improve patient outcomes, and create a safer, more efficient and cost effective OR.

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Traditionally, the majority of all surgeries have been open, requiring large incisions measuring up to 18 inches to access the operative site. Although this approach can be highly effective, it often results in significant trauma, pain and complications, as well as significant costs related to lengthy postoperative convalescent periods for the patient. In an effort to minimize these negative factors, MIS techniques and related technologies have been developed. MIS has proven to be as effective as traditional open surgery while offering patients substantially reduced pain and trauma, shortened convalescent periods and decreased overall patient care costs. While these benefits are significant, the minimally invasive approach presents challenges to surgeons, including the intricate reconstruction of patient tissue by suturing, delicate manipulation of small anatomical features and constrained access to, and limited visualization of, the operative site.

Computer Motion s vision is to bring the power of computers and robotics to the OR to facilitate a surgeon s ability to perform complex surgical procedures and enable new, minimally invasive microsurgical procedures that are currently very difficult or impossible to perform. The Company works with leading practitioners in multiple surgical disciplines to develop new MIS procedures using the Company s products to provide better visualization and improved dexterity for the surgeon.

The Company has developed four major products and a suite of supporting supplies, accessories and services. The four major products are the AESOP® Endoscope Positioner, a surgical robot capable of positioning an endoscope in response to a surgeon s commands; the ZEUS® Surgical System, a robotic platform designed to improve a surgeon s ability to perform complex surgical procedures and enable new, minimally invasive microsurgical procedures that are currently impossible or very difficult to perform; the HERMES® Control Center, a voice activated OR control system designed to enable a surgeon to directly control multiple OR devices, including the Company s AESOP system, through simple verbal commands; and the SOCRATES Telementoring System, an interactive telecollaborative system allowing a surgeon to mentor and collaborate with another surgeon during an operation. SOCRATES also allows a remote surgeon to participate in a surgery by remotely controlling AESOP, our endoscope-positioning robot.

ROBOTIC SYSTEMS

The Company s line of computer and robotic systems enhance a surgeon s ability to perform complex, minimally invasive surgeries. The Company has developed the EVOLVE surgical continuum to support a gradient learning curve for surgeons to safely and economically develop the skills required to transition from open to endoscopic surgery. All four of the Company s robotic products are integral to the EVOLVE process.

AESOP PLATFORM

The Computer Motion AESOP system is a surgical robot which approximates the form and function of a human arm and allows control of the endoscope (a specially designed optical tube which, when connected to a medical video camera and light source, is passed into the body to allow the surgeon to view the operative site on a video monitor) using simple verbal commands. This eliminates the need for a member of a surgical staff to manually control the camera and provides a more stable endoscopic image and more precise positioning of the endoscope. The Company estimates that over 175,000 MIS procedures have been successfully assisted by more than 800 AESOP systems in more than 600 hospitals and surgery centers around the world.

The AESOP platform is the world s first Food and Drug Administration (FDA) cleared surgical robot and incorporates the world s first FDA-cleared voice control interface for use in the OR. The AESOP system was introduced in the fourth quarter of 1994. AESOP 2000 with voice control was introduced in the fourth quarter of 1996. The AESOP 3000 platform, introduced in December 1997, is the world s first FDA-cleared surgical robot capable of assisting in advanced minimally invasive cardiothoracic procedures. The AESOP 3000 robotic arm features added flexibility and functionality over its predecessor, adding the range of motion necessary for endoscopic viewing in the thoracic (chest) cavity. AESOP is cleared for use by the FDA in general surgery, ear nose throat, cardiothoracic, urologic, vascular, bariatric, and gynecological procedures. The AESOP HR platform allows for control of AESOP through the HERMES Control Center. AESOP HR

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enables the operative surgeon to view the status of the AESOP device, save memory positions, and view the AESOP menu structure on a surgical monitor. The AESOP HR platform also allows the surgeon to adjust AESOP s speed to an optimal setting based on the constraints of the procedure.

The introduction of the Alpha Virtual Port in June 2000 enabled the application of AESOP in open procedures, which is especially useful when used in conjunction with the EVOLVE education continuum. The Alpha Virtual Port provides a free-space pivot point for the use of AESOP in sternotomy accessed cardiac procedures as well as open abdominal procedures. The application of the Alpha Virtual Port in conjunction with AESOP is the first step in the EVOLVE program s step-wise transition from open to closed procedures. The Alpha Virtual Port allows the operative surgeon in-training to gain experience with the technology prior to advancing to a closed MIS procedure approach.

Computer Motion has leveraged the core technologies underlying the AESOP platform to develop the ZEUS Surgical System, the HERMES Control Center, and the SOCRATES Telementoring System.

ZEUS PLATFORM

The Computer Motion ZEUS Surgical System is designed to fundamentally improve a surgeon s ability to perform complex, MIS procedures and to enable new, minimally invasive microsurgical procedures that are currently very difficult or impossible to perform with conventional surgical methods. The Company believes that these new MIS procedures will result in reduced patient pain and trauma, fewer complications, lessened cosmetic concerns, shortened convalescent periods and will increase the number of patients qualified for certain surgical procedures. As a result, the Company believes that an increase in minimally invasive procedures will produce lower overall healthcare costs to patients, hospitals and healthcare payors.

The ZEUS platform is comprised of three surgeon-controlled robotic arms, one of which positions an endoscope while the other two hold disposable and reusable surgical instruments. Each arm is individually mounted on the operating room table using the standard table rails. Because the arms are attached to the table, the table can be adjusted during a surgical procedure without removing the instruments. The surgeon sits near the operating room table at an open, comfortable, and portable console. The open design of the console provides the surgeon with an unobstructed view of the patient and allows clear communication with the operating room staff. At the console, the surgeon controls the instrument handles and views the operative site on a 3D video monitor or a boom mounted 3D binocular display. ZEUS senses the surgeon s hand movements through the new MicroWrist surgeon interface. It then scales the surgeon s hand movements into precise, tremor-free micro movements at the operative site.

The Company received the first in a series of FDA 510(k) clearances for ZEUS in October 2001. This 510(k) clearance allowed ZEUS to be used with blunt dissectors, retractors, atraumatic graspers and stabilizers during laparoscopic and thorascopic surgery. In September 2002, the company received an FDA 510(k) clearance for the marketing of ZEUS in general laparoscopic surgery. This clearance allows clinical use of the ZEUS system for a broad set of general surgery applications such as laparoscopic cholecystectomy and laparoscopic nissen fundoplication. The Company is also seeking additional FDA clearances for thoracic surgery, laparoscopic radical prostatectomy and cardiac procedures, with clinical trials ongoing.

The Company believes that the ZEUS platform will provide clinicians with the following significant benefits:

IMPROVED PRECISION. The ZEUS platform incorporates technology that is designed to enable a surgeon to scale his or her movements, allowing manipulation of instruments on a microsurgical scale while utilizing normal hand and arm movements. For instance, in microsurgical procedures which involve extremely small anatomical structures and which utilize sutures ranging from 20 to 40 microns (1/3 to 2/3 the width of a human hair), if a surgeon selects a scaling ratio of 4 to 1, each one inch movement by the surgeon would result in a 1/4 inch movement by the robotic surgical instruments. Various useful scaling ratios can be selected by the

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surgeon intra-operatively.

IMPROVED DEXTERITY. The ZEUS platform is designed to enhance a surgeon s performance by enabling robotic manipulation of surgical instruments, as opposed to hand-held instruments, which are very difficult to manipulate manually when performing challenging minimally invasive surgery. For instance, a surgeon can activate and deactivate the instrument handles to further extend his or her range of motion to complete a particular movement, such as suturing, without having to physically contort his or her arms. In addition, in order to gain anatomical access to certain regions of the body in a minimally invasive manner, the robotic instruments can be placed in positions that would be extremely difficult for a surgeon to manipulate manually using conventional MIS techniques due to the distance between the instruments and their relative positions to each other.

ELIMINATION OF INVOLUNTARY HAND TREMOR. The ZEUS platform is designed to hold the surgical instruments and the endoscope in a steady manner, eliminating a surgeon s incidental and unintended hand motions and tremors, which are intensified when holding surgical instruments for, extended periods of time.

ENHANCED VISUALIZATION. The ZEUS platform incorporates a robotic arm, which controls the endoscope to produce a steady, magnified video image displayed directly in front of the surgeon, which facilitates performance of MIS procedures. ZEUS also provides a state of the art stereo 3D endoscope system attached to the robotic arm.

IMPROVED MINIMALLY INVASIVE ANATOMICAL ACCESS. The ZEUS platform is designed to provide a surgeon with access to confined areas in the body and critical anatomical structures that are currently only accessible by means of highly invasive, open surgical procedures or multiple less invasive incisions. In the case of cardiac surgery, these less invasive approaches can require multiple 3 to 5 inch incisions and often involve the removal of rib cartilage, rib spreading and nerve trauma. In contrast, the ZEUS system is designed to provide a surgeon with complete access to the heart through several 3 to 5 millimeter ports.

MINIMIZED SURGEON FATIGUE. The ZEUS platform allows a surgeon to operate the surgical instrument handles in a comfortable, ergonomic position, including sitting down and positioning his or her forearms on armrests. The Company believes this enhanced ergonomic design can increase the efficiency and effectiveness of demanding and lengthy microsurgical procedures.

The ZEUS system is designed as an open platform system. This allows products from other corporations to integrate into the system. The Company has entered into alliances with these outside companies to develop complementary products to the ZEUS system, and to often offer their products as components of the ZEUS system. Included in these are: (i) visualization systems from Karl Storz, GMBH, Vista Medical Technologies, Inc., and Smith and Nephew Endoscopy; (ii) instrumentation from Scanlan International, Inc. and Karl Storz, GMBH, (iii) sutures from W.L. Gore & Associates and (iv) other specialty instruments from various medical device companies.

