UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2003

OR

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

For the transition period from _____to _____

Commission file number 000-30713

Intuitive Surgical, Inc.

(Exact name of Registrant as specified in its Charter)

Delaware	**77-0416458**
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification Number)

950 Kifer Road
Sunnyvale, California 94086
(Address of Principal Executive Offices including Zip Code)

(408) 523-2100
(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 reports), and (2) has been subject to such filing requirements for the past 90 days. YES x NO o

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). YES x NO o

The Registrant had 32,212,144 shares of Common Stock, $0.001 par value per share, outstanding as of November 5, 2003.

Intuitive Surgical, Inc.
TABLE OF CONTENTS

PART I. FINANCIAL INFORMATION **Page No.**

PART I -- FINANCIAL INFORMATION

Item 1. Financial Statements

INTUITIVE SURGICAL, INC.
CONSOLIDATED BALANCE SHEETS
(IN THOUSANDS, EXCEPT SHARE DATA)

	September 30, 2003 (Unaudited)	December 31, 2002 (See Note 1)
ASSETS		
Current assets:		
Cash and cash equivalents	$ 12,478	$ 17,607
Short-term investments	22,971	33,232
Trade receivables, net	23,656	16,887
Inventory, net	12,746	8,738
Prepaid expenses	2,983	1,912
Total current assets	74,834	78,376
Property and equipment, net	10,688	10,388
Intangible assets, net	9,917	2,568
Goodwill	142,995	--
Other assets	330	249
Total assets	238,764	91,581
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 11,420	$ 9,282
Accrued compensation and employee benefits	5,248	4,666
Warranty accrual	1,331	2,269
Restructuring accrual	1,332	--
Other accrued liabilities	2,629	3,497
Deferred revenue	8,824	4,638

Current portion of notes payable	1,156	1,511
Total current liabilities	31,940	25,863
Long-term notes payable	950	1,838
Deferred revenue	1,227	200
Commitments and contingencies	--	--
Stockholders' equity:		
Preferred stock, 2,500,000 shares authorized, $0.001 par value, issuable in series; no shares issued and outstanding as of September 30, 2003 and and December 31, 2002, respectively	--	--
Common stock, 100,000,000 shares authorized, $0.001 par value, 27,152,326 and 18,357,513 shares issued and outstanding as of September 30, 2003 and December 31, 2002, respectively	27	18
Additional paid-in capital	337,738	191,038
Deferred compensation	(375)	(223)
Accumulated deficit	(133,559)	(128,791)
Accumulated other comprehensive income	816	1,638
Total stockholders' equity	204,647	63,680
Total liabilities and stockholders' equity	$ 238,764	$ 91,581

See accompanying notes to condensed consolidated financial statements.

INTUITIVE SURGICAL, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS
(UNAUDITED)
(IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2003	2002	2003	2002
Sales:				
Products	$ 20,651	$ 15,723	$ 57,317	$ 47,424
Services	2,742	1,358	6,764	3,453
Total sales	23,393	17,081	64,081	50,877
Cost of sales:				
Products	9,398	7,499	24,075	22,666
Services	1,009	841	2,976	2,406
Total cost of sales	10,407	8,340	27,051	25,072
Gross profit	12,986	8,741	37,030	25,805
Operating costs and expenses:				
Selling, general, and administrative	12,242	11,693	31,840	30,262
Research and development	4,407	3,890	11,457	12,767
Total operating costs and expenses	16,649	15,583	43,297	43,029
Loss from operations	(3,663)	(6,842)	(6,267)	(17,224)
Other income, net	310	378	1,499	1,403
Net loss	$ (3,353)	$ (6,464)	$ (4,768)	$ (15,821)
Basic and diluted net loss per common share	$ (0.12)	$ (0.35)	$ (0.22)	$ (0.87)
Shares used in computing basic and diluted net loss per common share	26,878	18,250	21,296	18,199

See accompanying notes to condensed consolidated financial statements.

INTUITIVE SURGICAL, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)
(IN THOUSANDS)

	For the Nine Months Ended September 30,	
	2003	2002
OPERATING ACTIVITIES:		
Net loss	$ (4,768)	$ (15,821)

Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation	3,021	2,247
Loss on sales of fixed assets	5	64
Amortization of deferred compensation and stock compensation	379	543
Amortization/Impairment of intangible assets	1,350	584
Changes in operating assets and liabilities:		
Trade receivable	(2,294)	(5,796)
Prepaid expenses	(823)	1,106
Inventory	664	(3,689)
Other assets	11	--
Accounts payable	(5,754)	799
Accrued compensation and employee benefits	(1,477)	1,520
Warranty accrual	(1,238)	648
Restructuring accrual	(2,112)	--
Other accrued liabilities	(868)	1,530
Accrued royalty expense	--	(1,000)
Deferred revenue	2,987	645
Net cash used in operating activities	(10,917)	(16,620)
INVESTING ACTIVITIES:		
Acquisition of property and equipment	(1,914)	(5,228)
Disposition of property and equipment	192	62
Acquisition of business, net of cash acquired	(5,861)	--
Purchase of short-term investments	(5,966)	(11,527)
Proceeds from sales of short-term investments	10,674	21,216
Proceeds from maturities of short-term investments	4,899	17,167
Net cash provided by investing activities	2,024	21,690
FINANCING ACTIVITIES:		
Proceeds from issuance of common stock	5,181	1,948
Repurchase of common stock	(6)	(1)
Proceeds from notes payable	--	2,338
Repayment of notes payable	(1,243)	(1,562)
Net cash provided by financing activities	3,932	2,723
Foreign currency translation adjustments	(168)	60
Net increase (decrease) in cash and cash equivalents	(5,129)	7,853
Cash and cash equivalents, beginning of period	17,607	10,487
Cash and cash equivalents, end of period	$ 12,478	$ 18,340
Non-cash investing activity:		
Common stock issued in connection with acquisition of business	$ 141,437	$ --

See accompanying notes to condensed consolidated financial statements.

INTUITIVE SURGICAL, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

In this report, "Intuitive Surgical, " "Intuitive," and the "Company" refer to Intuitive Surgical, Inc.

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and notes required by accounting principles generally accepted in the United States for complete financial statements. In the opinion of management, all normal, recurring adjustments considered necessary for a fair presentation have been included. The consolidated balances at December 31, 2002 were derived from the audited financial statements included in Intuitive Surgical, Inc.'s Annual Report on Form 10-K/A for the year ended December 31, 2002, or the Annual Report. The financial statements should be read in conjunction with the audited financial statements for the year ended December 31, 2002, included in the Annual Report. The results for the interim period ended September 30, 2003 are not necessarily indicative of the results to be expected for the full year ending December 31, 2003 or future operating periods. Certain reclassifications have been made to prior year balances in order to conform to the current year presentation.

On June 30, 2003, Intuitive Surgical acquired Computer Motion, Inc. through the merger of Computer Motion with a wholly owned subsidiary of Intuitive Surgical. In the merger, each outstanding share of Computer Motion common stock was converted into 0.51426943 shares of Intuitive Surgical common stock and Intuitive Surgical assumed all of Computer Motion's outstanding options and warrants based on the same ratio. See "Note 3: Acquisition of Computer Motion, Inc."

In accordance with Statement of Financial Accounting Standards ("SFAS") No. 141, "Business Combinations," Intuitive Surgical, Inc. has included in its results of operations the results of Computer Motion, Inc. from its date of acquisition, June 30, 2003.

Revenue Recognition

The Company recognizes revenue when persuasive evidence of an arrangement exists, delivery has occurred or service has been rendered, the price is fixed or determinable and collectibility is reasonably assured.

In certain cases, revenue from direct system sales is generated from multiple-element arrangements that require judgment in the areas of customer acceptance, collectibility, the separability of units of accounting, and the fair value of individual elements. Effective July 1, 2003, the Company adopted the provisions of Emerging Issues Task Force, or EITF, Issue No. 00-21, "Revenue Arrangements with Multiple Deliverables" on a prospective basis. The principles and guidance outlined in EITF 00-21 provide a framework to (a) determine whether an arrangement involving multiple deliverables contains more than one unit of accounting, and (b) determine how the arrangement consideration should be measured and allocated to the separate units of accounting in the arrangement. The Company determined that its multiple-element arrangements are generally comprised of the following elements that would qualify as separate units of accounting: system sales, service, installation, and training. Each of these elements represent individual units of accounting as the delivered item has value to a customer on a stand-alone basis, objective and reliable evidence of fair value exists for undelivered items, and arrangements generally do not contain a general right of return relative

to the delivered item. The Company determines fair value based on the price of the deliverable when it is sold separately or based on third-party evidence. In accordance with the guidance in EITF 00-21, the Company uses the residual method to allocate the arrangement consideration when it does not have fair value of the system sale. Under the residual method, the amount of consideration allocated to the delivered item equals the total arrangement consideration less the aggregate fair value of the undelivered items. Assuming all other criteria for revenue recognition have been met, the Company recognizes revenue for system sales when delivery and acceptance occurs, for installation and training when the services are rendered, and for service ratably over the service period, which is generally one year.

Upon adoption of the provisions of EITF 00-21, the Company deferred approximately $1.7 million of revenue related to the fair value of the first year service for system sales delivered during the third quarter of 2003. This amount will be recognized as service revenue on a straight-line basis over the related service period, which is generally one year. Previously, in accordance with Staff Accounting Bulletin No. 101, "Revenue Recognition in Financial Statements," the Company accrued costs associated with these arrangements as warranty expense in the period the system was delivered and accepted.

The Company's distributors do not have price protection rights. One of the Company's distributors has return rights under limited circumstances. Such rights are accounted for under the provisions of SFAS No. 48, "Revenue Recognition When Right of Return Exists."

Revenue from sales of instruments and accessories is recognized upon delivery. Revenue related to future commitments under separately priced service contracts is deferred and recognized ratably over the service period. All costs associated with the provision of service and maintenance, including salaries, benefits, travel, spare parts and equipment, are recognized in cost of sales as incurred.

Amounts billed in excess of revenue recognized are included as deferred revenue in the condensed consolidated balance sheets.

The Company's *da Vinci* Surgical System, *Hermes* Control Center and *AESOP* Endoscope Positioner contain a software component. The Company believes that this software element is an incidental part of each system. The software element within the Company's products is not sold or marketed separately to customers, and the software does not operate independently of each system. Furthermore, the software development effort does not require a significant cost to the Company relative to the overall development cost of the product. As such, the software the Company provides is incidental to each system as a whole and the software revenue guidance provided in SOP 97-2 is not applicable to the Company's revenues.

Stock-Based Compensation

The Company applies Accounting Principles Board, or APB, Opinion No. 25, "Accounting for Stock Issued to Employees," and related interpretations in accounting for its stock option plans. Accordingly, no compensation expense has been recorded for stock option grants issued with an exercise price equal to the market value of the underlying stock on the date granted. The Company has recorded stock-based compensation, primarily related to deferred compensation arising from the Company's initial public offering in 2000 and its acquisition of Computer Motion in June 2003. As required under Statement of Financial Accounting Standards Board, or SFAS, No. 148, "Accounting for Stock-Based Compensation - Transition and Disclosure," the Company has provided the following pro forma net loss and pro forma net loss per share disclosures for stock-based awards as if the fair value-based method defined in SFAS 123, "Accounting for Stock-Based Compensation," had been applied (amounts in thousands, except per share amounts):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2003	2002	2003	2002
Net loss, as reported	$ (3,353)	$ (6,464)	$ (4,768)	$(15,821)
Add: Total stock-based employee compensation expense included in reported net loss, net of $0 related tax effect	83	148	379	543
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of $0 related tax effect	(2,123)	(1,875)	(6,107)	(5,370)
Pro forma net loss	$ (5,393)	$ (8,191)	$ (10,496)	$(20,648)
Loss per share:				
Basic and diluted - as reported	$ (0.12)	$ (0.35)	$ (0.22)	$ (0.87)
Basic and diluted - pro forma	$ (0.20)	$ (0.45)	$ (0.49)	$ (1.13)

The fair value for each stock option award granted was estimated at the date of grant using the Black-Scholes option-pricing model, assuming no expected dividends and the following weighted average assumptions:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2003	2002	2003	2002
Stock Option Plans:				
Average risk free interest rate	2.52 %	3.90 %	2.51 %	3.90 %
Average expected life (years)	4.0	4.0	4.0	4.0
Volatility	80 %	80 %	80 %	80 %
Stock Purchase Plan:				
Average risk free interest rate	1.21 %	1.71 %	1.48 %	1.71 %
Average expected life (years)	0.5	0.5	0.5	0.5
Volatility	48 %	48 %	48 %	48 %

Recent Accounting Pronouncements

In June 2002, the FASB issued SFAS 146, "Accounting for Costs Associated with Exit or Disposal Activities," which addresses accounting for restructuring, discontinued operation, plant closing, or other exit or disposal activity. SFAS 146 requires companies to recognize costs associated with exit or disposal activities when they are incurred rather than at the date of a commitment to an exit or disposal plan. The provisions of SFAS 146 are effective for exit or disposal activities that are initiated after December 31, 2002. Since SFAS 146 does not involve an entity newly acquired in a business combination, the restructuring accrual, recorded as a component of the purchase price in connection with the acquisition of Computer Motion (Note 3), was established based on the provisions of EITF Issue No. 95-3, "Recognition of Liabilities in Connection with a Purchase Business Combination" and, therefore, SFAS 146 has not had an impact on the Company's results of operations or financial position during the nine months ended September 30, 2003.

