AXIS CAPITAL HOLDINGS LTD
Form 10-K
February 22, 2010
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

FOR ANNUAL AND TRANSITION REPORTS PURSUANT TO SECTION 13 OR 15(d)

OF THE SECURITIES EXCHANGE ACT OF 1934

x ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2009

OR

¨ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from to

Commission file number 001-31721

AXIS CAPITAL HOLDINGS LIMITED

(Exact name of registrant as specified in its charter)

BERMUDA

(State or other jurisdiction of incorporation or organization)

98-0395986

(I.R.S. Employer Identification No.)

92 Pitts Bay Road, Pembroke, Bermuda HM 08

(Address of principal executive offices and zip code)

(441) 496-2600

(Registrant s telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	**Name of each exchange on which registered**
Common shares, par value $0.0125 per share	New York Stock Exchange
7.25% Series A preferred shares	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act:

None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes x No ¨

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes ¨ No x

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

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ¨

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

Large accelerated filer x	Accelerated filer ¨
Non-accelerated filer ¨ (Do not check if a smaller reporting company)	Smaller reporting company ¨

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

The aggregate market value of the voting and non-voting common equity held by non-affiliates of the registrant, computed by reference to the closing price as of the last business day of the registrant s most recently completed second fiscal quarter, June 30, 2009, was approximately $3.5 billion.

At February 16, 2010, there were outstanding 131,930,239 common shares, $0.0125 par value per share, of the registrant.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant s definitive proxy statement to be filed with the Securities and Exchange Commission pursuant to Regulation 14A relating to the annual meeting of shareholders to be held on May 6, 2010 are incorporated by reference in Part III of this Form 10-K.

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Cautionary Statement Regarding Forward-looking Statements

This Annual Report on Form 10-K contains forward-looking statements within the meaning of the U.S. federal securities laws. We intend these forward-looking statements to be covered by the safe harbor provisions for forward-looking statements in the United States securities laws. In some cases, these statements can be identified by the use of forward-looking words such as may, should, could, anticipate, estimate, expect plan, believe, predict, potential and intend. Forward-looking statements contained in this report may include information regarding our estim of losses related to catastrophes and other large losses, measurements of potential losses in the fair value of our investment portfolio and derivative contracts, our expectations regarding pricing and other market conditions, our growth prospects, and valuations of the potential impact of movements in interest rates, equity prices, credit spreads and foreign currency rates. Forward-looking statements only reflect our expectations and are not guarantees of performance.

These statements involve risks, uncertainties and assumptions. Accordingly, there are or will be important factors that could cause actual results to differ materially from those indicated in such statements. We believe that these factors include, but are not limited to, the following:

the occurrence of natural and man-made disasters,

actual claims exceeding our loss reserves,

general economic, capital and credit market conditions and the persistence of the recent financial crisis,

the failure of any of the loss limitation methods we employ,

the effects of emerging claims and coverage issues,

the failure of our cedants to adequately evaluate risks,

inability to obtain additional capital on favorable terms, or at all,

the loss of one or more key executives,

a decline in our ratings with rating agencies,

loss of business provided to us by our major brokers,

changes in accounting policies or practices,

changes in governmental regulations,

increased competition,

changes in the political environment of certain countries in which we operate or underwrite business,

fluctuations in interest rates, credit spreads, equity prices and/or currency values, and

the other matters set forth under Item 1A, *Risk Factors* and Item 7, *Management s Discussion and Analysis of Financial Conditions and Results of Operations* included in this report.

We undertake no obligation to update or revise publicly any forward-looking statements, whether as a result of new information, future events or otherwise.

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PART I

ITEM 1. BUSINESS

As used in this report, references to we, us, our or the Company refer to the consolidated operations of AXIS Capital Holdings Limited (AXIS Capital) and its direct and indirect subsidiaries and branches, including AXIS Specialty Limited (AXIS Specialty Bermuda), AXIS Specialty Limited (Singapore Branch), AXIS Specialty Europe Limited (AXIS Specialty Europe), AXIS Specialty London, AXIS Specialty Australia, AXIS Specialty Insurance Company (AXIS Specialty U.S.), AXIS Re Limited (AXIS Re Ltd.), AXIS Reinsurance Company (AXIS Re U.S.), AXIS Reinsurance Company (Canadian Branch), AXIS Surplus Insurance Company (AXIS Surplus), AXIS Insurance Company (AXIS Insurance Co.) and AXIS Re Europe, unless the context suggests otherwise. Tabular dollars are in thousands. Amounts in tables may not reconcile due to rounding differences.

GENERAL

AXIS Capital is the Bermuda-based holding company for the AXIS Group of Companies. AXIS Capital was incorporated on December 9, 2002. AXIS Specialty Bermuda commenced operations on November 20, 2001. AXIS Specialty Bermuda and its subsidiaries became wholly owned subsidiaries of AXIS Capital pursuant to an exchange offer consummated on December 31, 2002. Through our various operating subsidiaries and branches, we provide a broad range of insurance and reinsurance products to insureds and reinsureds worldwide operations with primary locations in Bermuda, the United States and Europe. Our business consists of two distinct global underwriting platforms, AXIS Insurance and AXIS Re.

During 2007, we purchased the assets of the Media Professional Division (Media Pro) of MPI Insurance Agency, Inc., an Aon Group, Inc. subsidiary. Media Pro was a full-service managing general underwriter with operations in the U.S., Canada and the U.K. We were the exclusive carrier for several of Media Pro s programs for the prior two years, and this purchase gave us the renewal rights to their broader professional lines portfolio.

During 2008, as part of our long-term strategy of global expansion, we established new underwriting branches in Singapore, Australia and Canada.

During 2009, we purchased Dexta Corporation Pty Ltd (Dexta), an underwriting agency in Australia. Since 2005, we have been providing professional indemnity, directors and officers liability and information technology liability insurance coverages as a direct offshore foreign insurer in Australia through Dexta. Effective January 1, 2009, the insurance coverages previously underwritten through Dexta are underwritten directly by AXIS Specialty Australia.