HERMES PLATFORM

The modernization of the OR has resulted in numerous medical devices that aid a surgeon, but also increase the complexity and costs of the OR. In many instances, these devices are manually controlled and monitored by someone other than a surgeon in response to a surgeon s spoken commands and request for status. The HERMES Control Center is designed to enable a surgeon to directly control multiple OR devices, including the Company s AESOP system, through simple verbal commands. The HERMES Control Center provides standardized visual and digitized voice feedback to a surgical team. The Company believes that the

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enhanced control and feedback provided by the HERMES Control Center improves safety, increases efficiency, shortens procedure times and reduces cost.

HERMES is a centralized control system that networks multiple HERMES-Ready medical devices and provides the surgeon and OR staff with direct control using simple verbal commands or an interactive touch screen pendant. The HERMES system provides both visual graphic feedback and digitized audio feedback to the surgical team. The visual feedback is displayed directly on the endoscopic video monitor and the digitized audio feedback provides valuable device-specific status information. The 28+ FDA-cleared devices controlled by the HERMES system include: endoscopic cameras, overhead cameras, light sources, insufflators, arthroscopic shavers, arthroscopic pumps, VCRs, printers, digital image capture device, OR lights, surgical tables, electrosurgical units, and the Company s telephone, port expander, AESOP and ZEUS systems. The HERMES-Ready interfaces for these cleared devices were created in collaboration between the Company and various HERMES alliance partners, such as Stryker Endoscopy, Smith and Nephew Endoscopy, Berchtold, Steris, Skytron, ValleyLab (TYCO), and ConMed. There are additional HERMES interface projects currently under development with these same HERMES alliance partners for an additional ten devices. These models are expected to release for commercial sale during the year 2003.

To leverage its proprietary voice recognition technology in the arthroscopic and laparoscopic markets, the Company has partnered with Stryker Endoscopy, a division of Stryker Corporation, to market and distribute the HERMES system and various associated HERMES-Ready device interfaces. Stryker is a leading manufacturer of endoscopic medical equipment. Stryker purchases the HERMES system as an original equipment manufacturer (OEM) and markets the HERMES system as an integrated component with several of its laparoscopic and arthroscopic products.

The Company has also entered into two additional HERMES alliance agreements with Smith & Nephew Endoscopy and Karl Storz Endoscopy America. Both Smith & Nephew and Karl Storz are leading manufacturers of endoscopic medical equipment. These agreements define collaboration between the Company and these two medical device companies to create HERMES-Ready interfaces for 40 additional medical device models. This engineering development work is currently underway, and the Company expects to make additional 510(k) submissions to the FDA in 2003 to allow some of these devices to be released for sale by Smith & Nephew and Karl Storz during 2003. Smith & Nephew will market a HERMES system as a component of their integrated digital OR offering. Karl Storz will distribute a HERMES related product that allows device integration with their integrated OR1 offering.

The Company intends to partner with other medical device manufacturers to expand the number and type of devices to be integrated with HERMES, including cautery/cutting devices, various imaging systems, devices for the cardiac catheter laboratory, and other equipment for varying clinical environments.

SOCRATES PLATFORM

The SOCRATES Telementoring System is the latest generation technology platform currently under development by the Company. SOCRATES enables remote access to HERMES networked devices via proprietary software and standard teleconferencing components. The SOCRATES system allows an operative surgeon to virtually, cost-effectively, and on an as-needed basis, communicate with a remote surgeon. SOCRATES enables the remote surgeon to help direct a surgical procedure thereby augmenting the operative surgeon s prior training experience.

The SOCRATES system enhances the utility of the HERMES Control Center with the AESOP-HR system by providing shared-remote control capability of the endoscope. The SOCRATES system provides the remote surgeon with an interface to the AESOP-HR system, enabling the remote surgeon to share control of the endoscope with the operative surgeon. AESOP s precision and stability ensure the remote surgeon s views are tremor-free and accurately positioned. It is common for surgeons to remotely collaborate; however, without the SOCRATES system, a remote surgeon is typically only able to view video of a procedure and provide

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feedback through video overlay and verbal commands. The SOCRATES system enhances this collaboration by making it more interactive by allowing remote physical control of the endoscope in the operating room.

In October 2001, the Company received FDA clearance for the Socrates Telementoring System for use as a point-to-point communication system, under the newly created FDA device category called Telemedicine devices.

Recent Developments

On March 7, 2003, the Company entered into an Agreement and Plan of Merger with Intuitive Surgical, Inc. At the effective time of the proposed merger, Intuitive Merger Corporation, Inc., formerly known as Iron Acquisition Corporation, a newly formed subsidiary of Intuitive Surgical, Inc., will be merged with and into Computer Motion, Inc., with Computer Motion, Inc. surviving the merger and continuing as a wholly owned subsidiary of Intuitive Surgical. For more information about the terms of the merger, see Note 10 in Item 1 above.

In connection with the proposed merger, Intuitive Surgical intends to file a registration statement on Form S-4, including a joint proxy statement/prospectus, with the Securities and Exchange Commission. Investors and security holders are urged to read the joint proxy statement/prospectus regarding the proposed merger when it becomes available because it will contain important information about the transaction. Investors and security holders may obtain a free copy of the joint proxy statement/prospectus when it is available and other documents filed by Intuitive Surgical and Computer Motion with the Securities and Exchange Commission at the Securities and Exchange Commission s web site at www.sec.gov. The joint proxy statement/prospectus and these other documents also may be obtained for free from Intuitive Surgical and Computer Motion.

Computer Motion, its directors and executive officers may be deemed to be participants in the solicitation of proxies from Computer Motion stockholders in favor of the proposed merger. A description of any interests that the directors and executive officers of Computer Motion may have in the transaction will be available in the joint proxy statement/prospectus.

Results of Operations

Since the first quarter of 1998, the Company has had quarter over quarter increases in revenues in all but six quarters. The Company believes it is penetrating only a small fraction of the total potential market for its products. Although many medical conditions that can be treated using the Company s products can also be treated by pharmaceuticals and other medical devices, the Company does not believe that it encounters direct competition for its AESOP, HERMES or SOCRATES products. The Company believes that it has only one direct competitor for its ZEUS product. Because its AESOP, HERMES, SOCRATES and ZEUS products are comprised of relatively new technologies, and because the current customer profiles are made up of early adopters that share the Company s pioneering vision for these new technologies, the Company does not believe that there is any statistical significance to its quarterly increase or decrease variations in business levels. The challenges the Company faces in its attempt to increase market share today involve market acceptance and adoption of these new technologies. The Company believes that statistical significance in any increases or decreases will not occur until its products receive larger mass-market acceptance and adoption. In addition, the Company believes that the sales cycles for capital medical equipment is approximately three to six months, especially for innovative technology like the Company s AESOP, HERMES, SOCRATES and ZEUS products. Thus, sales in the fourth quarter originate in the third quarter, and sales in the first quarter originate in the fourth quarter of the prior year. The Company also believes that prospecting for new sales tends to fall off in the fourth quarter since its sales focus is on closing sales for the current calendar year and because there are fewer working days available due to the holiday season. Other than the trend toward a reduction in fourth quarter sales, the Company does not believe that there are material seasonal trends.

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With the above understanding, the analysis of the Company s quarterly revenue changes is as follows:

Three months ended March 31, 2003 compared to the three months ended March 31, 2002.

Revenue. Revenue increased $1,320,000, or 23%, to $7,011,000 for the quarter ended March 31, 2003 from $5,691,000 for the quarter ended March 31, 2002. ZEUS revenue of $2,521,000 for the quarter increased $137,000, or 6%, over last year s first quarter of $2,384,000 as a result of a higher average selling price on the units shipped. AESOP revenue of $1,865,000 for the quarter increased $933,000, or 100%, over last year s first quarter of $932,000 as a result of an increased sales volume as well as a higher average selling price. HERMES revenue of $1,014,000 for the quarter decreased $97,000, or 9%, over last year s first quarter of $1,111,000 as the Company s OEM partners ordered fewer units. SOCRATES revenue of $242,000 for the quarter decreased $78,000, or 24%, over last year s first quarter of $320,000 due to fewer units shipped. Grant revenue of $240,000 for the quarter increased $152,000 over last year s first quarter of $88,000, as a result of the Company s increased research and development efforts relating to the 3-year NIST grant. Recurring revenues of $1,129,000 for the quarter increased $273,000 over last year s first quarter of $856,000, as the installed base of robotic systems increased leading to greater demand for parts, accessories, supplies and service.

Gross Profit. Gross profit increased $1,225,000, or 40%, to $4,271,000 for the quarter ended March 31, 2003 from $3,046,000 for the quarter ended March 31, 2002. Gross margin increased to 61% for the quarter from 54% for last year s first quarter. The increase in gross profit was attributable to higher overall revenues and a shift in product mix to products with higher gross margins.

Research and Development. Research and development expense increased $49,000, or 2%, to $2,701,000 for the quarter ended March 31, 2003 from $2,652,000 for the quarter ended March 31, 2002. The increase was due primarily to the planned expansion of the developmental training and education groups.

Selling, General and Administrative. Selling general and administrative expense increased $1,168,000, or 26%, to $5,693,000, for the quarter ended March 31, 2003 from $4,525,000 for the quarter ended March 31, 2002. The increase was a result of the planned increased efforts by the sales and marketing group to provide greater global support, specializing in the areas of cardiac, bariatric and pediatric surgeries.

Merger Expense. Merger expense for the quarter ended March 31, 2003 was $544,000. Merger expenses include professional fees as well as travel costs associated with the planned merger. As the target company, Computer Motion is required to expense all costs associated with the planned merger with Intuitive Surgical, Inc.

Litigation Provision. Litigation provision increased $2,748,000 to $3,039,000 for the quarter ended March 31, 2003 from $291,000 for the quarter ended March 31, 2002. The increase was a result of expenses incurred in preparation for the Company s patent infringement trial against Intuitive Surgical, Inc. Pursuant to the merger agreement with Intuitive Surgical Inc., on March 10, 2003, the parties filed stipulations to stay this litigation until August 31, 2003, subject to the stay being lifted if the merger agreement is terminated, or subject to this case being dismissed upon consummation of the transactions contemplated by the merger agreement.