In January 2003, the FASB issued Interpretation No. 46, or FIN 46, "Consolidation of Variable Interest Entities." FIN 46 requires a variable interest entity to be consolidated by a company if that company is subject to a majority of the risk of loss from the variable interest entity's activities or entitled to receive a majority of the entity's residual returns or both. A variable interest entity is a corporation, partnership, trust, or any other legal structures used for business purposes that either (a) does not have equity investors with voting rights, or (b) has equity investors that do not provide sufficient financial resources for the entity to support its activities. A variable interest entity often holds financial assets, including loans or receivables, real estate or other property. A variable interest entity may be essentially passive or it may engage in research and development or other activities on behalf of another company. The consolidation requirements of FIN 46 apply immediately to variable interest entities created after January 31, 2003. FIN 46 also requires consolidation of variable interest entities entered into prior to January 31, 2003 in the first fiscal year or interim period beginning after June 15, 2003. However, the FASB issued a subsequent FASB Staff position that delays this requirement until the end of the first interim or annual period ending after December 15, 2003. Certain of the disclosure requirements apply to all financial statements issued after January 31, 2003, regardless of when the variable interest entity was established. The adoption of FIN 46 has not had an impact on the Company's financial position or results of operations during the nine months ended September 30, 2003. The Company is currently evaluating the possible impact of the adoption of FIN 46 for potential variable interest entities entered into prior to January 31, 2003.

In October 2002, the Emerging Issues Task Force reached consensus on issue 00-21, or EITF 00-21, "Revenue Arrangements with Multiple Deliverables." The principles and application guidance of EITF 00-21 should be used to determine (a) how the arrangement consideration should be measured, (b) whether the arrangement should be divided into separate units of accounting, and (c) how the arrangement consideration should be allocated among the separate units of accounting. The guidance in this issue is effective for revenue arrangements entered into in fiscal periods beginning after June 15, 2003. Effective July 1, 2003, the Company prospectively adopted the provisions of EITF 00-21.

NOTE 2. CONCENTRATIONS OF RISK

Financial instruments which subject the Company to potential risk consist of its cash equivalents, short-term investments, accounts receivable, and foreign exchange contracts. The counterparties to the agreements relating to the Company's investment securities and foreign exchange contracts consist of various major corporations and financial institutions of high credit standing. The Company believes the financial risks associated with these financial instruments are minimal. For the nine months ended September 30, 2003 and 2002, no customer accounted for more than 10% of total sales. The Company extends reasonably short collection terms but does not require collateral. The Company provides reserves for potential credit losses but has not experienced significant losses to date.

The Company's *da Vinci* Surgical System, *Hermes* Control Center, *AESOP* Endoscope Positioner and related instruments, accessories and service, accounted for all of the Company's product sales for the three months and nine months ended September 30, 2003 and 2002. Purchases of key parts and components used to manufacture the Company's products are from limited supply sources. The inability of any of these suppliers to fulfill the Company's supply requirements may negatively impact future operating results.

The Company operates in one segment, the development and marketing of products designed for use in surgery. For the three months ended September 30, 2003, U.S. and international sales accounted for 86% and 14%, respectively, of total sales. For the three months ended September 30, 2002, U.S. and international sales accounted for 90% and 10%, respectively, of total sales.

NOTE 3. ACQUISITION OF COMPUTER MOTION, INC.

On June 30, 2003, the Company acquired all of the outstanding shares of Computer Motion, Inc. through a merger of Computer Motion with a wholly owned subsidiary of Intuitive Surgical. In the merger, each outstanding share of Computer Motion common stock has converted into 0.51426943 shares of Intuitive Surgical common stock and Intuitive Surgical assumed all of Computer Motion's outstanding options and warrants to purchase Computer Motion common stock based on the same ratio. The acquisition of Computer Motion is intended to enhance the Company's combined competitive position in key industries, while strengthening its work force. It also eliminated ongoing intellectual property litigation between the two companies. The acquisition is intended to enable the Company to focus on strategic products and customers, achieve significant cost synergies and economies of scale and improve results of its combined application of robotics to minimally invasive surgery bringing benefits to patients, surgeons and medical centers throughout the world. The exchange ratio in the acquisition was derived from estimates of future revenue and earnings of the combined company, in addition to measuring the relative ownership of the combined company implied by their contributions. The purchase price of this acquisition was $148.5 million resulting from the issuance to former Computer Motion stockholders the right to receive approximately 8.0 million shares of Intuitive Surgical common stock on June 30, 2003, after giving effect to the 1-for-2 stock reverse split effected on July 1, 2003, or the Reverse Split, with a fair value of approximately $125.7 million, the assumption of options and warrants to purchase approximately 1.4 million and 0.7 million shares, respectively, of Intuitive Surgical common stock at weighted average exercise prices of $13.68 and $20.52, after giving effect to the Reverse Split, with an aggregate Black-Scholes fair value of approximately $15.7 million, the funding of Computer Motion's second quarter operations through a working capital loan in the amount of $5.3 million, and estimated direct transaction costs of $1.8 million. The fair value of the Company's common stock was derived using an average market price per share of the Company's common stock of $15.64, after giving effect to the 1-for-2 stock reverse split effected on July 1, 2003, which was based on the closing prices for a range of trading days prior to and including the date of the acquisition, June 30, 2003 (June 24, June 25, June 26, June 27, and June 30). The measurement date for this transaction was the June 30, 2003 closing date, as the number of shares to be issued to Computer Motion stockholders was not fixed until that date.

In accordance with SFAS No. 141, the Company allocated the purchase price of the acquisition to the tangible assets, liabilities and intangible assets acquired, including in-process research and development, or IPR&D, based on their estimated fair values. The excess purchase price over those fair values is recorded as goodwill. The fair value assigned to intangible assets acquired is based on valuations prepared by an independent third party appraisal firm using estimates and assumptions provided by management. The goodwill recorded as a result of the acquisition is not expected to be deductible for tax purposes. In accordance with SFAS No. 142, goodwill and purchased intangible assets with indefinite useful lives acquired after June 30, 2001 are not amortized but will be reviewed at least annually for impairment. Purchased intangible assets with finite lives are amortized on a straight-line basis over their respective useful lives. (See Note 7.)

The total purchase price was comprised of the following (in thousands):

Value of Intuitive Surgical common stock issued....	$ 125,734
Assumption of Computer Motion warrants and options.	15,703
Total value of Intuitive Surgical securities.....	141,437
Direct transaction costs.....	1,774
Bridge loan facility.....	5,302
Total estimated purchase price.....	$ 148,513

At September 30, 2003, the Company decreased its valuation of the net property, plant, and equipment acquired by $0.4 million, with an offsetting increase to goodwill, based on updated information relating to assumptions made in the Company's purchase price allocation. The following purchase price allocation is

preliminary, as future business results may differ from inherent estimates contained in the allocation, including employee severance costs, obligations related to exiting lease commitments, and other underlying assumptions. The total purchase price has been allocated as follows (in thousands):

Cash and cash equivalents	$ 1,214
Accounts receivable, net	4,476
Inventories, net	4,672
Prepaid and other assets	269
Property, plant, and equipment	1,605
Other assets	70
Amortizable intangible assets:.	
Customer relationships	1,300
Developed and core technology	6,800
Trademark	200
Internal use software	300
In-process research and development	100
Goodwill	142,995
Accounts and notes payable	(7,892)
Restructuring accrual	(3,444)
Other accrued liabilities	(2,361)
Deferred revenue	(2,225)
Deferred compensation	434
Total purchase price	$ 148,513

Goodwill

Of the total purchase price, $143.0 million was allocated to goodwill. Goodwill represents the excess of the purchase price over the fair value of the underlying net tangible and intangible assets. Goodwill is not deductible for tax purposes. In accordance with SFAS No. 142, "Goodwill and Other Intangible Assets," goodwill will not be amortized, but instead will be tested for impairment at least annually (more frequently if certain indicators are present). In the event management determines that goodwill has been impaired, the Company will incur an accounting charge for the impairment during the fiscal quarter in which the determination is made. (See Note 7.)

Amortizable Intangible Assets

Of the total purchase price, approximately $8.6 million was allocated to amortizable intangible assets, comprised of developed technology of $3.5 million, core technology of $3.3 million, customer relationships of $1.3 million, and other intangible assets totaling $0.5 million. (See Note 7.)

Developed technology, comprised of products that have reached technological feasibility, includes most of Computer Motion's current products, including Aesop, Zeus, Socrates, and Hermes. Developed technology will be amortized on a straight-line basis over a period of seven years, representing the weighted average of the remaining product lives of the developed technology.

Core technology represents the value of patents, processes, and trade secrets, including certain designs and product features that Intuitive may integrate into future products. Core technology will be amortized on a straight-line basis over a period of seven years.

Customer relationships represent the value of Computer Motion's relationships with existing customers and is valued based upon the fair value of future business with these customers. Customer relationships and other intangible assets will be amortized on a straight line basis over a period of approximately seven years.

In-process research and development

Of the total purchase price, $0.1 million was allocated to in-process research and development. Projects which qualify as IPR&D represent those that have not yet reached technological feasibility and for which no future alternative uses exist. IPR&D was immediately, fully amortized into Intuitive Surgical's results for the three months ended June 30, 2003.

Deferred Compensation

Of the total purchase price, $0.4 million was allocated to deferred compensation for unvested options assumed, which represents the intrinsic value of unvested stock options for employees and fair value for non-employees. Deferred compensation will be amortized into expense for approximately three years using the graded vesting method.

Restructuring charges

Upon the consummation of the acquisition of Computer Motion, Intuitive's management approved plans to restructure the operations of the combined entity. The current restructuring plan provides for the elimination of redundant activities and infrastructure and will result in eliminating approximately 150 employees, or 75%, of the Computer Motion positions by December 31, 2003 generally with immediate severance payment upon termination. The plan includes vacating and subleasing 78% of the leased space in Goleta, California, consolidating European operations into a single site, and closing Computer Motion's Asia office, and transitioning to the Intuitive distribution sales model for the area. The Company will have a single sales and marketing organization and consolidate all manufacturing and administrative functions in Sunnyvale, California. Based upon this plan, the Company recorded a $3.4 million accrual in accordance with EITF 95-3, "Recognition of Liabilities in Connection with a Purchase Business Combination." In accordance with EITF 95-3, the restructuring accrual has been recorded as a component of the purchase price. The accrual is comprised of $2.6 million for employee severance costs, which are expected to be substantially paid out by the end of 2003, and $0.8 million to exit existing lease commitments, based upon total future lease commitments for facilities to be vacated of $2.6 million, offset by subleasing proceeds of $1.8 million. The Company has estimated vacancy periods of between 1 month and 3 years between exiting various sites and realizing subleasing proceeds.

The following table summarizes the restructuring activitiy for the nine months ended September 30, 2003 (in thousands):

	Employee Severance	Lease Commitments	Total
Balance at December 31, 2002	$ --	$ --	$ --
Costs incurred	2,628	816	3,444
Cash payments, net of subleasing proceeds	(2,018)	(86)	(2,104)
Currency impact	(8)	--	(8)
Balance at September 30, 2003	$ 602	$ 730	$ 1,332

	=========	=========	=========	=========

Pro forma results of operations

The following unaudited pro forma financial information for the three and nine months ended September 30, 2003 and September 30, 2002 give effect to the acquisition by Intuitive Surgical of Computer Motion as if it had occurred on January 1, 2003 and January 1, 2002, respectively. The pro forma financial information excludes charges for acquired in-process research and development. The unaudited pro forma financial information is not intended to represent or be indicative of the consolidated results of operations that Intuitive would have reported had the acquisition been completed as of the dates presented, and should not be taken as representative of the future consolidated results or financial position of Intuitive Surgical.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2003	2002	2003	2002
Sales	$ 23,393	$ 21,233	$ 74,491	$ 65,036
Net loss	$ (3,353)	$ (12,726)	$ (24,277)	$ (32,947)
Net loss per share	$ (0.12)	$ (0.48)	$ (0.83)	$ (1.26)

NOTE 4. CASH AND CASH EQUIVALENTS

Intuitive Surgical considers all highly liquid investments with an original maturity from date of purchase of 90 days or less to be cash equivalents for the purpose of balance sheet and statement of cash flows presentation. The carrying value of cash and cash equivalents approximates market value at September 30, 2003 and December 31, 2002.

NOTE 5. SHORT-TERM INVESTMENTS

All short-term investments are classified as available-for-sale, and therefore, are carried at fair market value. The Company views its available-for-sale portfolio as available for use in its current operations. Accordingly, all investments are classified as short-term, even though the stated maturity date may be one year or more beyond the current balance sheet date. Available-for-sale securities are stated at fair market value based upon quoted market prices of the securities. Unrealized gains and losses on such securities are reported as a separate component of stockholders' equity. Realized gains and losses on available-for-sale securities, together with amortization of premiums and discounts on debt securities, are included in interest income. The cost of securities sold is based on the specific identification method. Interest and dividends on securities classified as available-for-sale are included in interest income.

NOTE 6. INVENTORY

Inventory consists of the following (in thousands):

	September 30, 2003	December 31, 2002
Raw materials	$ 3,285	$ 3,420
Work-in-process	2,610	780
Finished goods	6,851	4,538
	$ 12,746	$ 7,738

NOTE 7. GOODWILL AND INTANGIBLE ASSETS

Goodwill represents the excess of the purchase price over the fair value of the underlying net tangible and intangible assets. In accordance with SFAS No. 142, "Goodwill and Other Intangible Assets," goodwill and intangible assets with indefinite useful lives can no longer be amortized; however, they will be tested for impairment at least annually in the fourth quarter of each fiscal year (more frequently if certain indicators are present). Intangible assets with finite useful lives will continue to be amortized over their respective useful lives. In the event management determines that goodwill has been impaired, the Company will incur an accounting charge for the impairment during the fiscal quarter in which the determination is made. Of the total purchase price related to the acquisition of Computer Motion, $143.0 million was allocated to goodwill and $8.6 million was allocated to amortizable intangible assets, comprised of developed technology of $3.5 million, core technology of $3.3 million, customer relationships of $1.3 million, and other intangible assets totaling $0.5 million.