Also in 2009, we established a new Global Accident & Health line of business within our insurance segment which, as of January 2010, provides domestic and international reinsurance coverage on a quota share, excess of loss and aggregate excess of loss basis. Coverages underwritten will include corporate personal accident and business travel accident products, association/affinity programs, student accident and catastrophic health products. We also expect to offer through this line of business U.S. insurance products including personal accident, business travel accident, student accident and sickness and special risks, including youth activities, day care and non-profit groups. These products will be offered to employer/employee and affinity groups as well as financial institutions, including banks, credit card issuers and credit unions.

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OUR BUSINESS STRATEGY

Our long-term business strategy focuses on utilizing our management s extensive expertise, experience and long-standing market relationships to identify and underwrite attractively priced risks while delivering insurance and reinsurance solutions to our customers. Our underwriters worldwide are focused on constructing a portfolio of risks that effectively utilizes our capital while optimizing the risk-reward characteristics of the portfolio. We exercise disciplined underwriting practices and manage a diverse book of business while seeking to maximize our profitability and generate superior returns on equity. To afford ourselves ample opportunity to construct a portfolio diversified by product and geography that meets our profitability and return objectives, we have implemented organic growth strategies in key markets worldwide.

The markets in which we operate have historically been cyclical. During periods of excess underwriting capacity, as defined by availability of capital, competition can result in lower pricing and less favorable policy terms and conditions for insurers and reinsurers. During periods of reduced underwriting capacity, pricing and policy terms and conditions are generally more favorable for insurers and reinsurers. Historically, underwriting capacity has been impacted by several factors, including industry losses, catastrophes, changes in legal and regulatory guidelines, investment results and the ratings and financial strength of competitors.

Our near-term strategies conform to our long-term objectives but also reflect changes and opportunities within the global marketplace. The following is an overview of the insurance and reinsurance market since our first full year of operations in 2002, together with a discussion as to how we have evolved during this period. The following table shows gross premiums written in each of our segments over the last five years:

Year ended December 31,	**2009**	**2008**	**2007**	**2006**	**2005**
Insurance	**$ 1,775,590**	$ 1,841,934	$ 2,039,214	$ 2,070,467	$ 1,875,017
Reinsurance	**1,811,705**	1,548,454	1,550,876	1,538,569	1,518,868
Total	**$ 3,587,295**	$ 3,390,388	$ 3,590,090	$ 3,609,036	$ 3,393,885

We were established in late 2001 to take advantage of the significant imbalance that had been created between the demand for insurance and reinsurance and the supply of capacity from adequately capitalized insurers and reinsurers. Pricing and deductibles were increasing dramatically and policy terms and coverages tightening across many specialist lines of business. In a short period of time following our formation, we were able to assemble a diverse portfolio of specialist insurance risks. We also established a property reinsurance portfolio largely comprising worldwide catastrophe exposure. Since our inception, we have focused our efforts on identifying and recruiting talented specialist underwriters and diligently building our infrastructure to access and analyze risks for our global portfolio and to deliver service of the highest quality to our clients.

During 2003, we were able to further diversify our global business by adding select underwriting teams and infrastructure in the U.S. and in Europe. Specifically, we established a meaningful presence in the wholesale insurance market in the U.S., which allowed us to quickly take advantage of favorable market conditions. We also entered the professional lines insurance business through a renewal rights transaction and simultaneous recruitment of an underwriting team from Kemper. The shortage of capacity for U.S. professional lines reinsurance business served as an opportunity for further diversification of our global treaty reinsurance business and establishment of a local presence in the U.S. reinsurance marketplace. By the end of 2003, we had also established a local presence in the Continental European reinsurance marketplace, allowing us to diversify into

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other traditional European treaty reinsurance business including motor liability and credit and bond. The establishment and growth of our U.S. and European reinsurance underwriting operations contributed to significant premium growth in our reinsurance segment during 2004 and 2005.

Since these early years of substantial growth, we have continued to establish our position in the global insurance and reinsurance marketplace. This has been against the backdrop of a softening market cycle throughout many of our property and liability lines of business, with increased competition, surplus underwriting capacity and deteriorating rates, terms and conditions all having an impact on our ability to write business. Despite this, our strong diversity by product and geography, has allowed us to effectively reallocate underwriting capacity around our business operations as we see market conditions change and business opportunities arise, allowing us to maintain a relatively stable level of gross premiums written during this period.

Within our reinsurance segment, although market conditions have not been particularly conducive to premium growth in recent years, including a trend of greater risk and retention appetite in the industry, conditions have generally been better than the primary market which has provided us with an opportunity to achieve greater market penetration in the U.S. and European reinsurance markets over this period. Further, market conditions improved across several lines of business during 2009, which, along with specific growth opportunities, allowed us to expand the segment this year.

Within our insurance segment, market conditions have been increasingly competitive for several years, with surplus capacity and price deterioration prevalent across most of our portfolio. As a result we have reduced our participation in certain business in recent years. The impact of this has been partially offset by specific growth opportunities. This has included the expansion of our professional lines business, both through the purchase of the Media Pro business in 2007 as well as new business opportunities arising during 2008 and 2009 in the aftermath of the financial market crisis. In recent years, we have also added underwriting expertise to our credit and political risk team and established a branch in Singapore, which has provided us with access to a broader range of distribution channels. This has allowed us to provide more products which are not as closely correlated to the property and liability cycle, in particular, emerging market sovereign and corporate credit. Our ability and appetite to write this business, however, was negatively impacted in the latter part of 2008 and throughout 2009 by the effects of the global financial crisis. In 2009, we established a new Global Accident and Health line of business within our insurance segment, which effective January 2010, provides corporate personal accident and business travel coverage as well as specialty and catastrophe health and ancillary property and casualty coverage. We intend to initially grow this business in the U.S. market and expand into the European, Canadian, Australian and Asian markets over time.

During 2007, we created a new Ceded Reinsurance Unit to coordinate our reinsurance purchasing activities, improve efficiency and consistency and take advantage of new opportunities in the marketplace. In recent years, we have expanded our reinsurance coverage, particularly for professional lines and casualty insurance business. This strategy has allowed us to reduce our overall net retentions relative to previous years and therefore deliver more value through an improvement in our risk/reward position.