Other Expense (Income). Other expense was $158,000 for the quarter ended March 31, 2003 compared to other expense of $30,000 for the quarter ended March 31, 2002. An increase in interest expense as well as a decrease in interest income accounted for this change.

Income Taxes Minimal provisions for state franchise taxes have been recorded on the Company s pre-tax losses to date. As of December 31, 2002, the Company had federal and state net operating loss

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(NOL) carryforwards of approximately of $78,718,000 and $14,074,000 respectively, which are available to offset future federal and state taxable income. Federal carryforwards expire between fifteen and twenty years after the year of loss and are restricted if significant changes in ownership occur. The state NOL carryforwards expire between five and seven years from the year of loss. The Tax Reform Act of 1986 contains provisions that may limit the net operating loss carryforwards available to be used in any given year in the event of significant changes in ownership interests. The Company does not believe that ownership changes to date have had an impact on its ability to utilize these carryforwards. There can be no assurance that ownership changes, including the potential merger as discussed in Note 10, will not significantly limit the Company s ability to use existing or future net operating loss or tax credit carryforwards.

Net loss and net loss per share. The net loss for the quarter ended March 31, 2003 was $7,874,000, or $.52 per share, compared to $4,458,000, or $.65 per share, for the quarter ended March 31, 2002 as increased legal fees related to both the lawsuit and potential merger with Intuitive Surgical were only partially offset by the Company s increase in revenue. Weighted average shares increased from 14,467,000 to 17,694,000 primarily due to the conversion of the Series B Convertible Preferred Stock to common stock.

Three months ended March 31, 2003 compared to the three months ended December 31, 2002.

Revenue. Revenue decreased $1,811,000, or 21%, to $7,011,000, for the quarter ended March 31, 2003 from $8,822,000 for the quarter ended December 31, 2002. ZEUS revenue of $2,521,000 for the quarter decreased $638,000 over the prior quarter of $3,159,000 due to fewer units shipped. AESOP revenue of $1,865,000 for the quarter decreased $308,000 over the prior quarter of $2,173,000 due primarily to a decrease in the number of systems shipped. HERMES revenue of $1,014,000 for the quarter decreased $666,000 over the prior quarter of $1,680,000 as the Company s OEM partners ordered fewer units. SOCRATES revenue of $242,000 for the quarter decreased $96,000 over the prior quarter of $338,000 due primarily to a decrease in the number of units shipped. Grant revenue of $240,000 for the quarter increased $111,000 over the prior quarter of $129,000 due primarily to the Company s increased research and development efforts relating to the NIST grant. Recurring revenue of $1,129,000 decreased $214,000 over the prior quarter of $1,343,000 due primarily to lower demand.

Gross Profit. Gross profit decreased $1,550,000, or 27%, to $4,271,000 for the quarter ended March 31, 2003 from $5,821,000 for the quarter ended December 31, 2002. Gross margin decreased to 61% for the quarter from 66% for the prior quarter. The decrease in gross profit is primarily due lower overall revenues.

Research and Development. Research and development expense increased $252,000, or 10%, to $2,701,000 for the quarter ended March 31, 2003 from $2,449,000 for the quarter ended December 31, 2002, primarily due to increased spending on clinical trials.

Selling, General and Administrative. Selling general and administrative expense increased $1,163,000, or 26%, to $5,693,000 for the quarter ended March 31, 2003 from $4,530,000 for the quarter ended December 31, 2002. The increase was a result of the planned increased efforts by the Company s marketing group to provide greater global support in the areas of cardiac, bariatric and pediatric surgeries.

Other Expense (Income). Other expense was $158,000 for the quarter ended March 31, 2003, compared to other expense of $68,000 for the quarter ended December 31, 2002. The decrease was due primarily to an increase in interest expense as well as a decrease in interest income.

Net loss and net loss per share. The net loss for the quarter ended March 31, 2003 was $7,874,000, or $.52 per share, compared to $6,233,000, or $.70 per share, for the quarter ended December 31, 2002, as decreased gross profit derived from decreased revenue combined with increased operating expenses resulted in a greater net loss.

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Weighted average shares increased from 17,494,000 to 17,694,000 primarily due to the issuance of shares related to the exercise of warrants issued in connection with Series C Convertible Preferred Stock.

Financial Condition

Since its inception, the Company s expenses have exceeded its revenues, resulting in an accumulated deficit of $125,923,000 as of March 31, 2003. Other than its initial public offering, the Company has primarily relied on proceeds from the sale and issuance of preferred and common stock and bridge debt financing to fund its operations.

At March 31, 2003, the Company s current ratio (current assets divided by current liabilities) was .91 to 1 compared to 1.13 to 1 at December 31, 2002, reflecting an increase of approximately $3,615,000 to current assets and an increase of approximately $7,403,000 to current liabilities, which includes a $4.4 million litigation provision for the Intuitive suit.

For the quarter ended March 31, 2003, the Company s use of cash in operating activities of $3,905,000 was primarily attributable to the net loss, which was offset by depreciation, amortization and the provision for doubtful accounts. In addition, working capital decreased by $3,788,000, which was primarily a result of an increase to accounts payable of $5,528,000 due to costs incurred in relation to the pending merger with Intuitive Surgical, Inc. (See Note 10). This increases was only partially offset by the increase to accounts receivable.

Cash outflow from purchases of plant and equipment was $659,000 for the quarter ended March 31, 2003. The Company currently has no material commitments for capital expenditures. For the quarter ended March 31, 2003, net cash provided by financing activities of $5,427,000 was primarily the result of proceeds from the Loan and Security Agreement with Agility Capital, LLC (See Note 5) as well as proceeds from the exercise of warrants issued in connection with the Series C Convertible Preferred Stock.

The Company s operations to date have consumed substantial amounts of cash, and the Company expects its capital and operating expenditures will exceed revenues for at least the next twelve months. The Company has raised additional funds through the following transactions. On February 13, 2003, the Company received $2.3 million from the proceeds of a short term secured bridge loan with Agility Capital, LLC. In addition, the Company received net proceeds of approximately $2,101,000 from the exercise of the Series C Convertible Preferred Stock warrants.

There is substantial doubt about the Company s ability to continue as a going concern. Management believes that it will be unable to fund its operations for the next twelve months with its current cash and cash equivalents. Management s plans in regard to these items include the following: Obtain cash proceeds under the working capital line of credit with Intuitive Surgical, dated March 6, 2003 (see Note 5); and obtain cash proceeds from the exercise of the Company s Series C Convertible Preferred Stock and other warrants. These plans are intended to enable the Company to continue its operations through March 31, 2004. The Company s need for additional financing will depend upon numerous factors, including, but not limited to, the progress and scope of ongoing research and development projects, the costs of training physicians to become proficient in the use of the Company s products and procedures, the ability to obtain required FDA approvals, the ability to successfully defend itself in any current or future patent litigation and the ability of the Company s customers to obtain medical reimbursement from third party payors.

Risk Factors That May Affect Future Results

The Company operates in a rapidly changing environment that involves a number of risks, some of which are beyond its control. A number of these risks are highlighted below. These risks could affect its

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actual future results and could cause them to differ materially from any forward-looking statements the Company has made.

THE COMPANY HAS A HISTORY OF LOSSES, AND EXPECTS TO INCUR LOSSES IN THE FUTURE SO IT MAY NEVER ACHIEVE PROFITABILITY.

From the Company s formation, it has incurred significant losses. For the three years ended December 31, 2002, 2001, and 2000 the Company has incurred net losses of $21,151,000, $16,413,000 and $16,349,000, respectively. In addition, the Company has incurred net losses from operations since inception and as of March 31, 2003 has an accumulated deficit of $125,923,000. The Company expects to incur additional losses as it continues spending for research and development efforts, clinical trials, manufacturing capacity and sales force expansion. As a result, the Company will need to generate significant revenues to achieve and maintain profitability. The Company cannot assure its stockholders that it will ever achieve significant commercial revenues, particularly from sales of its ZEUS product line, which is still under development and awaiting additional FDA clearances for certain significant applications and procedures, or that the Company will become profitable. It is possible that the Company may encounter substantial delays or incur unexpected expenses related to the clinical trials, market introduction and acceptance of the ZEUS platform, or any future products. If the time required to generate significant revenues and achieve profitability is longer than anticipated, the Company may not be able to continue its operations.

SINCE THE COMPANY S OPERATING EXPENDITURES CURRENTLY EXCEED ITS REVENUES, ANY FAILURE TO RAISE ADDITIONAL CAPITAL OR GENERATE REQUIRED WORKING CAPITAL COULD REDUCE THE COMPANY S ABILITY TO COMPETE AND PREVENT IT FROM TAKING ADVANTAGE OF MARKET OPPORTUNITIES.

The Company s operations to date have consumed substantial amounts of cash, and it expects its capital and operating expenditures will exceed revenues for at least the next year. The Company believes it will require substantial working capital to fund its operations for the current year and beyond. Management is in the process of pursuing financial arrangements to support operations through and after December 31, 2003. Management believes funding may be obtained from the following sources: current cash balances, the proceeds from the exercise of warrants, the issuance of additional debt or equity securities, funding from strategic partners and/or sale of assets. The Company cannot assure its stockholders that additional capital will be available on terms favorable to it, or at all. The various elements of the Company s business and growth strategies, including its introduction of new products, the expansion of its marketing and distribution activities, and obtaining regulatory approval or market acceptance will require additional capital. If adequate funds are not available or are not available on acceptable terms, the Company s ability to fund those business activities essential to its ability to operate profitably, including further research and development, clinical trials, and sales and marketing activities, would be significantly limited.