Other purchased intangible assets represent patents which are carried at cost less accumulated amortization. Amortization is computed using the straight-line method over the expected useful life of six or seven years.

For the three months ended September 30, 2003, in accordance with SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets," the Company impaired $0.1 million of developed technology intangible assets related to a product the Company no longer intends to produce and $0.1 million of other intangible assets related to internal software that has no future use.

At December 31, 2002, net intangible assets was $2.6 million comprised of patents with a gross value of $4.7 million and accumulated amortization of $2.1 million.

At September 30, 2003, net intangible assets is comprised of the following (in thousands):

	Gross	Accumulated Amortization	Impairment	Net
Developed Technology	$ 3,500	$ (129)	$ (93)	$ 3,278
Core Technology	3,300	(118)	--	3,182
Customer Relationships	1,300	(167)	--	1,133
Patents	4,710	(2,735)	--	1,975
Other intangible assets	500	(27)	(124)	349
Total intangible assets, net	$ 13,310	$ (3,176)	$ (217)	$ 9,917

Amortization expense related to intangible assets was $0.6 million and $1.1 million for the three and nine months ended September 30, 2003 and $0.2 million and $0.6 million for the three and nine months ended September 30, 2002.

Estimated future amortization expense related to intangible assets at September 30, 2003 is as follows (in thousands):

Fiscal Year	
2003 (remaining 3 months)	$ 526
2004	2,105
2005	2,105
2006	1,479
2007	1,248
Thereafter	2,454
Total	$ 9,917

NOTE 8. COMPREHENSIVE LOSS

The components of comprehensive loss consist of the following (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2003	2002	2003	2002
Net loss	$ (3,353)	$ (6,464)	$ (4,768)	$ (15,821)
Other comprehensive loss:				
Foreign currency translation adjustments	(13)	109	(168)	60
Change in unrealized gain (loss) on available-for-sale securities	(198)	689	(654)	847
Comprehensive loss	$ (3,564)	$ (5,666)	$ (5,590)	$ (14,914)

The components of accumulated other comprehensive income were as follows (in thousands):

	September 30, 2003	December 31, 2002
Accumulated net unrealized gain on available-for-sales securities	$ 969	$ 1,623
Foreign currency translation adjustments	(153)	15
Total accumulated other comprehensive income	$ 816	$ 1,638

NOTE 9. NET LOSS PER SHARE

The following table presents the computation of basic and diluted net loss per share (in thousands, except per share data):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2003	2002	2003	2002
Numerator used for basic and diluted net loss per common share	$ (3,353)	$ (6,464)	$ (4,768)	$ (15,821)
Denominator used for basic and diluted net loss per common share:				
Weighted-average shares outstanding	26,881	18,260	21,301	18,213
Less weighted-average shares subject to repurchase	(3)	(10)	(5)	(14)
Weighted-average shares used in computing basic and diluted net loss per common share	26,878	18,250	21,296	18,199
Basic and diluted net loss per common share	$ (0.12)	$ (0.35)	$ (0.22)	$ (0.87)

Potential common shares excluded from the computation of diluted net loss per share as their effect would be antidilutive were 4,977,000 and 3,803,000 shares respectively for the three and nine months ended September 30, 2003, and 2,556,000 and 2,440,000 shares, respectively, for the three and nine months ended September 30, 2002.

NOTE 10. PRODUCT WARRANTY PROVISIONS

The Company's standard policy is to warrant all shipped systems against defects in design, materials and workmanship by replacing failed parts during the first year of ownership. The Company's estimate of costs to service the warranty obligations is based on historical experience and current product performance trends. Prior to July 1, 2003, these costs were included in cost of goods sold at the time revenue is recognized. The warranty provision was reduced by material and labor costs used for replacement activities over the warranty period. Effective July 1, 2003, the Company adopted the provisions of EITF 00-21, "Accounting for Revenue Arrangements with Multiple Deliverables" on a prospective basis. Under EITF 00-21, for certain arrangements, a portion of the overall system price attributable to the first year service is deferred and recognized as revenue over the service period. As such, the Company no longer accrues warranty costs upon

delivery but rather recognizes warranty and related service costs as incurred. The warranty provision resulting from transactions prior to July 1, 2003 will be reduced in future periods for material and labor costs incurred as related product is returned during the warranty period or when the warranty period elapses. A review of warrany obligations is performed regularly to determine the adequacy of the reserve. Based on the outcome of this review, revisions to the estimated warranty liability are recorded as appropriate.

The following table reconciles the changes to the product warranty liability for the period indicated (in thousands):

	Balance at Beginning of Period	Warranty Usage	Warranties Expensed	Warranty Assumed in Acquisition	Balance at End of Period
Three months ended September 30, 2003.	$ 2,005	$ (674)	$ --	$ --	$ 1,331
Nine months ended September 30, 2003..	$ 2,269	$ (1,450)	$ 212	$ 300	$ 1,331

The Company from time to time enters into agreements to indemnify its customers against liability and damages arising from patent claims against the Company's product. The term of these agreements vary, but generally, a maximum obligation is not explicitly stated within the agreements. Historically, the Company has not been obligated to make any significant payments related to its customer indeminification clauses and no liabilities have been recorded for this obligation on its balance sheets as of September 30, 2003 and December 31, 2002.

NOTE 11. REVERSE STOCK SPLIT

Intuitive Surgical's stockholders approved a one-for-two reverse stock split, or the Reverse Split, on June 30, 2003 and the Reverse Split was effected on July 1, 2003. The par value of Intuitive's common stock after the Reverse Split remained at $0.001 per share. The rights of the holders of these securities were not otherwise modified. All shares outstanding and earnings per share information for all periods presented in these financial statements give effect to the Reverse Split. All shares, per share and market price data related to Intuitive's common shares outstanding and under employee stock plans reflect the retroactive effects of the Reverse Split.

NOTE 12. CONTINGENCIES

In September 2000, Brookhill-Wilk 1, LLC, or Wilk, filed a lawsuit against Intuitive Surgical in the United States District Court for the Southern District of New York (Case No. 00 Civ. 6599 (NRB)) alleging that by making, using, selling or offering for sale our *da Vinci* Surgical System, the Company is infringing United States Patent Nos. 5,217,003 and 5,368,015 in willful disregard of Wilk's patent rights. These patents concern methods and devices for "remote" surgery. In March 2001, Wilk withdrew its assertion of the '015 patent against the Company. On November 8, 2001, in response to a motion on one of Intuitive Surgical's noninfringement defenses, the District Court granted summary judgment of noninfringement of the '003 patent in the Company's favor and dismissed Wilk's complaint in its entirety without prejudice. Wilk appealed the summary judgment ruling to the U.S. Court of Appeals for the Federal Circuit. In April 2003, the Court of Appeals reversed the District Court's judgment and remanded the case for further proceedings. This reversal is based on the Court of Appeals' determination that the particular claim limitation at issue should be interpreted differently than as construed by the District Court.

Upon remand, Intuitive Surgical intends to continue to vigorously defend its rights and, if necessary, is prepared to conduct discovery and file further motions on whether the patent is infringed, valid and/or enforceable. Intuitive Surgical believes that it has multiple meritorious defenses to Wilk's allegations. However, litigation is unpredictable and Intuitive Surgical may not prevail. Both parties have expressed a desire to engage in non-binding mediation before engaging in further proceedings in the District Court. The District Court has not yet set a schedule for further proceedings if mediation is unsuccessful.

In July 2003, Wilk filed a new lawsuit against three of Intuitive Surgical's customers: Mt. Sinai Hospital, Lenox Hill Hospital and the New York and Presbyterian Hospital. Pursuant to agreements with those customers, the Company is defending the lawsuit on behalf of its customers. The Company does not expect this lawsuit to significantly impact the scope of the existing litigation with Wilk since any resolution of the existing Wilk litigation, whether on the merits or by settlement, will likely resolve this new lawsuit at the same time.

In September 2003, Wilk amended its complaint against Intuitive Surgical to include Computer Motion within the lawsuit and to allege that Computer Motion's Zeus product also infringes Wilk's '003 patent. Prior to the Company's acquisition of Computer Motion, Wilk sued Computer Motion but dismissed that lawsuit voluntarily in order to await the outcome of the appeal proceedings in Wilk's litigation with Intuitive Surgical. Intuitive Surgical believes that it has multiple meritorious defenses to Wilk's allegations against Computer Motion, including many of the same defenses that apply to Wilk's allegations against Intuitive Surgical. However, litigation is unpredictable and Intuitive Surgical may not prevail. Wilk's allegations against Computer Motion are directed only to Computer Motion products.

If the Company loses Wilk's suit against us and the three hospital customers, it will hurt our competitive position, may be costly and may prevent the Company from selling its products. If the Company loses the patent suit, it may need to obtain from Wilk a license to this technology to continue to market its products that have been found to infringe Wilk's patents. This license could be expensive, which could seriously harm the Company's business. If Wilk is successful in its suit against the Company and is unwilling to grant a license, the Company may be required to stop selling its products that are found to infringe Wilk's patents unless the Company can redesign them so they do not infringe Wilk's patents, which it may be unable to do. In addition, the Company could be required to pay Wilk damages, including treble damages, which could be substantial and harm its financial position. Due to the inherent uncertainties of litigation, however, the Company cannot accurately predict the ultimate outcome of the Wilk litigation at this time and, therefore, cannot estimate the range of possible loss.

During the second quarter of 2003, two former patients of The Valley Hospital in New Jersey filed suit against The Valley Hospital, their surgeons and Intuitive Surgical, Inc. alleging various harms caused during their surgeries. Intuitive was named because the *da Vinci* Surgical System was utilized for a portion of the surgeries and the detachable tip of an *EndoWrist* instrument is alleged to have remained in each patient after each surgery. Each suit alleges, among other things, negligence, carelessness and/or recklessness by each defendant, that the *da Vinci* Surgical System was defectively designed and manufactured, that Intuitive failed to properly instruct and train the surgeons in its use, and that the defendants failed to properly apprise the patients of the risks involved. Each suit seeks an unspecified amount of general, special and punitive damages from the defendants, in addition to a request to recover the costs of suit and attorney fees. As each suit was just recently filed, both are in very early stages and discovery has recently commenced. Due to the inherent uncertainties of the litigation, and the early stage of this case, the Company cannot accurately predict the outcome of this litigation at this time and therefore, cannot estimate the range of possible loss.

The foregoing proceedings could be expensive to litigate, may be protracted and the Company's confidential information may be compromised. Whether or not the Company is successful in these lawsuits, these proceedings could consume substantial amounts of its financial and managerial resources. At any time, the other parties may file additional claims against the Company, or the Company may file claims against them, which could increase the risk, expense and duration of the litigations. For more information on the Company's litigation with Wilk, see "Part II-Item 1: Legal Proceedings."

NOTE 13. SUBSEQUENT EVENT

On October 31, 2003, the Company sold 5,000,000 shares of newly issued common stock in an underwritten public offering at a price of $14.50 per share. The Company received net proceeds of approximately $67.7 million, after deducting the underwriting discount and offering expenses. The Company intends to use the net proceeds for general corporate purposes. The underwriters also have the option to purchase up to 750,000 additional shares at a price of $14.50 per share to cover over-allotments.

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

In this report, "Intuitive Surgical," "Intuitive," the "Company, " "we," "us," and "our" refer to Intuitive Surgical, Inc.

This Management's Discussion and Analysis of Financial Condition as of September 30, 2003 and Results of Operations for the three month and nine month periods ended September 30, 2003 and September 30, 2002 should be read in conjunction with the Management's Discussion and Analysis of Financial Condition and Results of Operations included in our Annual Report on Form 10-K/A for the year ended December 31, 2002.

Except for historical information, the discussion in this report contains forward-looking statements that involve risks and uncertainties, such as statements of our plans, objectives, expectations, and intentions. The cautionary statements made in this report should be read as applying to all related forward-looking statements wherever they appear in this report. Our actual results could differ materially from those discussed here. Factors that could cause or contribute to these differences include those discussed in "Factors Affecting Operating Results" below as well as those discussed elsewhere.

Intuitive®, da Vinci®, InSite®, EndoWrist®, Zeus®, Hermes®, and Aesop® are registered trademarks of Intuitive Surgical, Inc.

OVERVIEW

We design, manufacture and market the *da Vinci* Surgical System, an advanced surgical system that we believe represents a new generation of surgery-the third generation. The *da Vinci* Surgical System consists of a surgeon's console, a patient-side cart, a high performance vision system and proprietary "wristed" instruments. The *da Vinci* Surgical System seamlessly translates the surgeon's natural hand movements on instrument controls at a console into corresponding micro-movements of instruments positioned inside the patient through small puncture incisions, or ports. We believe that the *da Vinci* Surgical System is the only commercially available technology that can provide the surgeon with the intuitive control, range of motion, fine tissue manipulation capability and 3-D visualization characteristic of open surgery, while simultaneously allowing the surgeons to work through the small ports of minimally invasive surgery, or MIS. By placing computer-enhanced technology between the surgeon and the patient, we believe that the *da Vinci* Surgical System enables surgeons to perform better surgery in a manner never before experienced.