Our use of technology allows us to maintain a low-cost infrastructure and efficient underwriting operations. In addition, we believe our technological capabilities provide us with competitive advantages as we seek to improve our relationships with our customers, provide enhanced levels of customer service and optimize our internal decision making process. During 2009, we implemented additional levels of back-up across our core processing systems, communication networks and databases to mitigate the disruption to fundamental business processing. We also expanded our usability of remote application technologies (i.e., remote access, web applications), video conferencing and geographically dispersed data synchronization to meet the demands of a more mobile and dispersed workforce.

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We continue to strengthen our enterprise risk management framework, having created a separate Risk Management department during 2008. We value the strategic significance of an effective risk management structure, particularly in today s complex environment. Our ERM practices are currently evaluated as Strong by Standard & Poor s (S&P).

SEGMENT INFORMATION

Our underwriting operations are organized around our two global underwriting platforms, AXIS Insurance and AXIS Re and therefore we have determined that we have two reportable segments, insurance and reinsurance. Except for goodwill and intangible assets, we do not allocate our assets by segment as we evaluate the underwriting results of each segment separately from the results of our investment portfolio. Financial data relating to our segments is included in Note 3 to our Consolidated Financial Statements presented under Item 8 and in Management s Discussion and Analysis of Financial Condition and Results of Operations, under Item 7.

Insurance Segment

Lines of Business and Distribution

Our insurance segment offers specialty insurance products to a variety of niche markets on a worldwide basis. The following are the lines of business in our insurance segment:

Property: provides physical loss or damage, business interruption and machinery breakdown coverage for virtually all types of property, including commercial buildings, residential premises, construction projects and onshore energy installations. This line of business consists of both primary and excess risks, some of which are catastrophe-exposed.

Marine: provides coverage for traditional marine classes, including offshore energy, cargo, liability, recreational marine, fine art, specie, hull and war. Offshore energy coverages include physical damage, business interruption, operators extra expense and liability coverage for all aspects of offshore upstream energy, from exploration and construction through the operation and distribution phases.

Terrorism: provides coverage for physical damage and business interruption of an insured following an act of terrorism.

Aviation: provides hull and liability and specific war coverage primarily for passenger airlines but also for cargo operations, general aviation operations, airports, aviation authorities, security firms and product manufacturers.

Credit and political risk: provides credit and political risk insurance products for banks and corporations. Coverage is provided for a range of risks including sovereign default, credit default, political violence, currency inconvertibility and non-transfer, expropriation, aircraft non-repossession and contract frustration due to political events. The credit insurance coverage is primarily for lenders seeking to mitigate the risk of non-payment from their borrowers in emerging markets. For the credit insurance contracts, it is necessary for the buyer of the insurance (most often a bank) to hold an insured asset (most often an underlying loan) in order to claim compensation under the insurance contract. The traditional political risk coverage provides protection against sovereign actions that result in the impairment of cross-border investments for banks and major corporations (known as CEND coverages).

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Professional lines: provides coverage for directors and officers liability, errors and omissions liability, employment practices liability, fiduciary liability, crime, professional indemnity and other financial insurance related coverages for commercial enterprises, financial institutions and not-for-profit organizations. This business is predominantly written on a claims-made basis.

Liability: primarily targets primary and low/mid-level excess and umbrella commercial liability risks in the U.S. excess and surplus lines markets. Target industry sectors include construction, manufacturing, transportation and trucking and other services.

Other: primarily consists of employee medical coverage for self-insured, small and medium sized employers, for losses in excess of a given retention.

We produce business primarily through wholesale and retail brokers worldwide. Some of our insurance products are also distributed through managing general agents and underwriters. In the U.S., we have the ability to write business on an admitted basis using forms and rates as filed with state insurance regulators and on a non-admitted basis, or surplus lines basis, with flexibility in forms and rates as these are not filed with state regulators. Having non-admitted carriers in our U.S. group of companies provides the pricing flexibility needed to write non-standard coverage. Substantially all of our insurance business is written subject to aggregate limits, in addition to event limits.

Gross premiums written by broker, shown individually where premiums are 10% or more of the total in any of the last three years, were as follows:

Year ended December 31,	**2009**		**2008**		**2007**	
Marsh	**$ 309,278**	**17%**	$ 262,417	14%	$ 264,964	13%
Aon	**270,658**	**15%**	237,993	13%	259,929	13%
Willis	**150,197**	**9%**	156,887	9%	202,531	10%
Other brokers	**803,183**	**45%**	953,852	52%	1,056,163	52%
Managing general agencies and underwriters	**242,274**	**14%**	230,785	12%	255,627	12%
Total	**$ 1,775,590**	**100%**	$ 1,841,934	100%	$ 2,039,214	100%

No major customer accounted for more than 10% of the gross premiums written in the insurance segment.

Competitive Environment

We operate in highly competitive markets. In our insurance segment, where competition is focused on price as well as availability, service and other considerations, we compete with U.S. based companies with global insurance operations, as well as non U.S. global carriers and indigenous companies in regional and local markets. We believe we achieve a competitive advantage through a strong capital position and the strategic and operational linking of our practices, which allows us to design insurance programs on a global basis in alignment with the global needs of many of our clients.

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Reinsurance Segment

Lines of Business and Distribution

Our reinsurance segment operates through offices based in Bermuda, New York, Zurich and Singapore. We focus on writing business on an excess of loss basis, where possible, whereby we typically provide an indemnification to the reinsured entity for a portion of losses both individually and in the aggregate, on policies in excess of a specified individual or aggregate loss deductible. For business written on a proportional basis, we receive an agreed percentage of the premium and are liable for the same percentage of incurred losses. Reinsurance may be written on a portfolio/treaty basis or on an individual risk/facultative basis. The majority of our business is written on a treaty basis and primarily offered to us by reinsurance brokers worldwide.