FAILURE TO COMPLETE THE MERGER WITH INTUITIVE SURGICAL COULD HAVE AN ADVERSE IMPACT ON THE COMPANY AND ITS STOCK PRICE

Since entering into the merger agreement on March 7, 2003, the Company has made planning and operations decisions on the basis that the merger will be completed. These planning and operations decisions may have been different had the Company not entered into the merger agreement. For example, if the Company had not entered into the merger agreement, it may have pursued a debt or equity financing transaction in order to assure access to sufficient working capital as an independent company, rather than rely on the availability of Intuitive Surgical s cash assuming the merger will be completed. Moreover, the merger agreement contains restrictions on the Company s incurrence of debt and issuance of equity securities while the merger is pending. If the merger is not completed, not only will the Company not have the benefit of Intuitive Surgical s cash or have obtained other financing, but the Company also will have incurred a significant amount of non-operating expenses associated with the merger that it otherwise would not have

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incurred. Consequently, if the merger is not completed, the Company s financial condition likely will be worse than it would have been had it never entered into the merger agreement.

If the Company and Intuitive Surgical fail to complete the merger, the Company will face the difficulties of competing with limited cash resources and will need to attempt to raise additional debt or equity capital. Such financing may be available only on terms materially adverse to the Company, and may not be available at all.

Additionally, if the merger is not completed, the Company s stock would no longer be influenced by the exchange ratio established by the merger agreement, which could negatively impact the Company s current market valuation and stock price.

THE COMPANY HAS NOT OBTAINED THE CONSENT OF ARTHUR ANDERSEN LLP TO BE NAMED IN ITS FORM 10-K AS HAVING AUDITED THE COMPANY S FINANCIAL STATEMENTS. THIS WILL LIMIT YOUR ABILITY TO ASSERT CLAIMS AGAINST ARTHUR ANDERSEN LLP.

After reasonable efforts, the Company has been unable to obtain the consent of Arthur Andersen LLP to the incorporation into the registration statement of their report with respect to the consolidated financial statements of the Company for the years ended December 31, 2001 and December 31, 2000 which appear in its Annual Report on Form 10-K/A for the year ended December 31, 2002. Under these circumstances, Rule 437(a) under the Securities Act of 1933 permits the registration statement to be filed without a written consent from Arthur Andersen. The absence of such consent may limit your recovery on certain claims. In particular, and without limitation, you will not be able to assert claims against Arthur Andersen under Section 11 of the Securities Act of 1933 for any untrue statement of a material fact contained in the Company s financial statements for the years ended December 31, 2001 and 2000 or any omission to state a material fact required to be stated therein which appear in the Company s Annual Report on Form 10-K/A for the year ended December 31, 2002.

THE CONVICTION OF ARTHUR ANDERSEN LLP ON OBSTRUCTION OF JUSTICE CHARGES MAY ADVERSELY AFFECT ARTHUR ANDERSEN S ABILITY TO SATISFY CLAIMS ARISING FROM THE PROVISION OF AUDITING SERVICES TO THE COMPANY AND MAY IMPEDE THE COMPANY S ACCESS TO CAPITAL MARKETS.

Arthur Andersen LLP audited the Company s financial statements for the years ended December 31, 2001 and 2000 which are included in the Company s Form 10-K/A for the year ended December 31, 2002. On March 14, 2002, an indictment was unsealed charging Arthur Andersen LLP with federal obstruction of justice arising from the government s investigation of Enron Corp. On June 15, 2002, Arthur Andersen LLP was convicted of these charges. The impact of this conviction on Arthur Andersen LLP s financial condition may adversely affect the ability of Arthur Andersen LLP to satisfy any claims arising from its provision of auditing services to the Company.

Should the Company seek to access the public capital markets, SEC rules will require the Company to include or incorporate by reference in any prospectus three years of audited financial statements. The SEC s current rules would require the Company to present audited financial statements for one or more fiscal years audited by Arthur Andersen LLP and use reasonable efforts to obtain its consent until the audited financial statements for the fiscal year ending December 31, 2004 become available. If prior to that time the SEC ceases accepting financial statements audited by Arthur Andersen LLP, it is possible that the available audited financial statements for the years ended December 31, 2001 and 2000 audited by Arthur Andersen LLP might not satisfy the SEC s requirements. In that case, the Company would be unable to access the public capital markets unless an independent accounting firm is able to audit the financial statements originally audited by Arthur Andersen LLP. Any delay or inability to access the public capital markets caused by these

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circumstances could have a material adverse effect on the combined company s business, profitability and growth prospects.

IF THE COMPANY S PRODUCTS DO NOT ACHIEVE MARKET ACCEPTANCE, THE COMPANY WILL NOT BE ABLE TO GENERATE THE REVENUE NECESSARY TO SUPPORT ITS BUSINESS.

The Company anticipates that ZEUS will comprise a substantial majority of its sales in the future and its future success therefore depends on the successful development, commercialization and market acceptance of this product. Even if the Company is successful in obtaining the necessary regulatory clearances or approvals for ZEUS, its successful commercialization will depend upon the Company s ability to demonstrate the clinical safety and effectiveness, ease-of-use, reliability and cost-effectiveness of this product in a clinical setting. The Company cannot assure its investors that the FDA will allow it to conduct further clinical trials or that ZEUS will prove to be safe and effective in clinical trials under United States or international regulatory requirements. It is also possible that the Company may encounter problems in clinical testing that cause a delay in or prohibits commercialization of ZEUS. Moreover, the clinical trials may identify significant technical or other obstacles to overcome prior to the commercial deployment of ZEUS, resulting in significant additional product development expense and delays. Even if the safety and effectiveness of procedures using ZEUS are established, surgeons may elect not to recommend the use of the product for any number of reasons. Broad use of the Company s products will require significant surgeon training and practice, and the time and expense required to complete such training and practice could adversely affect market acceptance. Successful commercialization of the Company s products will also require that the Company satisfactorily address the needs of various decision makers in the hospitals that constitute the target market for its products and to address potential resistance to change in existing surgical methods. If the Company is unable to gain market acceptance of its products, the Company will not be able to sell enough of its products to be profitable, and the Company may be required to obtain additional funding to develop and bring to market alternative products.

IF THE COMPANY DOES NOT OBTAIN AND MAINTAIN NECESSARY DOMESTIC REGULATORY APPROVALS, THE COMPANY WILL NOT BE ABLE TO MARKET AND SELL ITS PRODUCTS IN THE UNITED STATES.

The Company s products in the United States are regulated as medical devices by the FDA. The FDA strictly prohibits the marketing of FDA-cleared or approved medical devices for unapproved uses. Failure to receive or delays in receipt of FDA clearances or approvals, including any resulting need for additional clinical trials or data as a prerequisite to approval or clearance, or any FDA conditions that limit the Company s ability to market its products for particular uses or indications, could impair the Company s ability to effectively develop a market for its products and impair its ability to operate profitably in the future.

The Company s operations are subject to the FDA s Quality System Regulation (a federal regulation governing medical devices) and ISO-9001 (a global standard for quality systems) and similar regulations in other countries, including EN-46001 Standards (the European standard for quality systems), regarding the design, manufacture, testing, labeling, record keeping and storage of devices. Ongoing compliance with FDA s Quality System Regulation requirements and other applicable regulatory requirements will be monitored through periodic inspection by federal and state agencies, including the FDA, and comparable agencies in other countries. The Company s manufacturing processes are subject to stringent federal, state and local regulations governing the use, generation, manufacture, storage, handling and disposal of certain materials and wastes. Failure to comply with applicable regulatory requirements can result in, among other things, suspensions or withdrawals of approvals, product seizures, injunctions, recalls of products, operating restrictions, and civil fines and criminal prosecution. Delays or failure to receive approvals or clearances for the Company s current submissions, or loss of previously received approvals or clearances, would materially adversely affect the marketing and sales of its products and impair its ability to operate profitably in the future.

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THE COMPANY S PRODUCTS ARE SUBJECT TO VARIOUS INTERNATIONAL REGULATORY PROCESSES AND APPROVAL REQUIREMENTS. IF THE COMPANY DOES NOT MAINTAIN THE NECESSARY INTERNATIONAL REGULATORY APPROVALS, THE COMPANY WILL NOT BE ABLE TO MARKET AND SELL ITS PRODUCTS IN FOREIGN COUNTRIES.

To be able to market and sell the Company s products in other countries, it must obtain regulatory approvals and comply with the regulations of those countries. For instance, the European Union requires that manufacturers of medical products obtain the right to affix the CE mark to their products before selling them in member countries of the European Union. The CE mark is an international symbol of adherence to quality assurance standards and compliance with applicable European medical device directives. In order to obtain the right to affix the CE mark to products, a manufacturer must obtain certification that its processes meet certain European quality standards. The Company has obtained the CE mark for all of its products, which means that these products may currently be sold in all of the member countries of the European Union.

If the Company modifies existing products or develops new products in the future, including new instruments, the Company will need to apply for permission to affix the CE mark to such products. In addition, the Company will be subject to annual regulatory audits in order to maintain the CE mark permissions it has already obtained. If the Company is unable to maintain permission to affix the CE mark to its products, the Company will no longer be able to sell its products in member countries of the European Union.

INTERNATIONAL SALES OF THE COMPANY S PRODUCTS ACCOUNT FOR A SIGNIFICANT PORTION OF ITS REVENUES AND THE COMPANY S GROWTH MAY BE LIMITED IF THE COMPANY IS UNABLE TO SUCCESSFULLY MANAGE THESE INTERNATIONAL ACTIVITIES.

The Company s business currently depends in large part on its sales activities in Europe and Asia, and the Company intends to expand its presence into additional foreign markets. Sales to markets outside of the United States accounted for approximately 26% of the Company s sales for the year ended December 31, 2002. The Company is subject to a number of challenges that relate to its international business activities. These challenges include:

the risks associated with foreign currency exchange rate fluctuation;

failure of local laws to provide the same degree of protection against infringement of the Company s intellectual property;

certain laws and business practices that could favor local competitors, which could slow the Company s growth in international markets;

building an organization capable of supporting geographically dispersed operations; and

the expense of establishing facilities and operations in new foreign markets.