In 1999, we obtained permission from the European Union to affix the CE Mark to the *da Vinci* Surgical System and *EndoWrist* instruments for general surgical and cardiac surgical use. Based on this approval, we recognized revenue for the first time in the second quarter of 1999 for the sale of our products. In July 2000, we received clearance from the U.S. Food and Drug Administration, or FDA, to begin commercialization of our *da Vinci* Surgical System in the United States for use in laparoscopic surgical procedures. In March 2001, we received clearance from the FDA for use of our *da Vinci* Surgical System in non-cardiac thoracoscopic surgical procedures. In May 2001, we received market clearance from the FDA to promote use of the *da Vinci* Surgical System for performance of laparoscopic radical prostatectomy procedures. In November 2002, we received clearance from the FDA for use of the *da Vinci* Surgical System in thoracoscopically-assisted cardiotomy procedures. In January 2003, we began promoting atrial septal defect closure surgery under the November 2002 cardiotomy clearance.

To date, the majority of our revenues have come from the sales of the *da Vinci* Surgical System, which are high revenue dollar items. A smaller, but increasing, percentage of revenues come from sales of *EndoWrist* instruments and accessories and ongoing service of installed *da Vinci* Surgical Systems. During the useful life of each installed *da Vinci* Surgical Systems, we expect to generate recurring revenue through sales of the *EndoWrist* instruments and accessories and ongoing service. Although we expect the majority of our revenues to continue to come from the sale of *da Vinci* Surgical Systems over the next few years, we believe that the percentage of revenue from our *EndoWrist* instruments and accessories and service will continue to increase. The percentage of revenue derived from recurring instrument, accessory, and service revenue has grown from 23% for the quarter ended September 30, 2002 to 33% for the quarter ended September 30, 2003.

Due to the high dollar revenue per system sold, small variations in system unit sales may cause revenue to vary significantly from quarter to quarter.

ACQUISITION OF COMPUTER MOTION

In June 2003, we acquired Computer Motion, Inc. in a stock transaction pursuant to which a wholly owned subsidiary of our company merged with and into Computer Motion. In connection with the merger, each outstanding share of Computer Motion common stock was converted into the right to receive 0.51426943 of one share of our common stock prior to giving effect to our 1-for-2 reverse stock split effective July 1, 2003. In addition, we assumed all of Computer Motion outstanding options and warrants. The total purchase price was approximately $148.5 million. In connection with our acquisition of Computer Motion, all pending patent litigation between the companies was dismissed and Robert Duggan, the Chief Executive Officer and Chairman of the Board of Directors of Computer Motion, and Eric Halvorson, a director of Computer Motion, were appointed to our board of directors.

Upon the consummation of the acquisition of Computer Motion, our management approved plans to restructure the operations of the combined entity. The current restructuring plan provides for the elimination of redundant activities and infrastructure and will result in eliminating approximately 150 employees, or 75%, of the Computer Motion positions by December 31, 2003 generally with immediate severance payment upon termination. The plan includes vacating and subleasing 78% of the leased space in Goleta, California, consolidating European operations into a single site, and closing Computer Motion's Asia office, and transitioning to our distribution sales model for the area. We will have a single sales and marketing organization and consolidate all manufacturing and administrative functions in Sunnyvale, California. We expect to achieve annual pre-tax cost savings of at least $18 million to be phased in beginning in the third quarter of 2003. Based upon this plan, we have recorded a $3.4 million accrual in accordance with EITF 95-3, "Recognition of Liabilities in Connection with a Purchase Business Combination." In accordance with EITF 95-3, the restructuring accrual has been recorded as a component of the purchase price. The accrual is comprised of $2.6 million for employee severance costs, which are expected to be substantially paid out by the end of 2003, and $0.8 million to exit existing lease commitments, based upon total future lease commitments for facilities to be vacated of $2.6 million, offset by subleasing proceeds of $1.8 million. We have estimated vacancy periods of between 1 month and 3 years between exiting various sites and realizing subleasing proceeds.

As of September 30, 2003, we have made significant progress toward the implementation of our restructuring plan. We have consolidated the sales and marketing resources of the two companies into a single organization and all manufacturing and administrative functions into our Sunnyvale, California headquarters. In addition, we are currently positioned to substantially realize annual pre-tax cost savings of at least $18 million.

The following table summarizes the restructuring activity for the nine months ended September 30, 2003 (in thousands):

	Employee	Lease

	Severance	Commitments	Total
Balance at December 31, 2002	$ --	$ --	$ --
Costs incurred	2,628	816	3,444
Cash payments, net of subleasing proceeds	(2,018)	(86)	(2,104)
Currency impact	(8)	--	(8)
Balance at September 30, 2003	$ 602	$ 730	$ 1,332

RESULTS OF OPERATIONS

Sales. Total sales for the three months ended September 30, 2003 were $23.4 million, up 37% from $17.1 million for the three months ended September 30, 2002. The increase in third quarter 2003 sales was driven by continued recurring revenue growth, consisting of instruments, accessories and service. Third quarter 2003 recurring revenue totaled $7.7 million, up $3.8 million over the prior year and up $1.4 million sequentially over the second quarter of this year. Higher recurring revenue was driven by growth in the installed base of *da Vinci* Surgical Systems and the number of surgical procedures performed with the system.

We shipped 15 *da Vinci* Surgical Systems during the third quarter of 2003, compared to 14 in the third quarter of 2002. During the third quarter of 2003, we shipped 16 fourth surgical arms, after having shipped 9 fourth arms during the second quarter of 2003. Overall, third quarter 2003 system revenue increased to $15.7 million from $13.2 million during the third quarter of last year. As of September 30, 2003, there were 192 cumulative *da Vinci* Surgical Systems shipped, compared to 132 as of September 30, 2002.

Total third quarter 2003 product sales and service revenue from Computer Motion products, consisting of Aesop®, Hermes® and Zeus®, totaled $1.3 million, or 6% of total sales. We shipped five Aesop systems during the third quarter of 2003. We had no revenue from Computer Motion products in the third quarter of 2002 as the acquisition of Computer Motion was completed on June 30, 2003.

Effective July 1, 2003, we prospectively adopted the provisions of EITF 00-21, "Accounting for Revenue Arrangements with Multiple Deliverables." As a result, we deferred $1.7 million of revenue related to the fair value of the first year service for system sales delivered during the third quarter of 2003. This amount will be recognized as service revenue on a straight-line basis over the related service period, which is generally one year. Previously, in accordance with Staff Accounting Bulletin No. 101, "Revenue Recognition in Financial Statements," we accrued costs associated with these arrangements as warranty expense in the period the system was delivered and accepted. Since we adopted EITF 00-21 on a prospective basis, only third quarter results reflect the impact of this accounting change and none of the previous periods have been restated.

On a year-to-date basis, total sales for the nine months ended September 30, 2003 were $64.1 million, up 26% from $50.9 million for the nine months ended September 30, 2002. The increase was driven by continued growth in recurring revenue. Sales of instruments, accessories and service grew to $19.5 million for the nine months ended September 30, 2003 from $10.4 million for the same period last year. Overall, system revenue for the nine months ended September 30, 2003 was $44.6 million, up $4.1 million from $40.5 million for the same period last year. The increase was due primarily to sales of 26 fourth arms during 2003, compared with no sales of fourth arms in 2002 as we began shipping the product in 2003. There were 43 *da Vinci* Surgical Systems shipped during the nine months ended September 30, 2003, equal to last year's total.

Product sales for the three months ended September 30, 2003 of $20.7 million were up $5.0 million compared to $15.7 million for the three months ended September 30, 2002. The increase was primarily due to higher instrument and accessory sales of $2.5 million, resulting primarily from a larger installed base of *da Vinci* Surgical Systems in 2003, and higher systems sales of $2.5 million, resulting primarily from fourth arm sales and one incremental *da Vinci* Surgical System sale.

Product sales for the nine months ended September 30, 2003 of $57.3 million were up $9.9 million compared to $47.4 million for the nine months ended September 30, 2002. The increase was primarily due to higher instrument and accessory sales of $5.8 million, resulting from a larger installed base of *da Vinci* Surgical Systems in 2003, and additional system revenue of $4.1 million driven by incremental revenue derived from the fourth surgical arm shipments in 2003.

Service sales for the three months ended September 30, 2003 of $2.7 million were up $1.3 million from $1.4 million for the three months ended September 30, 2002. Service sales for the nine months ended September 30, 2003 of $6.8 million were up $3.3 million from $3.5 million for the nine months ended September 30, 2002. The year-over-year increases resulted from a larger base of *da Vinci* Surgical systems on annual service contracts.

Gross Profit. Total gross profit for the three months ended September 30, 2003 was $13.0 million, or 55.5% of sales, compared with $8.7 million, or 51.2% of sales for the three months ended September 30, 2002. The year-over-year improvement in gross profit percentage resulted primarily from lower product service costs related to system reliability improvements, material cost reductions, and improved factory productivity. The total gross profit percentage for the three months ended September 30, 2003 decreased on a sequential basis from 63.2% reported for the three months ended June 30, 2003 due to the impacts of the Zeus trade-in program, Zeus inventory charges, and intangible asset amortization.

Total gross profit for the nine months ended September 30, 2003 was $37.0 million, or 57.8% of sales, compared with $25.8 million, or 50.7% of sales for the nine months ended September 30, 2002. The year-over-year improvement in gross profit resulted primarily from significantly lower product service and warranty costs related to system reliability improvements and improved factory productivity.

Product sales gross profit percentage increased from 52.3% for the three months ended September 30, 2002 to 54.5% for the three months ended September 30, 2003. Product sales gross profit percentage increased from 52.2% for the nine months ended September 30, 2002 to 58.0% for the nine months ended September 30, 2003. The year over year increases resulted primarily from significantly lower warranty costs and improved factory productivity.

Service sales gross profit percentage increased from 38.1% for the three months ended September 30, 2002 to 63.2% for the three months ended September 30, 2003. Service sales gross profit percentage increased from 30.3% for the nine months ended September 30, 2002 to 56.0% for the nine months ended September 30, 2003. The year over year increases resulted primarily from lower per system service costs derived from system reliability improvements and field service organization productivity gains.

Selling, General and Administrative Expenses. Selling, general and administrative expenses for the three months ended September 30, 2003 were $12.2 million, up 5% from $11.7 million for the three months ended September 30, 2002. The year-over-year increase was primarily due to higher headcount and travel related costs of $1.7 million associated with providing sales support to a larger installed base of *da Vinci* Surgical Systems and dedicating personnel to support Computer Motion integration activities. The increase was also due to other non-recurring Computer Motion integration costs incurred during the third quarter of 2003, including customer commitments, bad debts, and audit fees totaling approximately $0.8 million and amortization and impairment of intangible assets associated with the Computer Motion acquisition of $0.3 million, offset by lower litigation expenses of $1.5 million, and the impact of charges taken for unauthorized purchases of administrative supplies incurred during the third quarter of 2002.

Selling, general and administrative expenses for the nine months ended September 30, 2003 were $31.8 million, up 5% from $30.3 million for the nine months ended September 30, 2002. The year-over-year increase was primarily due to higher headcount and travel related costs of $2.6 million associated with supporting a larger installed base of *da Vinci* Surgical Systems and integrating Computer Motion activities, and intangible asset amortization and impairment of $1.3 million, offset by lower litigation costs of $1.9 million and reduced general operating expenses.

Selling, general and administrative expenses include costs for sales, marketing and administrative personnel, tradeshow expenses, legal expenses, regulatory fees and general corporate expenses. Selling, general and administrative expenses are expected to increase in the future to support expanding business activities and integrate the Computer Motion business.

Research and Development Expenses. Research and development expenses for the three months ended September 30, 2003 were $4.4 million, up 13% from $3.9 million for the three months ended September 30, 2002. The year-over-year increase resulted primarily from additional headcount assumed in the Computer Motion acquisition.

Research and development expenses for the nine months ended September 30, 2003 were $11.5 million, down 10% from $12.8 million for the nine months ended September 30, 2002. The year-over-year decrease resulted primarily from lower project materials costs of $1.0 million and lower project consulting costs of $1.0 million, offset by costs associated with additional headcount assumed in the Computer Motion acquisition.

Research and development expenses include costs associated with the design, development, testing and enhancement of our products. These enhancements represent significant improvements to our products. Research and development expenses also include expenditures for clinical trials and purchases of laboratory supplies. Research and development costs are expensed as incurred. Research and development expenses are expected to increase in the future due to the impact of the acquisition of Computer Motion.

Deferred Compensation. We record deferred compensation as the difference between the exercise price of options granted and the fair value of our common stock at the time of grant for financial reporting purposes. Deferred compensation is amortized to research and development expense and selling, general and administrative expense. Non-cash deferred compensation expense included in research and development expenses was $0.1 million and $0.1 million for the three months ended September 30, 2003 and 2002, respectively. Non-cash deferred compensation expense included in selling, general and administrative expenses was zero and $0.1 million for the three months ended September 30, 2003 and 2002, respectively. Non-cash deferred compensation expense included in research and development expenses was $0.2 million and $0.3 million for the nine months ended September 30, 2003 and 2002, respectively. Non-cash deferred compensation expense included in selling, general and administrative expenses was $0.2 million and $0.2 million for the nine months ended September 30, 2003 and 2002, respectively. Deferred compensation related to below market options granted prior to our initial public offering ($8.9 million) was fully amortized as of June 30, 2003. In connection with our acquisition of Computer Motion, we recorded $0.4 million of deferred compensation on unvested options which began amortizing into compensation expense over approximately a three year period beginning July 1, 2003 using the graded vesting method. The amount of deferred compensation expense to be recorded in future periods may decrease if unvested options for which deferred compensation has been recorded are subsequently canceled.