Our reinsurance segment provides non-life reinsurance to insurance companies on a worldwide basis. The following are the lines of business in our reinsurance segment:

Catastrophe: provides protection for most catastrophic losses that are covered in the underlying insurance policies written by our cedants. The exposure in the underlying policies is principally property exposure but also covers other exposures including workers compensation, personal accident and life. The principal perils in this portfolio are hurricane and windstorm, earthquake, flood, tornado, hail and fire. In some instances, terrorism may be a covered peril or the only peril. We underwrite catastrophe reinsurance principally on an excess of loss basis.

Property: includes reinsurance written on both a proportional and a per risk excess of loss basis and covers underlying personal lines and commercial property exposures. Here the primary reason for the product is not simply to protect against catastrophic perils, however they are normally included with limitations.

Professional Liability: covers directors and officers liability, employment practices liability, medical malpractice, lawyers and accountants liability, environmental liability and miscellaneous errors and omissions insurance risks. The underlying business is predominantly written on a claims-made basis. Business is written on both a proportional and excess of loss basis.

Credit and Bond: consists of reinsurance of trade credit insurance products and includes both proportional and excess of loss structures. The underlying insurance indemnifies sellers of goods and services in the event of a payment default by the buyer of those goods and services. Also included in this line of business is coverage for losses arising from a broad array of surety bonds issued by bond insurers principally to satisfy regulatory demands in a variety of jurisdictions around the world.

Motor: provides coverage to cedants for motor liability and, to a lesser degree, property damage losses arising out of any one occurrence. The occurrence can involve one or many claimants where the ceding insurer aggregates the claims from the occurrence.

Liability: provides coverage to insurers of standard casualty business, excess and surplus casualty business and specialty casualty programs. The primary focus of the underlying business is general liability, although workers compensation and auto liability are also written.

Engineering: provides coverage for all types of construction risks and risks associated with erection, testing and commissioning of machinery and plants during the construction stage. This line of business also includes coverage for losses arising from operational failures of machinery, plant and equipment and electronic equipment as well as business interruption.

Other: includes aviation, marine, personal accident and crop reinsurance.

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Gross premiums written by broker, shown individually where premiums are 10% or more of the total in any of the last three years, were as follows:

Year ended December 31,	2009		2008		2007	
Aon	**$ 677,810**	**37%**	$ 536,435	35%	$ 506,198	33%
Marsh	**496,900**	**27%**	507,257	33%	550,036	35%
Willis	**404,428**	**22%**	253,647	16%	190,603	12%
Other brokers	**62,944**	**4%**	145,834	9%	194,224	13%
Direct	**169,623**	**10%**	105,281	7%	109,815	7%
Total	**$ 1,811,705**	**100%**	$ 1,548,454	100%	$ 1,550,876	100%

No major customer accounted for more than 10% of the gross premiums written in the reinsurance segment.

Competitive Environment

In our reinsurance segment where competition tends to be focused on availability, service, financial strength and increasingly price, we compete with major U.S. and non-U.S. reinsurers as well as reinsurance departments of numerous multi-line insurance organizations. We believe we achieve a competitive advantage through our strong capital position as well as our technical expertise that allows us to respond quickly to customer needs and provide quality and innovative underwriting solutions. In addition, our customers highly value our exemplary service, strong capitalization and financial strength ratings.

REINSURANCE PROTECTION

Our Ceded Reinsurance Unit coordinates the purchase of treaty and facultative reinsurance to reduce our exposure to large losses or a series of large losses. All treaty reinsurance purchases and our facultative reinsurance strategies are pre-approved by our Reinsurance Purchasing Group, which consists of senior management. Facultative reinsurance provides for all or a portion of the insurance provided by a single policy and each policy reinsured is individually negotiated. Treaty reinsurance provides for a specified type or category of risks. Our reinsurance agreements may be on an excess of loss or proportional basis. Excess of loss covers provide a contractually set amount of cover after an excess point has been reached. This excess point can be based on the size of an industry loss or a fixed monetary amount. These covers can be purchased on a package policy basis, which provide cover for a number of lines of business within one contract. Proportional covers provide a proportional amount of coverage from the first dollar of loss. All of these reinsurance covers provide for recovery of a portion of losses and loss expenses from reinsurers. We remain liable for the original claim to the extent that reinsurers do not meet their obligations under these agreements.

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RESERVE FOR UNPAID LOSSES AND LOSS EXPENSES

We establish reserves for losses and loss expenses that arise from our insurance and reinsurance products. These reserves are balance sheet liabilities representing estimates of future amounts required to pay losses and loss expenses for insured or reinsured claims that have occurred at or before the balance sheet date, whether already known or not yet reported. Our loss reserves are established based upon our estimate of the total cost of claims that were reported to us but not yet paid (case reserves), and the anticipated cost of claims incurred but not yet reported to us (IBNR).

The table below shows the development of our loss reserves since inception. To illustrate an understanding of the information in this table, following is an example using reserves established at December 31, 2005.

The top lines of the table show for successive balance sheet dates the gross and net unpaid losses and loss expenses recorded at or prior to each balance sheet date. It can be seen that at December 31, 2005, a reserve of $3,270 million, net of reinsurance had been established.

The lower part of the table presents the net amounts paid as of periods subsequent to the balance sheet date. Hence in the year ended December 31, 2006, net payments of $880 million were made from the December 31, 2005 reserve balance. By the end of 2009, cumulative net payments against the December 31, 2005 net reserves were $1,771 million.

The upper part of the table shows the revised estimate of the net liabilities originally recorded as of the end of subsequent years. With the benefit of actual loss emergence over the intervening period, the net liabilities incurred as of December 31, 2005, are now estimated to be $2,529 million, rather than the original estimate of $3,270 million. Of the cumulative redundancy of $741 million recognized in the four years since December 31, 2005, $217 million was identified and recorded in 2006, $115 million in 2007, $188 million in 2008 and $221 million in 2009.

Importantly, the cumulative deficiency or redundancy for different balance sheet dates is not independent and therefore, should not be added together. In 2009, we have revised our estimate of the December 31, 2005, liabilities from $2,750 million to $2,529 million. This favorable development of $221 million will also be included in each column to the right of December 31, 2005, to recognize that there was also reserve redundancy in the reserves established at December 31, 2006, 2007 and 2008.