Currently, the majority of the Company s international sales are denominated in U.S. dollars. As a result, an increase in the value of the U.S. dollar relative to foreign currencies could make the Company s products less competitive in international markets. If the Company is unable to meet and overcome these challenges, its international operations may not be successful, which would limit the growth of the Company s business.

THE COMPANY MAY NEVER SELL ENOUGH PRODUCTS TO BE PROFITABLE BECAUSE THE COMPANY S CUSTOMERS MAY CHOOSE TO PURCHASE ITS COMPETITORS PRODUCTS OR MAY NOT ACCEPT THE COMPANY S PRODUCTS.

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The market for minimally invasive surgery products has been, and will likely continue to be, highly competitive. Many competitors in this market have significantly greater financial resources and experience than the Company. In addition, some of the Company s competitors, including Intuitive Surgical, have been, and may continue to be able to market their products sooner than the Company if they are able to achieve regulatory approval before the Company. Many medical conditions that can be treated using the Company s products can also be treated by pharmaceuticals or other medical devices and procedures. Many of these alternative treatments are widely accepted in the medical community and have a long history of use. In addition, technological advances with other procedures could make such therapies more effective or less expensive than using the Company s products and could render the Company s products obsolete or unmarketable. As a result, the Company cannot be certain that physicians will use the Company s products to replace or supplement established treatments or that its products will be competitive with current or future technologies.

IF SURGEONS OR INSTITUTIONS ARE UNABLE TO OBTAIN REIMBURSEMENT FROM THIRD-PARTY PAYORS FOR PROCEDURES USING THE COMPANY S PRODUCTS, OR IF REIMBURSEMENT IS INSUFFICIENT TO COVER THE COSTS OF PURCHASING THE COMPANY S PRODUCTS, THE COMPANY BE UNABLE TO GENERATE SUFFICIENT SALES TO SUPPORT ITS BUSINESS.

In the United States, the Company s products are primarily acquired by medical institutions that bill various third-party payors, such as Medicare, Medicaid and other government programs, and private insurance plans for the healthcare services they provide their patients. Third-party payors are increasingly scrutinizing whether to cover new products and, if so, the level of reimbursement. There can be no assurance that third-party reimbursement and coverage for the Company s products will be available or adequate, that current reimbursement amounts will not be decreased in the future, or that future legislation, regulation or reimbursement policies of third-party payors will not otherwise affect the demand for the Company s products or the Company s ability to sell its products on a profitable basis, particularly if the Company s products are more expensive than competing surgical or other procedures. If third-party payor coverage or reimbursement is not available or inadequate, purchasers of the Company s products would lose their ability to pay for the Company s products, and the Company s ability to make future sales and collect on outstanding accounts would be significantly impaired, which would limit the Company s ability to operate profitably.

IF THE COMPANY IS UNABLE TO PROTECT THE INTELLECTUAL PROPERTY CONTAINED IN ITS PRODUCTS FROM USE BY THIRD PARTIES, THE COMPANY S ABILITY TO COMPETE IN THE MARKET WILL BE HARMED.

The Company s success depends, in part, on its ability to obtain and maintain patent protection for its products by filing United States and foreign patent applications related to its technology, inventions and improvements. However, there can be no assurance that third parties will not seek to assert that the Company s devices and systems infringe their patents or seek to expand their patent claims to cover aspects of the Company s technology. As a result, there can be no assurance that the Company will not become subject to future patent infringement claims or litigation in a court of law, interference proceedings, or opposition to a patent granted in a foreign jurisdiction. The defense and prosecution of such intellectual property claims are costly, time-consuming, divert the attention of management and technical personnel and could result in substantial cost and uncertainty regarding the Company s future viability. Future litigation or regulatory proceedings, which could result in substantial cost and uncertainty, may also be necessary to enforce the Company s patent or other intellectual property rights or to determine the scope and validity of other parties proprietary rights. Any public announcements related to such litigation or regulatory proceedings initiated by the Company, or initiated or threatened against the Company by its competitors, could adversely affect the price of the Company s stock.

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The Company also relies upon trade secrets, technical know-how and continuing technological innovation to develop and maintain its competitive position, and the Company typically requires its employees, consultants and advisors to execute confidentiality and assignment of inventions agreements in connection with their employment, consulting or advisory relationships. There can be no assurance, however, that these agreements will not be breached or that the Company will have adequate remedies for any breach. Failure to protect the Company s intellectual property would limit its ability to produce and/or market its products in the future and would likely adversely affect the Company s revenues generated by the sale of such products.

THE COMPANY IS INVOLVED IN INTELLECTUAL PROPERTY LITIGATION WITH INTUITIVE SURGICAL AND BROOKHILL-WILK THAT MAY HURT THE COMPANY S COMPETITIVE POSITION, MAY BE COSTLY TO THE COMPANY AND MAY PREVENT THE COMPANY FROM SELLING ITS PRODUCTS.

On May 10, 2000, the Company filed a lawsuit in United States District Court alleging that Intuitive Surgical s *da Vinci* surgical robot system infringes on its United States Patent Nos. 5,524,180, 5,878,193, 5,762,458, 6,001,108, 5,815,640, 5,907,664 and 5,855,583. Subsequently, Computer Motion s complaint was amended to add allegations that Intuitive Surgical s *da Vinci* surgical robot infringed three additional Computer Motion patents United States Patent Nos. 6,244,809, 6,102,850 and 6,063,095. These patents concern methods and devices for conducting various aspects of robotic surgery. Intuitive Surgical has served an Answer and Counterclaim alleging non-infringement of each patent-in-suit, patent invalidity and unenforceability. Discovery is still underway. The parties have filed cross motions for summary judgment on the issue of patent infringement relating to the 108, 664, 809, and 850 patents. The Court recently granted Intuitive Surgical s motion for summary judgment of non-infringement relating to the 850 patent. The Court also recently granted the Company s motion for partial summary judgment relating to the 809 patent. The Court has not ruled on any of the remaining motions at this time. Pursuant to the merger agreement with Intuitive Surgical, Computer Motion and Intuitive Surgical filed on March 10, 2003, stipulations to stay this litigation until August 31, 2003, subject to the stay being lifted if the merger agreement is terminated, or subject to this case being dismissed upon consummation of the transactions contemplated by the merger agreement.

On or about December 7 and 8, 2000, the United States Patent and Trademark Office (USPTO) granted three of Intuitive Surgical s petitions for a declaration of an interference relating to the Company s 5,878,193, 5,907,664, and 5,855,583 patents. On March 30, 2002, the three judge panel of the Board of Patent Interferences issued decision orders on the parties preliminary motions. The Board granted the Company s motion on Interference No. 104,643 and issued an order for Intuitive Surgical to show cause why judgment should not be entered against Intuitive Surgical on this interference. The Board denied the Company s motion on the Interference No. 104,644 and entered judgment against the Company. The Board denied the Company s motions on the Interference No. 104,645, deferred decision on two of Intuitive Surgical s motions, and granted-in-part, denied-in-part and deferred-in-part on one of Intuitive Surgical s motions. The Board s decision on Interference No. 104,645 invalidated some of the parties claims, affirmed some of Intuitive Surgical s claims and provided for further proceedings related to two of the Company s claims and is therefore not final. On July 25, 2002, Computer Motion filed a civil action seeking review of the two adverse decisions in the United States District Court for the District of California. Pursuant to the merger agreement with Intuitive Surgical, Computer Motion and Intuitive Surgical filed on March 10, 2003, stipulations to stay this litigation until August 31, 2003, subject to the stay being lifted if the merger agreement is terminated, or subject to this case being dismissed upon consummation of the transactions contemplated by the merger agreement.

On February 21, 2001, Brookhill-Wilk filed suit against the Company alleging that its ZEUS surgical system infringed upon Brookhill-Wilk s United States Patent Nos. 5,217,003 and 5,368,015. Brookhill-Wilk s complaint seeks damages, attorneys fees and increased damages alleging willful patent infringement. On March 21, 2001, the Company served its Answer and Counterclaim alleging non-infringement of each patent-in-suit, patent invalidity and unenforceability. On November 8, 2001, the United States District Court for the

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Southern District of New York in the co-pending Brookhill-Wilk v. Intuitive Surgical, Inc., Civil Action No. 00-CV-6599 (NRB), issued an order interpreting the claims of Brookhill-Wilk s Patent No. 5,217,003 in a way that the Company believes excludes current applications of the Company s ZEUS surgical system. In light of this decision, on November 13, 2001, the parties to Brookhill Wilk v. Computer Motion, Inc. agreed to dismiss the case without prejudice. On March 25, 2002, Judge Alvin K. Hellerstein dismissed the case without prejudice.

On March 30, 2001, Intuitive Surgical and IBM Corporation filed suit alleging that the Company s AESOP, ZEUS and HERMES products infringe United States Patent No. 6,201,984, which was issued on March 13, 2001. The complaint seeks damages, a preliminary injunction, a permanent injunction, and costs and attorneys fees. The claims are directed to a surgical system employing voice recognition for control of a surgical instrument. Each of the asserted claims are limited to a surgical system employing voice recognition for control of a surgical robot and literally read on the Company s current AESOP product and the Company s ZEUS and HERMES products to the extent they are used with AESOP. A jury trial has been held on the issues of patent invalidity due to lack of enablement and failure to disclose the best mode in addition to damages. The Company s defense of unenforceability due to prosecution laches was tried before the District Court Judge. The jury returned a verdict finding IBM s United States Patent No. 6,201,984 valid, and finding Intuitive Surgical was damaged in an amount of $4.4 million. At December 31, 2002, the Company recorded a $4.4 million litigation provision for this related jury verdict. Prior to the jury s verdict. the Court ruled that the Company had not willfully infringed the patent. On December 10, 2002, the Court rendered an adverse decision on the Company s prosecution laches defense and on December 11, 2002, issued a judgment in Intuitive Surgical s and IBM s favor based upon the earlier jury verdict and the Court s December 10, 2002 ruling. Pursuant to the merger agreement with Intuitive, Computer Motion and Intuitive Surgical filed on March 10, 2003, stipulations to stay this litigation until August 31, 2003, subject to the stay being lifted if the merger agreement is terminated, or subject to this case being dismissed upon consummation of the transactions contemplated by the merger agreement.