Other Income. Other income for the three months ended September 30, 2003 was $0.3 million, down $0.1 million compared to $0.4 million for the three months ended September 30, 2002. The decrease resulted in reduced interest earnings on lower investment balances. Other income for the nine months ended September 30, 2003 was $1.5 million, up $0.1 million compared to $1.4 million for the nine months ended September 30, 2002. The increase resulted primarily from $0.5 million of gains realized during the first quarter of 2003 on sales of investment securities, partially offset by reduced interest earnings on lower investment balances.

LIQUIDITY AND CAPITAL RESOURCES

Our operations have been financed through the sales of our convertible preferred stock, yielding net proceeds of approximately $127.3 million, public offerings of our common stock, yielding approximately $114.5 million, and equipment financing arrangements, yielding approximately $11.0 million. The equipment arrangements provide financing at specific interest rates for periods of up to 48 months, at which time the principal is repaid to the lessors. As collateral for the equipment financing, we have granted the lessors a security interest in equipment specified under each arrangement.

As of September 30, 2003, we had working capital of $42.9 million, compared to $52.6 million as of December 31, 2002. The decrease during the nine months ended September 30, 2003 resulted primarily from the impact of the acquisition of Computer Motion, reflecting cash used to fund the second quarter 2003 Computer Motion operations of $5.3 million, restructuring costs of $3.4 million, and the negative fair value of working capital acquired of $1.0 million.

Net cash used by operating activities for the nine months ended September 30, 2003 was $10.9 million, comprised primarily of our net loss of $4.8 million and changes in net operating assets and liabilities of $10.9 million, offset by non-cash expenses of $4.8 million. Cash used by operating activities was $5.7 million less for the nine months ended September 30, 2003 compared to the nine months ended September 30, 2002 primarily due to a decrease in 2003 net loss of $11.1 million when compared to the 2002 net loss and higher non-cash expenses of $1.3 million, offset by higher use of net operating assets and liabilities of $6.7 million, mostly due to the Computer Motion acquisition.

Net cash provided by investing activities for the nine months ended September 30, 2003 of $2.0 million was $19.7 million less than $21.7 million for the nine months ended September 30, 2002 primarily due to decreased net movement into cash from short-term investments of $17.2 million resulting from a decrease in 2003 net loss of $11.1 million when compared to the 2002 net loss and general timing of conversions into cash to support short-term liquidity.

Net cash provided by financing activities was $3.9 million for the nine months ended September 30, 2003, compared to $2.7 million for the nine months ended September 30, 2002. This increase resulted from higher proceeds from issuance of common stock of $3.2 million, offset by decreased long-term borrowings of $2.0 million.

Our capital requirements depend on numerous factors, including the effects of our recently completed merger with Computer Motion, market acceptance of our products, the resources we devote to developing and supporting our products, and other factors. We expect to devote substantial capital resources to continue our research and development efforts, to expand our support and product development activities and for other general corporate activities. We believe that our current cash and short- term investment balances, together with revenue to be derived from the sale of our products, will be sufficient to fund our future operations. However, our ability to achieve these goals is subject to economic conditions and unanticipated changes in business conditions, and therefore, there can be no assurance that these results will be achieved.

On October 31, 2003, we sold 5,000,000 shares of newly issued common stock in an underwritten public offering at a price of $14.50 per share. We received net proceeds of approximately $67.7 million, after deducting the underwriting discount and offering expenses. We intend to use the net proceeds for general corporate purposes. The underwriters also have the option to purchase up to 750,000 additional shares at a price of $14.50 per share to cover over-allotments.

Contractual Obligations and Commercial Commitments

The following table summarizes all significant contractual payment obligations by payment due date:

Payments by Periods (in millions)

Contractual Obligation	Total	Under 1 Year	1-3 Years	3-5 Years	Over 5 Years
Long-term debt	$ 2.2	$ 1.3	$ .9	$ -	$ -
Building lease	13.3	3.6	9.7	-	-
Total	$ 15.5	$ 4.9	$ 10.6	$ -	$ -

CRITICAL ACCOUNTING POLICIES

We believe the following represent our critical accounting policies:

Revenue Recognition. We recognize revenue when persuasive evidence of an arrangement exists, delivery has occurred or service has been rendered, the price is fixed or determinable and collectibility is reasonably assured.

In certain cases, revenue from direct system sales is generated from multiple-element arrangements that require judgment in the areas of customer acceptance, collectibility, the separability of units of accounting, and the fair value of individual elements. Effective July 1, 2003, we adopted the provisions of Emerging Issues Task Force (EITF) Issue No. 00-21, "Revenue Arrangements with Multiple Deliverables" on a prospective basis. The principles and guidance outlined in EITF 00-21 provide a framework to (a) determine whether an arrangement involving multiple deliverables contains more than one unit of accounting and (b) determine how the arrangement consideration should be measured and allocated to the separate units of accounting in the arrangement. We determined that our multiple-element arrangements are generally comprised of the following elements that would qualify as separate units of accounting: system sales, service, installation, and training. Each of these elements represent individual units of accounting as the delivered item has value to a customer on a stand-alone basis, objective and reliable evidence of fair value exists for undelivered items, and arrangements generally do not contain a general right of return relative to the delivered item. We determine fair value based on the price of the deliverable when it is sold separately or based on third-party evidence. In accordance with the guidance in EITF 00-21, we use the residual method to allocate the arrangement consideration when we do not have fair value of the system sale. Under the residual method, the amount of consideration allocated to the delivered item equals the total arrangement consideration less the aggregate fair value of the undelivered items. Assuming all other criteria for revenue recognition have been met, we recognize revenue for system sales when delivery and acceptance occurs, for installation and training when the services are rendered, and for service ratably over the service period, which is generally one year.

Upon adoption of the provisions of EITF 00-21, we deferred $1.7 million related to the fair value of the first year service for system sales delivered during the third quarter of 2003. This amount will be recognized as service revenue on a straight-line basis over the related service period, which is generally one year. Previously, in accordance with Staff Accounting Bulletin No. 101, "Revenue Recognition in Financial Statements," we accrued costs associated with these arrangements as warranty expense in the period the system was delivered and accepted.

Our distributors do not have price protection rights. One of our distributors has return rights under limited circumstances. Such rights are accounted for under the provisions of SFAS No. 48, "Revenue Recognition When Right of Return Exists."

Revenue from sales of instruments and accessories is recognized upon delivery. Revenue related to future commitments under separately priced service contracts is deferred and recognized ratably over the service period. All costs associated with the provision of service and maintenance, including salaries, benefits, travel, spare parts and equipment, are recognized in cost of sales as incurred.

Amounts billed in excess of revenue recognized are included as deferred revenue in the accompanying consolidated balance sheets.

Our *da Vinci* Surgical System, *Hermes* Control Center and *AESOP* Endoscope Positioner contain a software component. We believe that this software element is an incidental part of each system. The software element within our products is not sold or marketed separately to customers and the software does not operate independently of each system. Furthermore, the software development effort does not require a significant cost to us relative to the overall development cost of the product. As such, the software we provide is incidental to each system as a whole and the software revenue guidance provided in SOP 97-2 is not applicable to our revenues

Allowance for Doubtful Accounts. The allowance for doubtful accounts is based upon management estimates. Factors underlying these estimates include analysis of days outstanding, customer payment history and management judgment. The allowance is adjusted periodically to reflect current data, activity, and associated risks.

Inventory Reserves. We write our inventory down for estimated obsolescence or unmarketable inventory equal to the difference between the cost of inventory and the estimated market value based upon assumptions about future demand and market conditions. If actual future demand or market conditions are less favorable than those projected by management, additional inventory write-downs may be required in the future.

Intangible Assets. We have intangible assets on our balance sheet related to the acquisition of Computer Motion and the acquisition of other patents. The valuation and classification of these assets and the assignment of useful amortization lives involves judgments and the use of estimates. The evaluation of these intangibles for impairment under established accounting guidelines is required on an ongoing basis. Changes in business conditions could potentially require future adjustments to asset valuations.

Goodwill. We have goodwill on our balance sheet relating to the acquisition of Computer Motion. Goodwill is recorded as the excess of the purchase price over the fair value of the net tangible and intangible assets acquired. Goodwill is not amortized, rather is tested for impairment at least annually. In the event we determine that goodwill has been impaired, we will record an accounting charge for the impairment during the fiscal quarter in which the determination is made.

Warranties. Effective July 1, 2003, for certain arrangements recorded under the provisions of EITF 00-21, we no longer accrue warranty costs upon delivery of the system. Actual warranty costs are expensed in the period incurred. For all other revenue arrangements, we provide for the estimated costs of product warranties at the time revenue is recognized. Our estimate of costs to service our warranty obligations is based upon historical experience and expectation of future conditions. If warranty claim activity and the costs associated with servicing those claims differ from our estimates, revisions to the estimated warranty liability may be required.

Contingencies. We are subject to proceedings, lawsuits and other claims related to our products, patents and other matters. We are required to assess the likelihood of any adverse judgments or outcomes to these matters as well as potential ranges of probable losses. A determination of the amount of reserves required, if any, for these contingencies is made after careful analysis of each individual issue. The required reserves may change in the future due to new developments in each matter or changes in approach such as a change in settlement strategy in dealing with these matters.

FACTORS AFFECTING OPERATING RESULTS

OUR FUTURE OPERATING RESULTS MAY BE BELOW SECURITIES ANALYSTS' OR INVESTORS' EXPECTATIONS, WHICH COULD CAUSE OUR STOCK PRICE TO DECLINE.

Because of our limited operating history, we have limited insight into trends that may emerge in our market and affect our business. The revenue and income potential of our market are unproven, and we may be unable to generate significant revenues. In addition, our costs may be higher than we, securities analysts or investors expect. If we fail to generate sufficient revenues or our costs are higher than we expect, our results of operations will suffer, which in turn could cause our stock price to decline. Further, future revenue from sales of our products is difficult to forecast because the market for new surgical technologies is still evolving. Our results of operations will depend upon numerous factors, including:

- the extent to which our products gain market acceptance;
- actions relating to regulatory matters;
- our timing and ability to develop our manufacturing and sales and marketing capabilities;
- demand for our products;
- the size and timing of specific sales and any collection delays related to those sales;
- the progress of surgical training in the use of our products;
- our ability to develop, introduce and market new or enhanced versions of our products on a timely basis;
- product quality problems;
- our ability to protect our proprietary rights and defend against third party challenges;
- our ability to license additional intellectual property rights;
- the integration of Computer Motion with our company;
- the progress and results of clinical trials; and
- third-party payor reimbursement policies.

Our operating results in any particular period will not be a reliable indication of our future performance. It is likely that in some future quarters, our operating results will be below the expectations of securities analysts or investors. If this occurs, the price of our common stock, and the value of your investment, will likely decline.

WE EXPERIENCE LONG AND VARIABLE SALES CYCLES, WHICH COULD HAVE A NEGATIVE IMPACT ON OUR RESULTS OF OPERATIONS FOR ANY GIVEN QUARTER.

Our *da Vinci* Surgical System has a lengthy sales and purchase order cycle because it is a major capital item and generally requires the approval of senior management at purchasing institutions. These factors may contribute to substantial fluctuations in our quarterly operating results, particularly during the periods in which our sales volume is low. Because of these fluctuations, it is likely that in some future quarters our operating results will fall below the expectations of securities analysts or investors. If that happens, the market price of our stock would likely decrease. These fluctuations also mean that you will not be able to rely upon our operating results in any particular period as an indication of future performance.

BECAUSE A SMALL NUMBER OF CUSTOMERS HAVE AND ARE LIKELY TO CONTINUE TO ACCOUNT FOR A SUBSTANTIAL PORTION OF OUR REVENUES, OUR REVENUES COULD DECLINE DUE TO THE LOSS OR DELAY OF A SINGLE CUSTOMER.

A relatively small number of customers account for a significant portion of our total revenues. During the three months ended September 30, 2003 and 2002, approximately 65% and 77%, respectively, of our revenues came from the sales of *da Vinci* Surgical Systems, which are high revenue dollar items. During the nine months ended September 30, 2003 and 2002, approximately 69% and 80%, respectively, of our revenues came from the sales of *da Vinci* Surgical Systems. During the three and nine month periods ended September 30, 2003 and 2002, no customer accounted for more than 10% of total sales. However, due to the high average selling price of the *da Vinci* Surgical System, our failure to add new customers that make significant purchases of our products could reduce our future revenues. The loss or delay of individual orders could have a significant impact on revenues and operating results.

IF OUR PRODUCTS DO NOT ACHIEVE MARKET ACCEPTANCE, WE WILL NOT BE ABLE TO GENERATE THE REVENUE NECESSARY TO SUPPORT OUR BUSINESS.

Our products represent a fundamentally new way of performing surgery. Achieving physician, patient and third-party payor acceptance of *Intuitive* surgery as a preferred method of performing surgery will be crucial to our success. If our products fail to achieve market acceptance, hospitals will not purchase our products and we will not be able to generate the revenue necessary to support our business. We believe that physicians' and third-party payors' acceptance of the benefits of procedures performed using our products will be essential for acceptance of our products by patients. Physicians will not recommend the use of our products unless we can demonstrate that they produce results comparable or superior to existing surgical techniques. Even if we can prove the effectiveness of our products through clinical trials, surgeons may elect not to use our products for any number of other reasons. For example, cardiologists may continue to recommend conventional open-heart surgery simply because such surgery is already widely accepted. In addition, surgeons may be slow to adopt our products because of the perceived liability risks arising from the use of new products and the uncertainty of reimbursement from third-party payors.

We expect that there will be a learning process involved for surgical teams to become proficient in the use of our products. Broad use of our products will require training of surgical teams. Market acceptance could be delayed by the time required to complete this training. We may not be able to rapidly train surgical teams in numbers sufficient to generate adequate demand for our products. We cannot be certain that our training programs will be cost effective or sufficient to meet our customers' needs.