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	Year ended December 31,								
	2001	**2002**	**2003**	**2004**	**2005**	**2006**	**2007**	**2008**	**2009**
Gross reserve for losses and loss expenses	$ 963	$ 215,934	$ 992,846	$ 2,404,560	$ 4,743,338	$ 5,015,113	$ 5,587,311	$ 6,244,783	$ 6,564,133
Reinsurance recoverable	-	(1,703)	(124,899)	(564,314)	(1,473,241)	(1,310,904)	(1,297,539)	(1,314,551)	(1,381,058)
Net losses and loss expenses reserve	963	214,231	867,947	1,840,246	3,270,097	3,704,209	4,289,772	4,930,232	5,183,075
Net reserves reestimated as of:									
1 Year later	$ 165	$ 158,443	$ 686,235	$ 1,457,250	$ 3,053,561	$ 3,367,232	$ 3,913,485	$ 4,507,061	
2 Years later	165	141,290	539,110	1,179,851	2,938,734	3,076,025	3,533,313		
3 Years later	165	109,711	434,221	1,080,083	2,750,476	2,773,158			
4 Years later	196	97,981	386,029	962,910	2,529,259				
5 Years later	196	96,864	347,544	889,190					
6 Years later	196	96,179	326,729						
7 Years later	196	92,517							
8 Years later	196								
Cumulative redundancy	$ 767	$ 121,714	$ 541,218	$ 951,056	$ 740,838	$ 931,051	$ 756,459	$ 423,171	
Cumulative net paid losses									
1 Year later	$ 15	$ 47,838	$ 108,547	$ 291,695	$ 880,120	$ 636,266	$ 615,717	$ 982,036	
2 Years later	125	56,781	169,853	432,963	1,292,738	999,280	1,147,990		
3 Years later	165	66,569	202,136	511,325	1,500,652	1,355,821			
4 Years later	165	63,835	221,644	574,874	1,771,039				
5 Years later	165	72,323	245,978	615,920					
6 Years later	165	80,099	254,676						
7 Years later	165	81,130							
8 Years later	165								
Impact of unrealized foreign exchange movements:	$ -	$ 961	$ 3,240	$ 4,664	$ (13,329)	$ 23,581	$ 28,588	$ (133,345)	$ 82,018
Gross reserve for losses and loss expenses re-estimated	$ 196	$ 111,420	$ 439,930	$ 1,434,178	$ 3,922,252	$ 3,961,497	$ 4,669,039	$ 5,771,504	
Reinsurance recoverable	-	(18,903)	(113,201)	(544,988)	(1,392,993)	(1,188,339)	(1,135,726)	(1,264,443)	
Net losses and loss expenses reserve re-estimated	196	92,517	326,729	889,190	2,529,259	2,773,158	3,533,313	4,507,061	
Cumulative redundancy on gross reserve	$ 767	$ 104,514	$ 552,916	$ 970,382	$ 821,086	$ 1,053,616	$ 918,272	$ 473,279	

The table above also shows the impact of foreign exchange rate movements. Movements in foreign exchange rates between periods result in variations in our net loss reserves, as the U.S. dollar, our reporting currency, strengthens or weakens against underlying currencies. For example, for the year ended December 31, 2009, the weakening of the U.S. dollar, primarily against the Euro and Sterling, resulted in an $82 million increase in our net loss reserves, established prior to, or during, 2009. We generally hold investments in the same currency as our net reserves, with the intent of matching the impact of foreign exchange movements on our assets and liabilities.

Conditions and trends that affected the development of liabilities in the past may not necessarily occur in the future. Accordingly, it may be inappropriate to anticipate future redundancies or deficiencies based on historical experience. The key issues and considerations involved in establishing our estimate of our loss reserves is discussed in more detail within the *Critical Accounting Estimates* *Reserve for Losses and Loss Expenses* section of Item 7. For additional information regarding the key underlying movements in our loss reserves in the last three years, refer to the *Group Underwriting Results* *Loss Ratio* section of Item 7.

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CASH AND INVESTMENTS

We seek to balance the investment portfolios objectives of (1) increasing book value with (2) the generation of stable investment income, while providing sufficient liquidity to meet our claims and other obligations. Liquidity needs arising from potential claims are of primary importance and are considered in asset class participation and the asset allocation process. Intermediate maturity investment grade fixed income securities have duration characteristics similar to our expected claim payouts and are therefore central to our investment portfolio s asset allocation. At December 31, 2009, the duration of our fixed maturities portfolio was 3 years, which approximates the estimated duration of our net insurance liabilities.

To optimize the growth in our book value, we may invest in other asset classes such as equity securities, high yield securities and alternative investments (e.g. hedge funds) which provide higher potential total rates of return. Such investments involve varying degrees of risk, including the potential for more volatile returns and reduced liquidity.

With regard to our investment portfolio, we utilize third party investment managers for security selection and trade execution functions, subject to our guidelines and objectives for each asset class. This enables us to actively manage our investment portfolio with access to top talents specializing in various products and markets. We select the managers based on various criteria including investment style, track record, performance and corporate governance. Additionally, we monitor approved investment asset classes for each subsidiary through analysis of our operating environment, including expected volatility of cash flows, overall capital position, regulatory and rating agency considerations. The Finance Committee of our Board of Directors approves our overall group asset allocation targets and investment policy and guidelines to ensure that they are consistent with our overall goals, strategies and objectives. We also have an Investment Committee, comprising senior management, which oversees the implementation of our investment strategy.

For additional information regarding the investment portfolio refer to the *Management s Discussion and Analysis of Financial Condition and Results of Operations Cash and Investments* section Item 7 and Note 5 Investments to our Consolidated Financial Statements presented under Item 8.

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ENTERPRISE RISK MANAGEMENT

OVERVIEW

Enterprise Risk Management (ERM)

ERM is our group-wide framework for identifying, managing, reporting and responding to risks that could affect the achievement of our strategic and financial objectives. The objectives of our ERM framework are to:

- Protect our capital base by monitoring the most efficient deployment of capital
- Monitor risk-taking within the Company against our risk-taking appetite;
- Enhance value creation and contribute to an optimal risk-return profile; and
- Support our group-wide decision making process by providing reliable and timely risk information.