The Company believes that all of its major product lines could be affected by this litigation. The patents subject to this litigation are an integral part of the technology incorporated in the Company s AESOP, ZEUS and HERMES product lines which together accounted for approximately 76% of its revenues for the year ended December 31, 2002. If the stay is lifted and the Company loses the suit brought by Intuitive Surgical and IBM or loses any patent infringement suit refiled by Brookhill-Wilk v. Intuitive Surgical, Inc., the Company may be prevented from selling its products as currently configured without first obtaining a license to the disputed technology from the successful party or modifying the product. Obtaining a license could be expensive, or could require that the Company license to the successful party some of its own proprietary technology, either of which result could seriously harm the Company s business. In the event that a successful party is unwilling to grant the Company a license, the Company will be required to stop selling its products that are found to infringe the successful party s patents unless the Company can redesign them so they do not infringe these patents, which the Company may be unable to do. Whether or not the Company is successful in these lawsuits, in the even the stay is lifted, the litigation could consume substantial amounts of the Company s financial and managerial resources. Further, because of the substantial amount of discovery often involved in connection with this type of litigation, there is a risk that some of the Company s confidential information could be compromised by disclosure during the discovery process.

BECAUSE THE COMPANY S INDUSTRY IS SUBJECT TO RAPID TECHNOLOGICAL CHANGE AND NEW PRODUCT DEVELOPMENT, THE COMPANY S FUTURE SUCCESS WILL DEPEND UPON ITS ABILITY TO EXPAND THE APPLICATIONS OF THE COMPANY S PRODUCTS.

The Company s success will depend to a significant extent upon its ability to enhance and expand the utility of its products so that they gain market acceptance. Failure to develop or introduce new products or

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product enhancements on a timely basis that achieve market acceptance could have a material adverse effect on the Company s business, financial condition and results of operations. In the past, some of the Company s competitors have been able to develop desirable product features (such as articulation of certain instruments and three dimensional visualization of their products) earlier than the Company has. The Company s inability to rapidly develop these features may have led to lower sales of some of the Company s products. In addition, technological advances with other therapies could make such therapies less expensive or more effective than using the Company s products and could render its technology obsolete or unmarketable. There can be no assurance that physicians will use the Company s products to replace or supplement established treatments or that the Company s products will be competitive with current or future technologies.

THE COMPANY MAY NOT BE ABLE TO EXPAND ITS MARKETING DISTRIBUTION ACTIVITIES IN ORDER TO MARKET ITS PRODUCTS COMPETITIVELY.

The Company anticipates significantly increasing the number of sales personnel to more fully cover its target markets, particularly as the Company expands its product offerings. It is possible the Company will be unable to compete effectively in attracting, motivating and retaining qualified sales personnel. Additionally, the Company currently intends to market and sell its products outside the United States and Europe, principally through distributors. In order to accomplish this, the Company will be required to expand its distributor network. The Company may not be able to identify suitable distributors or negotiate acceptable distribution agreements and any such distribution agreements may not result in significant sales. If the Company is unable to identify, attract, motivate and retain qualified sales personnel, suitable distributors or negotiate acceptable distribution agreements, the Company may not be successful in expanding the market for its products outside of the United States and Europe.

CONCENTRATION OF OWNERSHIP AMONG THE COMPANY S EXISTING EXECUTIVE OFFICERS, DIRECTORS AND PRINCIPAL STOCKHOLDERS MAY PREVENT NEW INVESTORS FROM INFLUENCING SIGNIFICANT CORPORATE DECISIONS.

The Company s current directors and executive officers beneficially own approximately 24.84% of its outstanding common stock. These stockholders, acting together, have the ability to significantly influence the election of the Company s directors and the outcomes of other stockholder actions and, as a result, direct the operation of its business, including delaying or preventing a proposed acquisition of the Company.

IF THE COMPANY LOSES ITS KEY PERSONNEL OR IS UNABLE TO ATTRACT AND RETAIN ADDITIONAL PERSONNEL, THE COMPANY S ABILITY TO COMPETE WILL BE HARMED.

The Company s future business and operating results depend in significant part on its key management, scientific, technical and sales personnel, many of whom would be difficult to replace, and future success will depend partially upon the Company s ability to retain these persons and recruit additional qualified management, technical, marketing, sales, regulatory, clinical and manufacturing personnel. Competition for such personnel is intense and the Company may have difficulty attracting or retaining such personnel. In addition, the Company does not have employment agreements with the majority of its key personnel and also does not maintain life insurance on any of its employees that may make it more difficult to retain its key personnel in the future.

THE COMPANY S FUTURE OPERATING RESULTS MAY FALL BELOW SECURITIES ANALYSTS OR INVESTORS EXPECTATIONS, WHICH COULD CAUSE THE COMPANY S STOCK PRICE TO DECLINE AND DIMINISH THE VALUE OF ITS INVESTORS HOLDINGS.

The Company s results of operations may vary significantly from quarter to quarter depending upon numerous factors, including but not limited to, the following:

- delays associated with the FDA and other regulatory clearance and approval processes;
- healthcare reimbursement policies;

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timing and results of clinical trials;

demand for its products;

changes in pricing policies by the Company or its competitors;

the number, timing and significance of its competitors product enhancements and new products;

product quality issues; and

component availability and supplier delivery performance.

In addition, the Company s operating results in any particular period may not be a reliable indication of its future performance. It is likely that in some future quarters, the Company s operating results will be below the expectations of securities analysts or investors. If this occurs, the price of the Company s common stock, and the value of its investors holdings, will likely decline.

THE COMPANY MAY INCUR SUBSTANTIAL COSTS DEFENDING SECURITIES CLASS ACTION LITIGATION DUE TO ITS STOCK PRICE VOLATILITY.

The market price of the Company s common stock is likely to be volatile and may be affected by a number of factors, including but not limited to, the following:

actual or anticipated decisions by the FDA with respect to approvals or clearances of its competitors products;

actual or anticipated fluctuations in its operating results;

announcements of technological innovations;

new commercial products announced or introduced by the Company or its competitors;

changes in third party reimbursement policies;

developments concerning the Company s or its competitors proprietary rights;

conditions and trends in the medical device industry;

governmental regulation;

changes in financial estimates by securities analysts; and

general stock market conditions.

Securities class action litigation has often been brought against companies when the market price of their securities declines. The Company could be especially prone to such risk because technology companies have experienced greater than average stock price volatility in recent years. If the Company were subject to securities litigation, the Company would incur substantial costs and divert management s attention defending any such claims.

THE COMPANY S RELIANCE ON SOLE OR SINGLE SOURCE SUPPLIERS COULD HARM ITS ABILITY TO MEET DEMAND FOR THE COMPANY S PRODUCTS IN A TIMELY MANNER OR WITHIN ITS PROJECTED BUDGET.

The Company relies on independent contract manufacturers, some of which are single source suppliers, for the manufacture of the principal components of its products. In some instances, the Company relies on companies that are sole suppliers of key components of its products. If one of these sole suppliers goes out of business, the Company could face significant production delays until an alternate supplier is found, or until the product could be redesigned and revalidated to accommodate a new supplier s replacement component. In addition, the Company generally submits purchase orders based upon its suppliers current price lists. Since the Company generally does not have written contracts for future purchase orders with its suppliers, these suppliers may increase the cost of the parts the Company purchases in the future. Failure to find additional suppliers on a timely basis could result in the delay or cancellation of customer orders and a corresponding delay or reduction of expected revenue.

The Company s manufacturing experience to date has been focused primarily on assembling components produced by third-party manufacturers. In scaling up manufacturing of new products, the

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Company may encounter difficulties involving quality control and assurance, component availability, adequacy of control policies and procedures, lack of qualified personnel and compliance with the FDA s Quality System Regulations requirements. The Company may elect to internally manufacture components currently provided by third parties or to implement new production processes. The Company cannot assure its stockholders that manufacturing yields or costs will not be adversely affected by a transition to in-house production or to new production processes if such efforts are undertaken. If necessary, this expansion will require the commitment of capital resources for facilities, tooling and equipment and for leasehold improvements. Further, the Company s delay or inability to expand its manufacturing capacity or to obtain the commitment of such resources could result in its inability to meet demand for its products, which could harm the Company s ability to generate revenues, lead to customer dissatisfaction and damage its reputation.

THE USE OF THE COMPANY S PRODUCTS COULD RESULT IN PRODUCT LIABILITY CLAIMS THAT COULD BE EXPENSIVE AND HARM ITS BUSINESS.

As a medical device manufacturer, the Company faces an inherent business risk of financial exposure to product liability claims in the event that the use of its products results in personal injury or death. The Company also faces the possibility that defects in the design or manufacture of its products might necessitate a product recall. It is possible that the Company will experience losses due to product liability claims or recalls in the future. The Company currently maintains product liability insurance with coverage limits of $5,000,000, but future claims may exceed these coverage limits. The Company may also require increased product liability coverage as additional potential products are successfully commercialized. Such insurance is expensive, difficult to obtain and may not be available in the future on acceptable terms, or at all. While the Company has not had any material product liability claims to date, its defense of any future product liability claim, regardless of its merit or eventual outcome, would divert management s attention and could result in significant legal costs. In addition, a product liability claim or any product recalls could also harm its reputation or result in a decline in revenues.

THE COMPANY S CONTINUED GROWTH WILL SIGNIFICANTLY STRAIN ITS RESOURCES AND, IF THE COMPANY FAILS TO MANAGE THIS GROWTH, ITS ABILITY TO MARKET, SELL AND DEVELOP ITS PRODUCTS MAY BE HARMED.