WE ARE INVOLVED IN INTELLECTUAL PROPERTY LITIGATION WITH BROOKHILL-WILK 1, LLC THAT MAY HURT OUR COMPETITIVE POSITION, MAY BE COSTLY TO US AND MAY PREVENT US FROM SELLING OUR PRODUCTS.

In September 2000 Brookhill-Wilk 1, LLC, or Wilk, filed a lawsuit against Intuitive Surgical in the United States District Court for the Southern District of New York (Case No. 00 Civ. 6599 (NRB)) alleging that by making, using, selling or offering for sale our *da Vinci* Surgical System, we are infringing United States Patent Nos. 5,217,003 and 5,368,015 in willful disregard of Wilk's patent rights. These patents concern methods and devices for "remote" surgery. In March 2001, Wilk withdrew its assertion of the '015 patent against our company. In November 2001, in response to a motion on one of Intuitive Surgical's noninfringement defenses, the District Court granted summary judgment of noninfringement of the '003 patent in our favor and dismissed Wilk's complaint in its entirety without prejudice. Wilk appealed the summary judgment ruling to the U.S. Court of Appeals for the Federal Circuit. In April 2003, the Court of Appeals reversed the

District Court's judgment and remanded the case for further proceedings. This reversal is based on the Court of Appeals' determination that the particular claim limitation at issue should be interpreted differently than as construed by the District Court.

Upon remand, we intend to continue to vigorously defend our rights and, if necessary, are prepared to continue to conduct discovery and file further motions on whether the patent is infringed, valid and/or enforceable. We believe that we have multiple meritorious defenses to Wilk's allegations. However, litigation is unpredictable and we may not prevail.. Both parties have expressed a desire to engage in non-binding mediation before engaging in further proceedings in the District Court. The District Court has not yet set a schedule for further proceedings if mediation is unsuccessful.

In July 2003, Wilk filed a new lawsuit against three of our customers: Mt. Sinai Hospital, Lenox Hill Hospital and the New York and Presbyterian Hospital. Pursuant to agreements with those customers, we are defending the lawsuit on behalf of our customers. We do not expect this lawsuit to significantly impact the scope of the existing litigation with Wilk since any resolution of the existing Wilk litigation, whether on the merits or by settlement, will likely resolve this new lawsuit at the same time.

In September 2003, Wilk amended its complaint against our company to include Computer Motion within the lawsuit and to allege that Computer Motion's Zeus product also infringes Wilk's '003 patent. Prior to our acquisition of Computer Motion, Wilk sued Computer Motion but dismissed that lawsuit voluntarily in order to await the outcome of the appeal proceedings in Wilk's litigation with our company. We believe that we have multiple meritorious defenses to Wilk's allegations against Computer Motion, including many of the same defenses that apply to Wilk's allegations against our company. However, litigation is unpredictable and we may not prevail. Wilk's allegations against Computer Motion are directed only to Computer Motion products.

If we lose Wilk's suit against us and the three hospital customers, it will hurt our competitive position, may be costly to us and may prevent us from selling our products. If we lose the patent suit, we may need to obtain from Wilk a license to this technology if we are to continue to market our products that have been found to infringe Wilk's patents. This license could be expensive, which could seriously harm our business. If Wilk is successful in its suit against us and is unwilling to grant us a license, we may be required to stop selling our products that are found to infringe Wilk's patents unless we can redesign them so they do not infringe Wilk's patents, which we may be unable to do. In addition, we could be required to pay Wilk damages, including treble damages, which could be substantial and harm our financial position. Due to the inherent uncertainties of litigation, however, we cannot accurately predict the ultimate outcome of the Wilk litigation at this time and, therefore, cannot estimate the range of possible loss.

The foregoing proceeding could be expensive to litigate, may be protracted and our confidential information may be compromised. Whether or not we are successful in this lawsuit, the proceeding could consume substantial amounts of our financial and managerial resources. At any time, Wilk may file additional claims against our company, or we may file claims against Wilk, which could increase the risk, expense and duration of the litigations.

IF WE ARE UNABLE TO PROTECT THE INTELLECTUAL PROPERTY CONTAINED IN OUR PRODUCTS FROM USE BY THIRD PARTIES, OUR ABILITY TO COMPETE IN THE MARKET WILL BE HARMED.

Our commercial success will depend in part on obtaining patent and other intellectual property protection for the technologies contained in our products, and on successfully defending our patents and other intellectual property against third party challenges. We will incur substantial costs in obtaining patents and, if necessary, defending our proprietary rights. The patent positions of medical device companies, including ours, can be highly uncertain and involve complex and evolving legal and factual questions. We do not know whether we will obtain the patent protection we seek, or that the protection we do obtain will be found valid and enforceable if challenged. We also do not know whether we will be able to develop additional patentable proprietary technologies. If we fail to obtain adequate protection of our intellectual property, or if any protection we obtain is reduced or eliminated, others could use our intellectual property without compensating us, resulting in harm to our business. We may also determine that it is in our best interests to voluntarily challenge a third party's products or patents in litigation or administrative proceedings, including patent interferences or reexaminations. In addition, the laws of certain foreign countries do not protect intellectual property rights to the same extent as do the laws of the United States.

OTHERS MAY ASSERT THAT OUR PRODUCTS INFRINGE THEIR INTELLECTUAL PROPERTY RIGHTS, WHICH MAY CAUSE US TO ENGAGE IN COSTLY DISPUTES AND, IF WE ARE NOT SUCCESSFUL IN DEFENDING OURSELVES, COULD ALSO CAUSE US TO PAY SUBSTANTIAL DAMAGES AND PROHIBIT US FROM SELLING OUR PRODUCTS.

We are aware of both United States and foreign patents issued to third parties that relate to computer-assisted surgery, remote surgery, and minimally invasive surgery. Some of these patents on their face appear broad enough to cover one or more aspects of our present technology, and may cover aspects of our future technology. We do not know whether any of these patents, if challenged, would be held valid, enforceable and infringed. From time to time, we receive, and likely will continue to receive, letters from third parties inviting us to license their patents. We may be sued by, or become involved in an administrative proceeding with, one or more of these third parties. We cannot assure you that a court or administrative body would agree with any arguments or defenses we have concerning invalidity, unenforceability or noninfringement of any third-party patent. In addition to the issued patents of which we are aware, other parties may have filed, and in the future are likely to file, patent applications covering surgical products that are similar or identical to ours. We cannot assure you that any patents issuing from applications filed by a third party will not cover our products or will not have priority over our patent applications.

The medical device industry has been characterized by extensive litigation and administrative proceedings regarding patents and other intellectual property rights, and companies have employed such actions to gain a competitive advantage. If third parties assert infringement or other intellectual property claims against us as Brookhill-Wilk 1, LLC has, our technical and management personnel will experience a significant diversion of time and effort and we will incur large expenses defending our company. If third parties in any patent action are successful, our patent portfolio may be damaged, we may have to pay substantial damages, including treble damages, and we may be required to stop selling our products or obtain a license which, if available at all, may require us to pay substantial royalties. We cannot be certain that we will have the financial resources or the substantive arguments to defend our patents from infringement or claims of invalidity or unenforceability, or to defend against allegations of infringement of third-party patents. In addition, any public announcements related to litigation or administrative proceedings initiated by us, or initiated or threatened against us, could cause our stock price to decline.

THE RIGHTS AND MEASURES WE RELY ON TO PROTECT THE INTELLECTUAL PROPERTY UNDERLYING OUR PRODUCTS MAY NOT BE ADEQUATE TO PREVENT THIRD PARTIES FROM USING OUR TECHNOLOGY, WHICH COULD HARM OUR ABILITY TO COMPETE IN THE MARKET.

In addition to patents, we typically rely on a combination of trade secret, copyright and trademark laws, nondisclosure agreements and other contractual provisions and technical security measures to protect our intellectual property rights. Nevertheless, these measures may not be adequate to safeguard the technology underlying our products. If they do not protect our rights adequately, third parties could use our technology, and our ability to compete in the market would be reduced. In addition, employees, consultants and others who participate in developing our products may breach their agreements with us regarding our intellectual property, and we may not have adequate remedies for the breach. We also may not be able to effectively protect our intellectual property rights in some foreign countries. For a variety of reasons, we may decide not to file for patent, copyright or trademark protection outside the United States. We also realize that our trade secrets may become known through other means not currently foreseen by us. Notwithstanding our efforts to protect our intellectual property, our

competitors may independently develop similar or alternative technologies or products that are equal or superior to our technology and products without infringing any of our intellectual property rights, or may design around our proprietary technologies.

OUR PRODUCTS RELY ON LICENSES FROM THIRD PARTIES, AND IF WE LOSE ACCESS TO THESE TECHNOLOGIES, OUR REVENUES COULD DECLINE.

We rely on technology that we license from others, including technology that is integral to our products. We have entered into license agreements with SRI International, IBM Corporation, MIT, Olympus Optical Co., Ltd., and Heartport, Inc., now part of Johnson & Johnson. Any of these agreements may be terminated for breach. If any of these agreements is terminated, we may be unable to reacquire the necessary license on satisfactory terms, or at all. The loss or failure to maintain these licenses could prevent or delay further development or commercialization of our products.

PUBLIC ANNOUNCEMENTS OF LITIGATION EVENTS MAY CAUSE OUR STOCK PRICE TO DECLINE.

During the course of our administrative proceedings and/or lawsuits, there may be public announcements of the results of hearings, motions, and other interim proceedings or developments in the litigation. If securities analysts or investors perceive these results to be negative, it could have a substantial negative effect on the trading price of our stock.

OUR PRODUCTS ARE SUBJECT TO A LENGTHY AND UNCERTAIN DOMESTIC REGULATORY PROCESS. IF WE DO NOT OBTAIN AND MAINTAIN THE NECESSARY DOMESTIC REGULATORY APPROVALS, WE WILL NOT BE ABLE TO MARKET AND SELL OUR PRODUCTS IN THE UNITED STATES.

Our products and operations are subject to extensive regulation in the United States by the U.S. Food and Drug Administration, or FDA. The FDA regulates the research, testing, manufacturing, safety, labeling, storage, recordkeeping, promotion, distribution and production of medical devices in the United States to ensure that medical products distributed domestically are safe and effective for their intended uses. In order for us to market certain products for use in the United States, we generally must first obtain clearance from the FDA pursuant to Section 510(k) of the Federal Food, Drug, and Cosmetic Act, or FFDCA. Clearance under Section 510(k) requires demonstration that a new device is substantially equivalent to another device with 510(k) clearance or grandfather status. If we significantly modify our products after they receive FDA clearance, the FDA may require us to submit a separate 510(k) or premarket approval application, or PMA, for the modified product before we are permitted to market the products in the U.S. In addition, if we develop products in the future that are not considered to be substantially equivalent to a device with 510(k) clearance or grandfather status, we will be required to obtain FDA approval by submitting a PMA.

The FDA may not act favorably or quickly in its review of our 510(k) or PMA submissions, or we may encounter significant difficulties and costs in our efforts to obtain FDA clearance or approval, all of which could delay or preclude sale of new products in the United States. Furthermore, the FDA may request additional data or require us to conduct further testing, or compile more data, including clinical data and clinical studies, in support of a 510(k) submission. The FDA may also, instead of accepting a 510(k) submission, require us to submit a PMA, which is typically a much more complex and burdensome application than a 510(k). To support a PMA, the FDA would likely require that we conduct one or more clinical studies to demonstrate that the device is safe and effective. We may not be able to meet the requirements to obtain 510(k) clearance or PMA approval, or the FDA may not grant any necessary clearances or approvals. In addition, the FDA may place significant limitations upon the intended use of our products as a condition to a 510(k) clearance or PMA approval. Product applications can also be denied or withdrawn due to failure to comply with regulatory requirements or the occurrence of unforeseen problems following clearance or approval. Any delays or failure to obtain FDA clearance or approvals of new products we develop, any limitations imposed by the FDA on new product use, or the costs of obtaining FDA clearance or approvals could have a material adverse effect on our business, financial condition and results of operations.

In order to conduct a clinical investigation involving human subjects for the purpose of demonstrating the safety and effectiveness of a device, a company must, among other things, apply for and obtain Institutional Review Board, or IRB approval of the proposed investigation. In addition, if the clinical study involves a "significant risk" (as defined by the FDA) to human health, the sponsor of the investigation must also submit and obtain FDA approval of an investigational device exemption, or IDE, application. Most of our products to date have been considered significant risk devices requiring IDE approval prior to investigational use. We may not be able to obtain FDA and/or IRB approval to undertake clinical trials in the U.S. for any new devices we intend to market in the United States in the future. If we obtain such approvals, we may not be able to comply with the IDE and other regulations governing clinical investigations or the data from any such trials may not support clearance or approval of the investigational device. Failure to obtain such approvals or to comply with such regulations could have a material adverse effect on our business, financial condition and results of operations.

COMPLYING WITH FDA REFULATIONS IS AN EXPENSIVE AND TIME-CONSUMING PROCESS, AND OUR FAILURE TO COMPLY FULLY COULD SUBJECT US TO SIGNIFICANT ENFORCEMENT SANCTIONS.