Risk Landscape

Within our ERM framework, we distinguish between the following sources of risk:

- *Insurance* the inherent uncertainty as to the occurrence, amount and timing of insurance liabilities transferred to us through the underwriting process.
- *Credit* the risk of incurring financial loss due to diminished creditworthiness of our counterparties.
- *Investment* risk of potential losses in our investment portfolio as a result of market risks, as well as risk inherent in individual securities.
- *Operational* risks associated with our people, processes and systems, including external events.
- *Funding and liquidity* the risk that we are unable to meet our short-term financial obligations or raise funds to finance our commitments at an affordable cost. For further review of our liquidity and capital management refer to the *Liquidity and Capital Resources* section of Item 7.

Risk Governance

The Risk Committee of our Board of Directors (Board) oversees, on the basis of proposals from management, the creation of a framework for the management of risk. The framework, ultimately approved by the Board, includes our risk management methodologies, standards, tolerances, and risk strategies. Our Risk Committee also assesses whether management is addressing risk issues in a timely and appropriate manner.

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Our Risk Management Committee, comprising our Chief Executive Officer, Chief Financial Officer, Chief Risk Officer and senior management from both our insurance and reinsurance segments and operations, is responsible for maintaining our risk standards as well as monitoring aggregations, risk tolerances and emerging risks. The Risk Management Committee acts as an interface between our Risk Committee and management, who are responsible for managing our business within defined risk tolerances.

Our Risk Management department oversees risk taking activities throughout the group, providing guidance and support for risk management practices. The Risk Management department is also responsible for assessing the combined impact of all risks and reporting on the group s risk position by class of risk, segment of business, legal entity and group.

Our risk governance structure is complemented by our Internal Audit department. Internal Audit is an independent, objective assurance function that assesses the adequacy and effectiveness of our internal control systems. Internal audit also coordinates risk-based audits and compliance reviews and other specific initiatives to evaluate and address risk within targeted areas of our business.

Our risk management philosophy, framework and practices have provided us with stability during volatile times and we continuously seek to refine and update our approach. Regular, clear and open communication has helped us to build a consistent risk management culture across our diverse organization.

Risk Appetite

Our basis for accepting risk is determined by our risk appetite, as approved by our Board. Our risk appetite is a function of our capital, profitability and stakeholder expectations of the types of risk we hold within our business. The Risk Committee regularly reviews our risk profile to ensure alignment with our risk appetite.

Our risk appetite primarily reflects our tolerance for risk from our overall underwriting portfolio, including individual events (natural peril or non natural peril catastrophes), and from our investment portfolio. In addition, we specifically focus on the relationship between combinations of different risks to assess the potential for reduction in our profitability and capital base. Ensuring that our capital is sufficient to take advantage of market opportunities even in stressed market conditions is of key importance.

An element of our ERM framework is our economic capital model. Utilizing this modeling framework provides us with a holistic view of the capital we put at risk in any year by allowing us to understand the relative interaction between all of the risks impacting us. This integrated approach recognizes that a single risk factor can affect different sub-portfolios and that different risk factors can have different mutual dependencies. The economic capital model is used to support, inform and improve decision making across the Group. The model is regularly updated to reflect changes in our business and the external environment.

Recognizing that in extreme scenarios, many risks may interact to cause an impairment of our capital, our Board requires that the enterprise risk within our business is managed to preserve capital under such stress conditions. Our Board also recognizes that financial strength ratings are a key element of our competitive positioning and our ability to raise further capital. We actively manage and monitor our available capital against the capital required to operate at our targeted financial strength rating. We also review our available capital, both at a group and individual legal entity level, against the evolving capital requirements of the risk-based regulatory regimes to which we are subject.

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MANAGING INSURANCE RISKS

Overview

Since our inception in 2001, we have expanded our international underwriting presence, with offices in Bermuda, the U.S., Europe, Singapore, Canada and Australia. Our disciplined underwriting approach coupled with an extensive group wide peer review process has enabled us to manage this growth in a controlled and consistent manner. This, coupled with our focus on maintaining high levels of experience in our underwriting teams, has ensured that our risk profile aligns closely with our defined risk appetite. We emphasize quality of underwriting rather than volume of business or market share.

A critical element of our management of insurance risk is our rigorous peer review process which allows us to monitor market conditions and aggregations risk-by-risk, at the highest levels within the Company. Another key component of our mitigation of insurance risk is the purchase of reinsurance. The business that we accept is not always fully retained; but instead portions may be reinsured. We have a centralized Reinsurance Purchasing Group which coordinates our reinsurance purchasing as part of our overall risk management strategy.

Modeling natural peril catastrophes

Natural peril catastrophic risk is our largest aggregate exposure. In managing this risk, we are concerned with both the loss of capital due to a single event and the loss of capital that would occur from multiple (but perhaps small events) in any year. Natural catastrophes such as earthquakes, storms and floods represent a challenge for risk management due to their accumulation potential and occurrence volatility.

We use multiple commercial vendor models to price and accumulate risks. These models cover the major peril regions where we face potential exposure. In our reinsurance segment, we have also developed an internal proprietary application which allows us to track the results from various models for both pricing and aggregation purposes. Modeling allows us to simulate many hypothetical loss scenarios to supplement our experienced underwriting judgment. We centrally oversee our modeling for consistency in approach and form a global perspective on our group-wide accumulations.

We impose limits on natural peril catastrophe risk exposure at the group level. Based on our current tolerance, we are not willing to lose more than 25% of our prior year-end capital for a modeled single occurrence 1-in-250 year return period probable maximum net loss. We also impose limits on probable maximum losses in any one zone from a single event. A zone is a geographical area in which insurance risks are considered to be correlated to a single catastrophe event. Our executive management receives regular reports on our group-wide total natural peril exposures by peril and territory to ensure active monitoring of our risk positions.

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The table below shows our loss exposures to peak natural peril catastrophe territories. We have developed these loss estimates using vendor models and our own assessments for non vendor modeled exposures. These estimates include assumptions regarding the location, size and magnitude of an event, the frequency of events, the construction type and damageability of property in a zone, and the cost of rebuilding property in a zone.