The Company s growth will continue to place significant demands on its management and resources. In order to compete effectively against current and future competitors, prepare products for clinical trials and develop future products, the Company believes it must continue to expand its operations, particularly in the areas of research and development and sales and marketing. It is likely that the Company will be required to implement additional operating and financial controls, hire and train additional personnel, install additional reporting and management information systems and expand its physical operations. The Company s future success will depend, in part, on its ability to manage future growth and the Company cannot assure its investors that it will be successful in doing so.

FUTURE SALES OF THE COMPANY S COMMON STOCK COULD DEPRESS THE MARKET PRICE OF ITS COMMON STOCK.

Future sales of the Company s common stock could depress the market price of its common stock. On March 12, 2003, the Company filed a registration statement on Form S-3 covering the resale of 500,000 shares of its common stock issuable upon exercise of a warrant. This registration statement has not been declared effective. On December 13, 2002, the Company filed a registration statement on Form S-3 (File No. 333-101830) covering the resale of up to an aggregate of 16,931,365 shares of its common stock issuable upon conversion of the Company s Series C Convertible Preferred Stock, as payment of dividends on the Series C Convertible Preferred Stock, as a conversion premium on the Series C Convertible Preferred Stock and upon exercise of certain warrants. This registration statement was declared effective on December 23, 2002. On February 28, 2002 the Company filed a registration statement on Form S-3 (File No. 333-83552) covering the

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resale of 5,075,771 shares of its common stock by certain selling stockholders. In addition, on or prior to February 13, 2002, the Company issued 2,911,039 shares of common stock upon conversion of all the shares of its Series B Convertible Preferred Stock. The Company filed a registration statement on Form S-3 (File No. 333-58962) covering the shares of common stock issued to holders upon the conversion of the Series B Convertible Preferred Stock and issuable upon exercise of certain warrants issued to the former holder of its Series B Convertible Preferred Stock. The Securities and Exchange Commission declared this registration statement effective on September 24, 2001. In the future, the Company may issue additional options, warrants or other derivative securities convertible into its common stock. The public sale of the Company s common stock by the selling stockholders who control large blocks of its common stock could depress the market price of its common stock.

FAILURE TO SATISFY NASDAQ NATIONAL MARKET LISTING REQUIREMENTS MAY RESULT IN THE COMPANY S STOCK BEING DELISTED FROM THE NASDAQ NATIONAL MARKET AND BEING SUBJECT TO RESTRICTIONS ON PENNY STOCK .

The Company s common stock is currently listed on the Nasdaq National Market under the symbol RBOT. For continued inclusion on the Nasdaq National Market, the Company must maintain, among other requirements, $10.0 million in stockholders equity, a minimum bid price of $1.00 per share, and a market value of its public float of at least $5.0 million. On December 31, 2002, the Company s stockholders equity was $5.7 million, leaving the Company non-compliant with the new minimum stockholders equity standard on the Nasdaq National Market. In the event that the Company fails to maintain the minimum stockholders equity standard or other listing standards on a continuous basis, the Company s common stock may be removed from listing on the Nasdaq National Market. If the Company s common stock is delisted from the Nasdaq National Market, and the Company is not able to list the shares on the Nasdaq Small Cap Market or another exchange, trading of its common stock, if any, would be conducted in the over-the-counter market in the so-called pink sheets or, if available, the Nasdaq s Electronic Bulletin Board. As a result, stockholders could find it more difficult to dispose of, or to obtain accurate quotations as to the value of the Company s common stock, and the trading price per share could decline.

If the Company s shares are not listed on any exchange or on the Nasdaq National Market, they are also subject to the regulations regarding trading in penny stocks, which are those securities trading for less than $5.00 per share. The following is a list of the restrictions on the sale of penny stocks:

Prior to the sale of penny stock by a broker-dealer to a new purchaser, the broker-dealer must determine whether the purchaser is suitable to invest in penny stocks. To make that determination, a broker-dealer must obtain, from a prospective investor, information regarding the purchaser s financial condition and investment experience and objectives. Subsequently, the broker-dealer must deliver to the purchaser a written statement setting forth the basis of the suitability finding. A broker-dealer must obtain from the purchaser a written agreement to purchase the securities. This agreement must be obtained for every purchase until the purchaser becomes an established customer.

The Exchange Act requires that prior to effecting any transaction in any penny stock, a broker-dealer must provide the purchaser with a risk disclosure document that contains, among other things, a description of the penny stock market and how it functions and the risks associated with such investment. These disclosure rules are applicable to both purchases and sales by investors.

A dealer that sells penny stock must send to the purchaser, within ten days after the end of each calendar month, a written account statement including prescribed information relating to the security. As a result of a failure to maintain the trading of the Company s stock on the Nasdaq National Market and the rules regarding penny stock transactions, the investors ability to sell to a third party may be limited. The Company makes no guarantee that its current market makers will continue to make a market in its securities, or that any market for its securities will continue.

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Available Information

The Company s annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934 are available free of charge on the Company s web site at www.computermotion.com.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The Company is not subject to any meaningful market risks related to currency, commodity prices or similar matters. The Company is sensitive to short-term interest rate fluctuations to the extent that such fluctuations impact the interest income the Company receives on the marketable securities, which consist of bank certificates of deposit, commercial paper, and corporate bonds, all of which by policy must mature within 360 days. The primary objective of the Company s investment activities is to preserve principal while at the same time maximizing the income the Company receives from its investments without significantly increasing risk.

Trade accounts receivable and certain marketable securities are financial instruments, which may subject the Company to concentration of credit risk. Although the Company does not anticipate collection problems with its receivables, payment is contingent to a certain extent upon the economic condition of the hospitals, which purchase the Company s products. The credit risk associated with receivables is limited due to the dispersion of the receivables over a number of customers in a number of geographic areas. The Company monitors credit worthiness of its customers to which it grants credit terms in the normal course of business. Marketable securities are placed with high credit qualified financial institutions and Company policy limits the credit exposure to any one financial instrument; therefore, credit loss is reduced.

ITEM 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

Regulations under the Securities Exchange Act of 1934, as amended, require public companies, including the Company, to maintain disclosure controls and procedures, which are defined to mean a company s controls and other procedures that are designed to ensure that information required to be disclosed in the reports that it files or submits under the Securities Exchange Act of 1934 are recorded, processed, summarized and reported, within the time periods specified in the Securities and Exchange Commission s rules and forms. The Company s Chief Executive Officer and Chief Accounting Officer, based upon their evaluation of the Company s disclosure controls and procedures within 90 days before the filing date of this report, concluded that as of their evaluation date, the Company s disclosure controls and procedures were effective for this purpose.

Changes in Internal Controls

There were no significant changes in the Company s internal controls or to the Company s knowledge, in other factors that could significantly affect these controls subsequent to the date of their evaluation, which occurred as of the evaluation date referenced in the above paragraph.

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PART II. OTHER INFORMATION

ITEM 1. LITIGATION

On May 10, 2000, the Company filed a lawsuit in United States District Court alleging that Intuitive Surgical s *da Vinci* surgical robot system infringes on its United States Patent Nos. 5,524,180, 5,878,193, 5,762,458, 6,001,108, 5,815,640, 5,907,664 and 5,855,583. Subsequently, Computer Motion s complaint was amended to add allegations that Intuitive Surgical s *da Vinci* surgical robot infringed three additional Computer Motion patents United States Patent Nos. 6,244,809, 6,102,850 and 6,063,095. These patents concern methods and devices for conducting various aspects of robotic surgery. Intuitive Surgical has served an Answer and Counterclaim alleging non-infringement of each patent-in-suit, patent invalidity and unenforceability. Discovery is still underway. The parties have filed cross motions for partial summary judgment on the issue of patent infringement relating to the 664, 809, and 850 patents. The Court recently granted Intuitive Surgical s motion for summary judgment of non-infringement relating to the 850 patent. The Court also recently granted the Company s motion for partial summary judgment relating to the 809 patent. The Court has not ruled on any of the remaining motions at this time. Pursuant to the merger agreement with Intuitive Surgical, Computer Motion and Intuitive Surgical filed on March 10, 2003, stipulations to stay this litigation until August 31, 2003, subject to the stay being lifted if the merger agreement is terminated, or subject to this case being dismissed upon consummation of the transactions contemplated by the merger agreement.

On or about December 7 and 8, 2000, the United States Patent and Trademark Office (USPTO) granted three of Intuitive Surgical s petitions for a declaration of an interference relating to the Company s 5,878,193, 5,907,664, and 5,855,583 patents. On March 30, 2002, the three judge panel of the Board of Patent Interferences issued decision orders on the parties preliminary motions. The Board granted the Company s motion on Interference No. 104,643 and issued an order for Intuitive Surgical to show cause why judgment should not be entered against Intuitive Surgical on this interference. The Board denied the Company s motion on the Interference No. 104,644 and entered judgment against the Company. The Board denied the Company s motions on the Interference No. 104,645, deferred decision on two of Intuitive Surgical s motions, and granted-in-part, denied-in-part and deferred-in-part on one of Intuitive Surgical s motions. The Board s decision on Interference No. 104,645 invalidated some of the parties claims, affirmed some of Intuitive Surgical s claims and provided for further proceedings related to two of the Company s claims and is therefore not final. On July 25, 2002, Computer Motion filed a civil action seeking review of the two adverse decisions in the United States District Court for the District of California. Pursuant to the merger agreement with Intuitive Surgical, Computer Motion and Intuitive Surgical filed on March 10, 2003, stipulations to stay this litigation until August 31, 2003, subject to the stay being lifted if the merger agreement is terminated, or subject to this case being dismissed upon consummation of the transactions contemplated by the merger agreement.