Because our products, including the *da Vinci* Surgical System, are commercially distributed, numerous postmarket regulatory requirements apply, including the following:

- Quality System Regulation, or QSR, which requires manufacturers to follow elaborate design, testing, control, documentation and other quality assurance procedures during the manufacturing process;
- labeling regulations;
- the FDA's general prohibition against false or misleading statements in the labeling or promotion of products for unapproved or "off-label" uses;
- the Reports of Corrections and Removals regulation, which requires that manufacturers report to the FDA recalls and field corrective actions taken to reduce a risk to health or to remedy a violation of the FFDCA that may pose a risk to health; and
- the Medical Device Reporting regulation, which requires that manufacturers report to the FDA if their device may have caused or contributed to a death or serious injury or malfunctioned in a way that would likely cause or contribute to a death or serious injury if it were to recur.

We are subject to inspection and marketing surveillance by the FDA to determine our compliance with regulatory requirements. If the FDA finds that we have failed to comply, it can institute a wide variety of enforcement actions, ranging from a regulatory letter to a public warning letter to more severe civil and criminal sanctions. Our failure to comply with applicable requirements could lead to an enforcement action that may have an adverse effect on our financial condition and results of operations.

We have modified the labeling, advertising and user training for the *da Vinci* Surgical System to call out specific procedures that we believe are within the scope of our existing 510(k) clearances. We cannot assure you that the FDA would agree that all such specific procedures are within the scope of the existing general clearance or that we have compiled adequate information to support the safety and efficacy of using the *da Vinci* Surgical System for all such specific procedures. We also have modified the hardware and software in the *da Vinci* Surgical System since clearance in ways that we believe do not require new 510(k) clearance. We cannot assure you that the FDA would agree with our determinations not to seek new 510(k) clearance for any of these changes. Computer Motion also modified the hardware and software in its products subsequent to 510(k) clearance without seeking new clearance. We cannot assure you that the FDA would agree with the determinations not to seek new 510(k) clearance for any of these changes. The FDA could impose enforcement sanctions and/or require us to

obtain 510(k) clearance for any modification to our products or Computer Motion's products. We may be prohibited from marketing the modified device until such 510(k) clearance is granted.

In December 2002, the FDA inspected our Sunnyvale manufacturing facility and issued a Form FDA 483 setting forth three observed compliance deficiencies relating to the QSR and two observed deficiencies relating to the Reports of Corrections and Removals regulation. In January 2003, we wrote to the FDA indicating our response to each observation with proposed corrective actions. That same month, the FDA informed us that the adequacy of our promised corrections and actions would be verified during the next inspection of our facility. To date, the FDA has not returned for another inspection and we continue to evaluate and upgrade our QSR compliance. We cannot assure you that, upon reinspection, the FDA will find that our promised corrective actions are appropriate or that they have been adequately implemented. We also cannot assure you that the FDA will not find other deficiencies in our compliance with the QSR and other postmarket regulations.

We recently acquired Computer Motion and are working to integrate its FDA compliance system with our own. Our review is not complete, but we believe that Computer Motion likely has had deficiencies in QSR compliance, complaint handling, MDR reporting and Corrections and Removals reporting in the last several years that will require submission of retroactive reports to the FDA. We are also reviewing whether Computer Motion responded to complaints with appropriate follow up. We cannot assure you that the FDA will not seek to impose enforcement sanctions on us for Computer Motion violations preceding our acquisition of Computer Motion, that the FDA will agree that since the acquisition we have corrected all regulatory problems, or that our review of Computer Motion's complaint handling will not lead us to initiate recalls or field actions to remedy problems with Computer Motion products already in the field.

OUR PRODUCTS ARE SUBJECT TO VARIOUS INTERNATIONAL REGULATORY PROCESSES AND APPROVAL REQUIREMENTS. IF WE DO NOT OBTAIN AND MAINTAIN THE NECESSARY INTERNATIONAL REGULATORY APPROVALS, WE WILL NOT BE ABLE TO MARKET AND SELL OUR PRODUCTS IN FOREIGN COUNTRIES.

To be able to market and sell our products in other countries, we must obtain regulatory approvals and comply with the regulations of those countries. These regulations, including the requirements for approvals, and the time required for regulatory review vary from country to country. Obtaining and maintaining foreign regulatory approvals are expensive, and we cannot be certain that we will receive regulatory approvals in any foreign country in which we plan to market our products. If we fail to obtain regulatory approval in any foreign country in which we plan to market our products, our ability to generate revenue will be harmed.

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. In January 1999, we received permission to affix the CE mark to our *da Vinci* Surgical System and *EndoWrist* instruments.

If we modify existing products or develop new products in the future, including new instruments, we may need to apply for permission to affix the CE mark to such products. In addition, we will be subject to annual regulatory audits in order to maintain the CE mark permissions we have already obtained. We cannot be certain that we will be able to obtain permission to affix the CE mark for new or modified products or that we will continue to meet the quality and safety standards required to maintain the permissions we have already received. If we are unable to maintain permission to affix the CE mark to our products, we will no longer be able to sell our products in member countries of the European Union.

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

Domestic institutions will typically bill the services performed with our products to various third-party payors, such as Medicare, Medicaid and other government programs and private insurance plans. If hospitals do not obtain sufficient reimbursement from third-party payors for procedures performed with our products, or if government and private payors' policies do not permit reimbursement for surgical procedures performed using our products, we may not be able to generate the revenues necessary to support our business. Our success in international markets also depends upon the eligibility of our products for reimbursement through government-sponsored health care payment systems and third-party payors. Reimbursement practices vary significantly by country. Many international markets have government-managed healthcare systems that control reimbursement for new products and procedures. Other foreign markets have both private insurance systems and government-managed systems that control reimbursement for new products and procedures. Market acceptance of our products may depend on the availability and level of reimbursement in any country within a particular time. In addition, health care cost containment efforts similar to those we face in the United States are prevalent in many of the other countries in which we intend to sell our products and these efforts are expected to continue.

BECAUSE OUR MARKETS ARE HIGHLY COMPETITIVE, CUSTOMERS MAY CHOOSE TO PURCHASE OUR COMPETITORS' PRODUCTS OR MAY NOT ACCEPT INTUITIVE SURGERY, WHICH WOULD RESULT IN REDUCED REVENUE AND LOSS OF MARKET SHARE.

Intuitive surgery is a new technology that must compete with established minimally invasive surgery and open surgery. These procedures are widely accepted in the medical community and in many cases have a long history of use. We also face competition from several companies that are developing new approaches and products for the minimally invasive surgery market. In addition, we may face competition from companies that develop robotic and computer-assisted surgical systems in the future. Our revenues may be reduced or eliminated if our competitors develop and market products that are more effective or less expensive than our products. If we are unable to compete successfully, our revenues will suffer. We may not be able to maintain or improve our competitive position against current or potential competitors, especially those with greater resources.

In many cases, the medical conditions that can be treated using our products can also be treated by drugs or other medical devices and procedures. Many of these alternative treatments are also widely accepted in the medical community and have a long history of use. In addition, technological advances could make such treatments more effective or less expensive than using our products, which could render our products obsolete or unmarketable. We cannot be certain that physicians will use our products to replace or supplement established treatments or that our products will be competitive with current or future technologies.

IF DEFECTS ARE DISCOVERED IN OUR PRODUCTS, WE MAY INCUR ADDITIONAL UNFORESEEN COSTS, HOSPITALS MAY NOT PURCHASE OUR PRODUCTS AND OUR REPUTATION MAY SUFFER.

Our products incorporate mechanical parts and computer software, either of which can contain errors or failures, especially when first introduced. In addition, new products or enhancements may contain undetected errors or performance problems that, despite testing, are discovered only after commercial shipment. Because our products are designed to be used to perform complex surgical procedures, we expect that our customers will have an increased sensitivity to such defects. We cannot assure you that our products will not experience errors or performance problems in the future. If we experience flaws or performance problems, any of the following could occur:

- delays in product shipments;
- loss of revenue;

- delay in market acceptance;
- diversion of our resources;
- damage to our reputation;
- increased service or warranty costs; or
- product liability claims.

WE HAVE LIMITED EXPERIENCE IN MANUFACTURING OUR PRODUCTS AND MAY ENCOUNTER MANUFACTURING PROBLEMS OR DELAYS THAT COULD RESULT IN LOST REVENUE.

We have manufactured a limited number of our products for sales to customers. We may be unable to establish or maintain reliable, high-volume manufacturing capacity. Even if this capacity can be established and maintained, the cost of doing so may increase the cost of our products and reduce our ability to compete. We may encounter difficulties in scaling up production of our products, including:

- problems involving production yields;
- quality control and assurance;
- component supply shortages;
- shortages of qualified personnel; and
- compliance with state, federal and foreign regulations.

Manufacturing our products is a complex process. If demand for our products exceeds our manufacturing capacity, we could develop a substantial backlog of customer orders. If we are unable to establish and maintain larger-scale manufacturing capabilities, our ability to generate revenues will be limited and our reputation in the marketplace would be damaged.

IF OUR MANUFACTURING FACILITIES DO NOT CONTINUE TO MEET FEDERAL, STATE OR EUROPEAN MANUFACTURING STANDARDS, WE MAY BE REQUIRED TO TEMPORARILY CEASE ALL OR PART OF OUR MANUFACTURING OPERATIONS, WHICH COULD RESULT IN PRODUCT DELIVERY DELAYS AND LOST REVENUE.

Our manufacturing facilities are subject to periodic inspection by regulatory authorities and our operations will continue to be regulated by the FDA for compliance with Good Manufacturing Practice requirements contained in the FDA's Quality System Regulations, or QSR. We are also required to comply with International Organization for Standardization, or ISO, quality system standards in order to produce products for sale in Europe. If we fail to continue to comply with Good Manufacturing Practice requirements or ISO standards, we may be required to cease all or part of our operations until we comply with these regulations. We are currently in compliance with ISO standards. The FDA inspected our Mountain View and Sunnyvale facilities in March 2000 and December 2002, respectively. The Good Manufacturing Practice issues raised by the FDA during the inspections either were satisfactorily resolved with the FDA, or we believe can be resolved by us to the FDA's satisfaction, although we cannot assure you that we will be able to do so. We continue to be subject to FDA inspections at any time. Maintaining such compliance is difficult and costly. We cannot be certain that our facilities will be found to comply with Good Manufacturing Practice requirements or ISO standards in future inspections and audits by regulatory authorities.

The FDA inspected the Goleta facilities of Computer Motion in 1998 and noted deficiencies in Computer Motion's systems for reviewing and reporting product-related complaints and defect information. We have determined that these deficiencies may not have been addressed. While the Goleta manufacturing facility has been closed and production of certain product has been transferred to our Sunnyvale facility, these issues raised by the FDA must nonetheless be resolved. We are presently addressing the situation to resolve all the issues to our own and the FDA's satisfaction, although we cannot assure you that we will be able to do so, nor can we assess what regulatory impact, if any this may have on our company.

The state of California also requires that we maintain a license to manufacture medical devices. Our facilities and manufacturing processes were inspected in February 1998. In March 1998, we passed the inspection and received a device manufacturing license from the California Department of Health Services. In March 2002, our facilities and manufacturing processes in our Sunnyvale facility were re-inspected by the Food and Drug Branch, or FDB, and we were issued an updated device manufacturing license for our Sunnyvale facility. We are subject to periodic inspections by the California Department of Health Services and, if we are unable to maintain this license following any future inspections, we will be unable to manufacture or ship any products.

OUR RELIANCE ON SOLE AND SINGLE SOURCE SUPPLIERS COULD HARM OUR ABILITY TO MEET DEMAND FOR OUR PRODUCTS IN A TIMELY MANNER OR WITHIN BUDGET.

Some of the components necessary for the assembly of our products are currently provided to us by sole source suppliers or single source suppliers. We purchase components through purchase orders rather than long-term supply agreements and generally do not maintain large volumes of inventory. The disruption or termination of the supply of components could cause a significant increase in the costs of these components, which could affect our profitability. A disruption or termination in the supply of components could also result in our inability to meet demand for our products, which could harm our ability to generate revenues, lead to customer dissatisfaction and damage our reputation. Furthermore, if we are required to change the manufacturer of a key component of our products, we may be required to verify that the new manufacturer maintains facilities and procedures that comply with quality standards and with all applicable regulations and guidelines. The delays associated with the verification of a new manufacturer could delay our ability to manufacture our products in a timely manner or within budget.

THE USE OF OUR PRODUCTS COULD RESULT IN PRODUCT LIABILITY CLAIMS THAT COULD BE EXPENSIVE, DIVERT MANAGEMENT'S ATTENTION AND HARM OUR BUSINESS.

Our business exposes us to significant risks of product liability claims. The medical device industry has historically been litigious, and we face financial exposure to product liability claims if the use of our products were to cause injury or death. There is also the possibility that defects in the design or manufacture of our products might necessitate a product recall. Although we maintain product liability insurance, the coverage limits of these policies may not be adequate to cover future claims. Particularly as sales of our products increase, we may be unable to maintain product liability insurance in the future at satisfactory rates or in adequate amounts. A product liability claim, regardless of its merit or eventual outcome, could result in significant legal defense costs. A product liability claim or any product recalls could also harm our reputation or result in a decline in revenues.

During the second quarter of 2003, two former patients of The Valley Hospital in New Jersey filed suit against The Valley Hospital, their surgeons and Intuitive Surgical, Inc. alleging various harms caused during their surgeries. Intuitive was named because the *da Vinci* Surgical System was utilized for a portion of the surgeries and the detachable tip of an *EndoWrist* instrument is alleged to have remained in each patient after each surgery. Each suit alleges, among other things, negligence, carelessness and/or recklessness by each defendant, that the *da Vinci* Surgical System was defectively designed and manufactured, that we failed to properly instruct and train the surgeons in its use, and that the defendants failed to properly apprise the patients of the risks involved. Each suit seeks an unspecified amount of general, special and punitive damages from the defendants, in addition to a request to recover the costs of suit and attorney fees. As each suit was just recently filed, both are in very early stages and discovery has recently commenced.