(in millions of U.S. dollars)

Zone	Perils	50 Year Return Period	100 Year Return Period	250 Year Return Period
U.S.	Hurricane	$ 692.9	$ 958.5	$ 1,292.3
California	Earthquake	391.4	671.7	968.0
Europe	Windstorm	432.9	679.4	945.5
Japan	Earthquake	234.5	325.6	595.9
Japan	Windstorm	91.1	137.0	150.8

The following table provides our estimate of industry losses for the corresponding scenarios above:

(in billions of U.S. dollars)

Zone	Perils	50 Year Return Period	100 Year Return Period	250 Year Return Period
U.S.	Hurricane	$ 78.1	$ 121.1	$ 194.6
California	Earthquake	16.3	27.9	50.0
Europe	Windstorm	21.2	30.3	44.0
Japan	Earthquake	14.7	20.8	37.8
Japan	Windstorm	15.3	20.8	33.8

In the event a competitor infringes on our patent or other intellectual property rights, enforcing those rights may be difficult and time consuming. Even if successful, litigation to enforce our intellectual property rights or to defend our patents against challenge could be expensive and time consuming and could divert management s attention. We may not have sufficient resources to enforce our intellectual property rights or to defend our patents against a challenge. In addition, confidentiality agreements executed by our employees, consultants and advisors may not be enforceable or may not provide meaningful protection for our trade secrets or other proprietary information in the event of unauthorized use or disclosure. If we are unable to protect our intellectual property rights, we could lose market share to our competitors and our business could suffer.

Our dependence on international revenues, which account for a significant portion of our total revenues, could harm our business.

Because our future profitability will depend in part on our ability to increase product sales in international markets, we are exposed to risks specific to business operations outside the United States. These risks include:

the challenge of managing international sales without direct access to the end customer;

the risk of inventory build-up by our distributors which could negatively impact sales in future periods (for example, our distributor in Japan has built up a significant inventory of product in anticipation of the receipt of reimbursement approvals);

obtaining reimbursement for procedures using our devices in some foreign markets;

the burden of complying with complex and changing foreign regulatory requirements;

longer accounts receivable collection time;

significant currency fluctuations, which could cause our distributors to reduce the number of products they purchase from us because the cost of our products to them could increase relative to the price they could charge their customers;

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reduced protection of intellectual property rights in some foreign countries; and

contractual provisions governed by foreign laws.

We are substantially dependent on two distributors in our international markets, and if we lose either distributor or if either distributor significantly reduces its product demand, our international and total revenues could decline.

We are substantially dependent on a limited number of significant distributors in our international markets, and if we lose these distributors and fail to attract additional distributors, our international revenues could decline. ITX Corporation, formerly known as Nissho Iwai Corporation, is our primary distributor in Asia. It accounted for 21% of our international revenues in 2003 and 55% of our international revenues in 2002. M.D.H. s.r.l. Forniture Ospedaliere, our distributor in Italy, accounted for 22% of our international revenues in 2003 and 17% of our international revenues for 2002. Because international revenues accounted for 20% of our total revenues for 2003 and these two distributors represented 43% of that total, the loss of either distributor or a significant decrease in unit purchases by either distributor could cause our revenues to decline substantially. If we are unable to attract additional international distributors, our international revenues may not grow.

Our relationships with third-party distributors could negatively affect our sales.

We sell our products in international markets through third-party distributors over whom we have limited control, and, if they fail to adequately support our products, our sales could decline. During the first quarter of 2003, we terminated our agreements with three of our international distributors and although we contracted with replacement distributors we have expended significant time and resources in doing so, and our sales in the three affected markets have suffered during the transition period that we estimate ended September 30, 2003. However, if our distributors or we terminate other distributor agreements, we could incur similar or more burdensome expenses, have to expend significant time and resources in finding replacement distributors and our sales could decrease during any related transition period.

We are aware that some of our international distributors have built up inventory of our products. As a result, future sales to these distributors could be negatively impacted and 2003 sales to our Japanese distributor were so affected. In addition, while these distributors have no price protection and no right of return relating to purchased products, if we permit the return of any of these products, we will have to adjust our revenues relating to these products which may also impact our revenue recognition policy on future distributor sales.

In 2002, we significantly increased our allowance for uncollectible accounts to address the risk associated with longer collection periods that have arisen principally with our European distributors. Although the deterioration we experienced in international collections in 2002 stabilized in 2003, we may encounter new difficulties with collections that require further increases in our allowance for uncollectible accounts in the future, and we may require specific accounts to post letters of credit or pay in advance to minimize credit risk to the Company. Additional future increases in our allowance for uncollectible accounts would reduce our profits.

If customers in markets outside the United States experience difficulty obtaining reimbursement for procedures using our products, international sales could decline.

Certain of the markets outside the United States in which we sell our products require that specific reimbursement codes be obtained before reimbursement for procedures using our products can be approved. As a result, in countries where specific reimbursement codes are strictly

required and have not yet been issued, reimbursement has been denied on that basis. For example, ITX Corporation, our distributor in Japan, is seeking to obtain reimbursement coverage in Japan, but to date has not received this approval. If we or our distributors are unable to either obtain the required reimbursement codes or develop an effective strategy to resolve the reimbursement issue, physicians in foreign markets may be unwilling to purchase our products which could negatively impact our international revenues.

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If third-party payors do not reimburse health care providers for use of the RITA system, purchases could be delayed and our revenues could decline.

Physicians, hospitals and other health care providers may be reluctant to purchase our products if they do not receive coverage or adequate reimbursement for the cost of procedures using our products from third-party payors, such as Medicare, Medicaid and private health insurance plans. If physicians believe that using our system will add cost to a procedure but will not add sufficient offsetting economic or clinical benefits, physician adoption of our products could be delayed. Even though the American Medical Association has established CPT codes relating to liver procedures and bone tumor procedures, some third-party payors still may not cover or reimburse adequately for liver or bone tumor procedures using our products. We are aware of liver procedures using our system where the patient s insurance has denied coverage. In addition, there are no assigned CPT codes for radiofrequency ablation of tumors in organs other than liver or bone. Further, we believe the advent of the Medicare fixed payment schedules has made it difficult to receive adequate liver reimbursement for procedures using our products in the outpatient setting. Medicare reimbursement levels for procedures using our products are highest when our products are used in an in-patient setting. If there is a trend toward the use of our products on an outpatient basis or if coverage continues to be denied or reimbursement levels continue to be inadequate, physician use of our products could decline which would cause our revenues to decline.