On February 21, 2001, Brookhill-Wilk filed suit against the Company alleging that its ZEUS surgical system infringed upon Brookhill-Wilk s United States Patent Nos. 5,217,003 and 5,368,015. Brookhill-Wilk s complaint seeks damages, attorneys fees and increased damages alleging willful patent infringement. On March 21, 2001, the Company served its Answer and Counterclaim alleging non-infringement of each patent-in-suit, patent invalidity and unenforceability. On November 8, 2001, the United States District Court for the Southern District of New York in the co-pending Brookhill-Wilk v. Intuitive Surgical, Inc., Civil Action No. 00-CV-6599 (NRB), issued an order interpreting the claims of Brookhill-Wilk s Patent No. 5,217,003 in a way that the Company believes excludes current applications of the Company s ZEUS surgical system. In light of this decision, on November 13, 2001, the parties to Brookhill Wilk v. Computer Motion, Inc. agreed to dismiss the case without prejudice. On March 25, 2002, Judge Alvin K. Hellerstein dismissed the case without prejudice.

On March 30, 2001, Intuitive Surgical and IBM Corporation filed suit alleging that the Company s AESOP, ZEUS and HERMES products infringe United States Patent No. 6,201,984, which was issued on

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March 13, 2001. The complaint seeks damages, a preliminary injunction, a permanent injunction, and costs and attorneys fees. The claims are directed to a surgical system employing voice recognition for control of a surgical instrument. Each of the asserted claims are limited to a surgical system employing voice recognition for control of a surgical robot and literally read on the Company s current AESOP product and the Company s ZEUS and HERMES products to the extent they are used with AESOP. A jury trial has been held on the issues of patent invalidity due to lack of enablement and failure to disclose the best mode in addition to damages. The Company s defense of unenforceability due to prosecution laches was tried before the District Court Judge. The jury returned a verdict finding IBM s United States Patent No. 6,201,984 valid, and finding Intuitive was damaged in an amount of $4.4 million. At December 31, 2002, the Company recorded a $4.4 million litigation provision for this related jury verdict. Prior to the jury s verdict, the Court ruled that the Company had not willfully infringed the patent. On December 10, 2002, the Court rendered an adverse decision on the Company s prosecution laches defense and on December 11, 2002, issued a judgment in Intuitive Surgical s and IBM s favor based upon the earlier jury verdict and the Court s December 10, 2002 ruling. Pursuant to the merger agreement with Intuitive Surgical, Computer Motion and Intuitive Surgical filed on March 10, 2003, stipulations to stay this litigation until August 31, 2003, subject to the stay being lifted if the merger agreement is terminated, or subject to this case being dismissed upon consummation of the transactions contemplated by the merger agreement.

The Company believes that all of its major product lines could be affected by this litigation. The patents subject to this litigation are an integral part of the technology incorporated in the Company s AESOP, ZEUS and HERMES product lines which together accounted for approximately 76% of its revenues for the year ended December 31, 2002. If the stay is lifted and the Company loses the suit brought by Intuitive Surgical and IBM or loses any patent infringement suit refiled by Brookhill-Wilk v. Intuitive Surgical, Inc., the Company may be prevented from selling its products as currently configured without first obtaining a license to the disputed technology from the successful party or modifying the product. Obtaining a license could be expensive, or could require that the Company license to the successful party some of its own proprietary technology, either of which result could seriously harm the Company s business. In the event that a successful party is unwilling to grant the Company a license, the Company will be required to stop selling its products that are found to infringe the successful party s patents unless the Company can redesign them so they do not infringe these patents, which the Company may be unable to do. Whether or not the Company is successful in these lawsuits, in the even the stay is lifted, the litigation could consume substantial amounts of the Company s financial and managerial resources. Further, because of the substantial amount of discovery often involved in connection with this type of litigation, there is a risk that some of the Company s confidential information could be compromised by disclosure during the discovery process.

ITEM 2. CHANGES IN SECURITIES AND USE OF PROCEEDS

Series C Convertible Preferred Stock Financing

The Company commenced a Series C Convertible Preferred Stock financing during the quarter ended December 31, 2002. As a part of that financing, on January 27, 2003, the Company received stockholder approval to convert $999,600 of an outstanding promissory note from the Company to Robert W. Duggan, the Company s Chairman and Chief Executive Officer, into shares of the Company s Series C Convertible Preferred Stock. On January 29, 2003, the Company issued 714 shares of Series C Convertible Preferred Stock in exchange for the note. In addition, the stockholders approved the purchase of an additional $999,600 of Series C Convertible Preferred Stock by Mr. Duggan, or his designees, which was received on March 4, 2003. These issuances were exempted from registration based on Section 4(2) of the Securities Act of 1933, as amended.

Loan and Security Agreements

On February 13, 2003, the Company entered into a Loan and Security Agreement with Agility Capital, LLC, for a short-term bridge loan in the aggregate principal amount of $2,300,000. In connection with the bridge loan, the Company issued a warrant to purchase up to an aggregate of 500,000 shares of the Company s common stock at an exercise price of $.97 per share. The Company valued the warrants using the Black-Scholes option pricing model. The fair value of the warrants was recorded as a debt issuance cost and was recorded as deferred interest expense and additional paid-in capital in accordance with APB 14. The deferred interest expense is being amortized to interest expense over the life of the loan.

In connection with the proposed merger, Computer Motion and Intuitive Surgical have entered into a Loan and Security Agreement, under which Intuitive Surgical has agreed to provide a short-term secured

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bridge loan of up to $7.3 million. The loan will terminate and all outstanding amounts will become due and payable 120 days following termination of the merger agreement (the Maturity Date). Under the terms of the agreement, the Company is required to pay off the Loan and Security Agreement with Agility Capital, LLC, with its initial borrowings. Interest on the loan will accrue at a rate of 8% per annum and will payable on the Maturity Date. At March 31, 2003 no funds had been borrowed against this secured bridge loan.

Preferred Stock Exchange

On March 6, 2003, prior to the execution of the merger agreement, all 20 holders of the Company s Series C Convertible Preferred Stock agreed with Computer Motion to exchange all of the 8,797 outstanding shares of Series C Convertible Preferred Stock for a like number of newly-issued shares of Series D Convertible Preferred Stock. The preferred stock exchange was effected in order to eliminate the provisions of the Series C Convertible Preferred Stock that could have restricted the ability of Computer Motion to enter into the merger agreement or affected Intuitive Surgical s willingness to enter into the merger agreement. There were three general effects of the preferred stock exchange: (1) The holders of Series D Convertible Preferred Stock will vote together with the holders of common stock to approve and adopt the merger agreement. Each share of Series D Convertible Preferred Stock will be entitled to 1,000 votes, while each share of common stock will be entitled to one vote. (2) The Series D Convertible Preferred Stock will automatically convert into Computer Motion common stock immediately prior to the merger, so all Computer Motion stockholders will receive Intuitive Surgical common stock, rather than a combination of common stock and preferred stock, in the merger. (3) The preferred stock exchange eliminated any premium to the holders of Series D Convertible Preferred Stock if the holders would otherwise receive merger consideration in an amount that provides a result of 135% of their initial investment and, in exchange, provides the holders of Series D Convertible Preferred Stock with a guaranteed minimum return of 35% on their initial investment which, if the average closing bid price of Computer Motion common stock during the pricing period of the merger is less than approximately $1.86 per share, then the holders of Computer Motion Series D Convertible Preferred Stock will receive a greater number of shares of Intuitive Surgical common stock in the merger relative to the holders of Computer Motion common stock.

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

a.) Exhibits

99.1 Certification of Periodic Report by Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, 18 U.S.C. Section 1350.

99.2 Certification of Periodic Report by Chief Accounting Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, 18 U.S.C. Section 1350.

b) Reports on Form 8-K.

Report on Form 8-K, filed February 7, 2003, filed by the Company to demonstrate its compliance with Nasdaq s minimum stockholders equity requirement

Report on Form 8-K, filed February 24, 2003, filed by the Company to report on the Loan and Security Agreement entered into with Agility Capital, LLC.

Report on Form 8-K, filed March 11, 2003, filed by the Company to report an Agreement and Plan of Merger by and among Computer Motion, Inc. and Intuitive Surgical, Inc.

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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.

Date: May 15, 2003

COMPUTER MOTION, INC

By: /s/ Robert W. Duggan

Robert W. Duggan
Chairman of the Board of Directors
and Chief Executive Officer

By: /s/ Larry Redfern

Larry Redfern
Controller and Chief Accounting Officer

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CERTIFICATIONS

I, Robert W. Duggan, Chairman and Chief Executive Officer of Computer Motion, Inc., certify that:

1. I have reviewed this quarterly report on Form 10-Q of Computer Motion, Inc.;

2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report; and

3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results or operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report.

4. The registrant s other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Rules 13a-14 and 15d-14 of the Exchange Act) for the registrant and we have:

a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;

b) evaluated the effectiveness of the registrant s disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the Evaluation Date); and

c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;

5. The registrant s other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant s auditors and the audit committee of registrant s board of directors (or persons performing the equivalent function):

a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant s ability to record, process, summarize and report financial data and have identified for the registrant s auditors any material weaknesses in internal controls; and

b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant s internal controls; and

6. The registrant s other certifying officers and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Dated: May 15, 2003

COMPUTER MOTION, INC.

By: /s/ Robert W. Duggan

Robert W. Duggan
Chairman of the Board of Directors
and Chief Executive Officer

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I, Larry Redfern, Chief Accounting Officer of Computer Motion, Inc., certify that:

1. I have reviewed this quarterly report on Form 10-Q of Computer Motion, Inc.;

2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report; and

3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results or operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report.

4. The registrant s other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Rules 13a-14 and 15d-14 of the Exchange Act) for the registrant and we have:

a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;

b) evaluated the effectiveness of the registrant s disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the Evaluation Date); and

c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;

5. The registrant s other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant s auditors and the audit committee of registrant s board of directors (or persons performing the equivalent function):

a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant s ability to record, process, summarize and report financial data and have identified for the registrant s auditors any material weaknesses in internal controls; and

b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant s internal controls; and

6. The registrant s other certifying officers and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Dated: May 15, 2003

COMPUTER MOTION, INC.

By: /s/ Larry Redfern

Larry Redfern
Controller and Chief Accounting Officer

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EXHIBIT INDEX

Exhibit Number	Description
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