IF WE LOSE OUR KEY PERSONNEL OR ARE UNABLE TO ATTRACT AND RETAIN ADDITIONAL PERSONNEL, OUR ABILITY TO COMPETE WILL BE HARMED.

We are highly dependent on the principal members of our management and scientific staff. Our product development plans depend, in part, on our ability to attract and retain engineers with experience in mechanics, software and optics. Attracting and retaining qualified personnel will be critical to our success, and competition for qualified personnel is intense. We may not be able to attract and retain personnel on acceptable terms given the competition for such personnel among technology and healthcare companies, and universities. The loss of any of these persons or our inability to attract and retain qualified personnel could harm our business and our ability to compete.

INTERNATIONAL SALES OF OUR PRODUCTS ACCOUNT FOR A SIGNIFICANT PORTION OF OUR REVENUES, WHICH EXPOSES US TO RISKS INHERENT IN INTERNATIONAL OPERATIONS. OUR GROWTH MAY BE LIMITED IF WE ARE UNABLE TO SUCCESSFULLY MANAGE OUR INTERNATIONAL ACTIVITIES.

Our business currently depends in large part on our activities in Europe and other foreign markets. Sales to markets outside of the United States accounted for approximately 14% of our sales for the three months ended September 30, 2003 and 10% for the three months ended September 30, 2002. Sales to markets outside of the United States accounted for approximately 21% of our sales for the nine months ended September 30, 2003 and 15% for the nine months ended September 30, 2002.

We are subject to a number of challenges that specifically relate to our international business activities. These challenges include:

- failure of local laws to provide the same degree of protection against infringement of our intellectual property;
- protectionist laws and business practices that favor local competitors, which could slow our growth in international markets;
- the risks associated with foreign currency exchange rate fluctuation;
- the expense of establishing facilities and operations in new foreign markets; and
- building an organization capable of supporting geographically dispersed operations.

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

TERMINATION OF RELATIONSHIPS WITH FORMER DISTRIBUTORS OF COMPUTER MOTION COULD RESULT IN LITIGATION.

Our integration strategy related to our acquisition of Computer Motion provides that we terminate Computer Motion's relationships with a number of companies that served as Computer Motion's distributors prior to the acquisition. Several of these former distributors have informed us that they believe that they are entitled to compensation in connection with such termination. We may be unable to resolve these claims without litigation. Due to the inherent uncertainties of litigation, we cannot accurately predict the ultimate outcome of any such litigation at this time and, therefore, cannot estimate the range of possible loss. If we sue or are sued by any of Computer Motion's former distributors, these proceddings could be expensive to litgate, may be protracted and Comptuer Motion's confidential information may be compromised. Whether or not we are successful in these lawsuits, these proceedings could consume substantial amounts of our financial and managerial resources.

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 COMPUTER MOTION.

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

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We are not subject to any meaningful market risks related to currency, commodity prices or similar matters. We are sensitive to short-term interest rate fluctuations to the extent that such fluctuations impact the interest income we receive on the investment of the remaining proceeds from our public offerings.

The primary objective of our investment activities is to preserve principal while at the same time maximizing the income we receive from our investments without significantly increasing risk. Some of the securities that we invest in may have market risk. This means that a change in prevailing interest rates may cause the principal amount of the investment to fluctuate. For example, if we hold a security that was issued with a fixed interest rate at the then-prevailing rate and the prevailing interest rate later rises, the principal amount of our investment will probably decline. To minimize this risk in the future, we intend to maintain our portfolio of cash equivalents and short-term investments in a variety of securities. We classify our cash equivalents and marketable securities as "fixed-rate" if the rate of return on such instruments remains fixed over their term. These "fixed-rate" investments include commercial paper and government and non-government debt securities. We classify our cash equivalents and marketable securities as "variable-rate" if the rate of return on such investments varies based on the change in a predetermined index or set of indices during their term. These "variable-rate" investments primarily include money market accounts. The average time to maturity of all of our investments as of September 30, 2003 was approximately 1.69 years. At September 30, 2003, approximately 11% of our investment portfolio was composed of investments with original maturities of one year or less.

ITEM 4. CONTROLS AND PROCEDURES

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

As required by SEC Rule 13a-15(b), we carried out an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures as of the end of the quarter covered by this report. Based on the foregoing, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective at the reasonable assurance level.

There has been no change in our internal controls over financial reporting during our most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, our internal controls over financial reporting.

PART II. - OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

BROOKHILL-WILK 1, LLC

In September 2000, Brookhill-Wilk 1, LLC, or Wilk, filed a lawsuit against Intuitive Surgical in the United States District Court for the Southern District of New York (Case No. 00 Civ. 6599 (NRB)) alleging that by making, using, selling or offering for sale our *da Vinci* Surgical System, we are infringing United States Patent Nos. 5,217,003 and 5,368,015 in willful disregard of Wilk's patent rights. These patents concern methods and devices for "remote" surgery. In March 2001, Wilk withdrew its assertion of infringement of the '015 patent against our Company. In November 2001, in response to a motion on one of Intuitive Surgical's noninfringement defenses, the District Court granted summary judgment of noninfringement of the '003 patent in our favor and dismissed Wilk's complaint in its entirety without prejudice. Wilk appealed the summary judgment ruling to the U.S. Court of Appeals for the Federal Circuit. In April 2003, the Court of Appeals reversed the District Court's judgment and remanded the case for further proceedings. This reversal is based on the Court of Appeals' determination that the particular claim limitation at issue should be interpreted differently than as construed by the District Court.

Upon remand, we intend to continue to vigorously defend our rights and, if necessary, are prepared to continue to conduct discovery and file further motions on whether the patent is infringed, valid and/or enforceable. We believe that we have multiple meritorious defenses to Wilk's allegations. However, litigation is unpredictable and we may not prevail. Both parties have expressed a desire to engage in non-binding mediation before engaging in further proceedings in the District Court. The District Court has not yet set a schedule for further proceedings if mediation is unsuccessful.

In July 2003, Wilk filed a new lawsuit against three of Intuitive Surgical's customers: Mt. Sinai Hospital, Lenox Hill Hospital and the New York and Presbyterian Hospital. Pursuant to agreements with those customers, the Company is defending the lawsuit on behalf of its customers. The Company does not expect this lawsuit to significantly impact the scope of the existing litigation with Wilk since any resolution of the existing Wilk litigation, whether on the merits or by settlement, will likely resolve this new lawsuit at the same time.

In September 2003, Wilk amended its complaint against Intuitive Surgical to include Computer Motion within the lawsuit and to allege that Computer Motion's Zeus product also infringes Wilk's '003 patent. Prior to the Company's acquisition of Computer Motion, Wilk sued Computer Motion but dismissed that lawsuit voluntarily in order to await the outcome of the appeal proceedings in Wilk's litigation with Intuitive Surgical. Intuitive Surgical believes that it has multiple meritorious defenses to Wilk's allegations against Computer Motion, including many of the same defenses that apply to Wilk's allegations against Intuitive Surgical. However, litigation is unpredictable and Intuitive Surgical may not prevail. Wilk's allegations against Computer Motion are directed only to Computer Motion products.

If we lose Wilk's suit against us and the three hospital customers, it will hurt our competitive position, may be costly to us and may prevent us from selling our products. If we lose the patent suit, we may need to obtain from Wilk a license to this technology if we are to continue to market our products that have been found to infringe Wilk's patents. This license could be expensive, which could seriously harm our business. If Wilk is successful in its suit against us and is unwilling to grant us a license, we may be required to stop selling our products that are found to infringe Wilk's patents unless we can redesign them so they do not infringe Wilk's patents, which we may be unable to do. In addition, we could be required to pay Wilk damages, including treble damages, which could be substantial and harm our financial position. Due to the inherent uncertainties of litigation, however, the Company cannot accurately predict the ultimate outcome of the Wilk litigation at this time and, therefore, cannot estimate the range of possible loss.

OTHER LEGAL MATTERS

In September 2002, we discovered that one of our employees had purchased approximately $0.9 million in administrative supplies without the authorization or knowledge of the Company's management. This matter was investigated by law enforcement authorities and Company advisors. We have since terminated this employee's employment and have taken actions intended to ensure that no similar incidents can occur in the future, including implementing additional controls relating to our cash disbursement process. In addition, we are seeking to recover our loss. We have filed a claim with our insurance carrier, from which we received proceeds of $0.5 million, and filed suit against the sellers of the administrative supplies in December 2002. Our complaint alleged that each of the defendants has (i) violated various sections of the Racketeer Influenced and Corrupt Organization, or RICO, Act through their extortion, coercion, intimidation, fraud, bribery and racketeering activity in connection with the unauthorized purchase of office supplies, and (ii) committed unlawful business acts and practices in violation of Cal. Bus. & Prof. Code Section 17200 et seq. Our suit seeks to recover actual and treble damages, costs and attorney fees for the damage caused by each of defendants through their illegal conduct. In January 2003, we amended our complaint to allege that each defendant further unlawfully offered prizes and gifts in violation of Cal. Bus. & Prof. Code Section 17537 and unlawfully failed to advertise limitations on the quantity of its sales in violation of Cal. Bus. & Prof. Code Section 17500.5. The amended complaint reiterates our claim to recover actual and treble damages, costs and attorney fees. Discovery has not yet begun. Defendants have demurred to the complaint, alleging that the complaint does not contain sufficiently pled information to support each of Intuitive's causes of action. The Court will resolve the demurrer before the case continues.

During the second quarter of 2003, two former patients of The Valley Hospital in New Jersey filed suit against The Valley Hospital, their surgeons and our company alleging various harms caused during their surgeries. Intuitive was named because the *da Vinci* Surgical System was utilized for a portion of the surgeries and the detachable tip of an *EndoWrist* instrument is alleged to have remained in each patient after each surgery. Each suit alleges, among other things, negligence, carelessness and/or recklessness by each defendant, that the *da Vinci* Surgical System was defectively designed and manufactured, that Intuitive failed to properly instruct and train the surgeons in its use, and that the defendants failed to properly apprise the patients of the risks involved. Each suit seeks an unspecified amount of general, special and punitive damages from the defendants, in addition to a request to recover the costs of suit and attorney fees. As each suit was just recently filed, both are in very early stages and discovery has recently commenced.

We are subject to legal proceedings and claims that arise in the normal course of our business. We do not know whether we will prevail in these matters nor can we assure that any remedy could be reached on commercially viable terms, if at all. Due to the inherent uncertainties of litigation, we cannot accurately predict the ultimate outcome of these matters at this time and, therefore, cannot estimate the range of possible loss.

ITEM 2. CHANGES IN SECURITIES AND USE OF PROCEEDS

None.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

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

None.

ITEM 5. OTHER INFORMATION

None.

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) Exhibits.

Exhibit Number	Description
31	Certifications of the Company's Chief Executive Officer and Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32	Certifications of the Company's Chief Executive Officer and Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

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(b) Reports on Form 8-K.

On July 15, 2003, we filed a current report on Form 8-K announcing the completion of our merger with Computer Motion, Inc.

On August 7, 2003, we furnished a current report on Form 8-K announcing our second quarter 2003 financial results.

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.

INTUITIVE SURGICAL, INC.
(Registrant)
By: /s/ SUSAN K. BARNES
Susan K. Barnes
Senior Vice President, Chief Financial Officer and Assistant Secretary

Date: November 14, 2003

EXHIBIT INDEX

Exhibit Number	Description
31	Certifications of the Company's Chief Executive Officer and Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
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Exhibit 31

Certification of Chief Executive Officer
Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

I, Lonnie M. Smith, certify that:

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

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

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

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

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

b) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

c) disclosed in this report any change in the registrant's internal controls over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal controls over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal controls over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

a) all significant deficiencies and material weaknesses in the design or operation of internal controls over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

b)any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls over financial reporting.

Date: November 14, 2003

/s/ Lonnie M. Smith
Lonnie M. Smith
Chief Executive Officer

Certification of Chief Financial Officer
Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

I, Susan K. Barnes, certify that:

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

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

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

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

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

b) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

c) disclosed in this report any change in the registrant's internal controls over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal controls over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal controls over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

a) all significant deficiencies and material weaknesses in the design or operation of internal controls over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls over financial reporting.

Date: November 14, 2003

/s/ Susan K. Barnes
Susan K. Barnes
Chief Financial Officer

Exhibit 32

Certification of Chief Executive Officer
Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

Pursuant to 18 U.S.C. § 1350, as created by Section 906 of the Sarbanes-Oxley Act of 2002, the undersigned officer of Intuitive Surgical, Inc. (the "Company") hereby certifies, to such officer's knowledge, that:

(i) the accompanying Quarterly Report on Form 10-Q of the Company for the quarterly period ended September 30, 2003 (the "Report") fully complies with the requirements of Section 13(a) or Section 15(d), as applicable, of the Securities Exchange Act of 1934, as amended; and

(ii) the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Dated: November 14, 2003

/s/ Lonnie M. Smith

Lonnie M. Smith

Chief Executive Officer

Certification of Chief Financial Officer
Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

Pursuant to 18 U.S.C. § 1350, as created by Section 906 of the Sarbanes-Oxley Act of 2002, the undersigned officer of Intuitive Surgical, Inc. (the "Company") hereby certifies, to such officer's knowledge, that:

(i) the accompanying Quarterly Report on Form 10-Q of the Company for the quarterly period ended September 30, 2003 (the "Report") fully complies with the requirements of Section 13(a) or Section 15(d), as applicable, of the Securities Exchange Act of 1934, as amended; and

(ii) the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Dated: November 14, 2003

/s/ Susan K. Barnes

Susan K. Barnes

Chief Financial Officer