We depend on key employees in a competitive market for skilled personnel and without additional employees, we cannot grow or achieve profitability.

We are highly dependent on the principal members of our management team, including our Chief Executive Officer and Chief Financial Officer, as well as key staff in the areas of finance, operations and research and development. Our future success will depend in part on the continued service of our staff and our ability to identify, hire and retain additional personnel. The market for qualified management personnel in Northern California, where our offices are located, is competitive and is expected to remain so. Because the environment for good personnel is so competitive, costs related to compensation may increase significantly. If we are unable to attract and retain both the management team and key personnel we need to support and grow our business, our business will suffer.

We may be subject to costly and time-consuming product liability actions.

We manufacture medical devices that are used on patients in both minimally invasive and open surgical procedures and, as a result, we may be subject to product liability lawsuits. To date, we have not been subject to a product liability claim; however, any product liability claim brought against us, with or without merit, could result in the increase of our product liability insurance rates or the inability to secure coverage in the future. In addition, we could have to pay any amount awarded by a court in excess of policy limits. Finally, even a meritless or unsuccessful product liability claim could be time consuming and expensive to defend and could result in the diversion of management s attention from managing our core business.

Any failure in our physician training efforts could result in lower than expected product sales.

It is critical to our sales effort to train a sufficient number of physicians and to instruct them properly in the procedures that utilize our products. We have established formal physician training programs and rely on physicians to devote adequate time to understanding how and when our products should be used. If physicians are not properly trained, they may misuse or ineffectively use our products. Such use may result in unsatisfactory patient outcomes, patient injury and related liability or negative publicity that could have an adverse effect on our product sales.

We may incur significant costs related to a class action lawsuit due to the likely volatility of our stock.

Our stock price may fluctuate for a number of reasons including:

failure of the public market to support the valuation established in our initial public offering or our 2003 private placement transaction;

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our ability to successfully commercialize our products;

announcements regarding patent litigation or the issuance of patents to us or our competitors;

quarterly fluctuations in our results of operations;

announcements of technological or competitive developments by us or our competitors;

product liability claims;

regulatory developments regarding us or our competitors;

acquisitions or strategic alliances by us or our competitors;

changes in estimates of our financial performance or changes in recommendations by securities analysts; and

general market conditions, particularly for companies with small market capitalizations.

Securities class action litigation is often brought against a company after a period of volatility in the market price of its stock. If our future quarterly operating results are below the expectations of securities analysts or investors, the price of our common stock would likely decline. Stock price fluctuations may be exaggerated if the trading volume of our common stock is low. Any securities litigation claims brought against us could result in substantial expense and divert management s attention from our core business.

We have limited experience manufacturing our disposable devices in substantial quantities, and if we are unable to hire sufficient additional personnel or to purchase additional equipment or are otherwise unable to meet customer demand, our business could suffer.

To be successful, we must manufacture our products in substantial quantities in compliance with regulatory requirements at acceptable costs. If we do not succeed in manufacturing quantities of our disposable devices that meet customer demand, we could lose customers and our business could suffer. At the present time, we have limited high-volume manufacturing experience. Our manufacturing operations are currently focused on the in-house assembly of our disposable devices. As we increase our manufacturing volume and the number of product designs for our disposable devices, the complexity of our manufacturing processes will increase. Because our manufacturing operations are primarily dependent upon manual assembly, if demand for our system increases we will need to hire additional personnel and may need to purchase additional equipment. If we are unable to sufficiently staff and equip our manufacturing operations or are otherwise unable to meet customer demand for our products, our business could suffer.

We may be required to relocate, or choose to relocate, to a new facility in 2004. If so, we will incur moving expenses, and if we become unable to meet custormer demand, our business could suffer.

The operating lease on our current facility expires in August of 2004. We believe that during 2004 we will be able to either renew the lease on our existing facility, or lease alternative space, at commercially reasonable terms. If we choose to relocate to a new facility, we will incur normal and customary moving costs and may experience an interruption in our manufacturing operations. If we become unable to meet customer demand for our products, our business could suffer.

We are dependent on two suppliers as the only sources of a component that we use in our disposable devices, and any disruption in the supply of this component could negatively affect our business.

Until 2003, there was only one supplier available to provide us with a component that we include in our disposable devices. During the quarter ended June 30, 2003, we qualified a second supplier. However, a disruption in the supply of this component is still possible and could negatively affect revenues. If we were unable to remedy a disruption in supply of this component within twelve months, we could be required to

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redesign the handle of our disposable devices, which could divert engineering resources from other projects or add to product costs. In addition, a new or supplemental filing with applicable regulatory authorities may require clearance prior to our marketing a product containing new materials. This clearance process may take a substantial period of time, and we may be unable to obtain necessary regulatory approvals for any new material to be used in our products on a timely basis, if at all. This could also create supply disruptions that could negatively affect our business.

We are dependent on two suppliers as our only sources of an accessory device used in conjunction with our Starburst XLi and Xlie lines of disposable devices, and any disruption in the supply of these devices could negatively affect our revenues.

Until December 2002, we had only one supplier available to provide us with accessory infusion pumps used in conjunction with our Starburst XLi line of disposable devices. Our Starburst Xlie product line, introduced in 2003, also requires an accessory infusion pump. During the quarters ended September 30, 2002 and December 31, 2002, we experienced shortages in the supply of accessory infusion pumps. In December 2002, we qualified a new accessory infusion pump from our existing supplier for which we now have approval from UL and conditional approval from TUV for use in the United States and Europe. Also in December 2002, we qualified a second supplier of an accessory infusion pump, although we have not yet shipped this product to our customers commercially. Although we were able to remedy this supply disruption, future disruptions in the supply of this component are still possible and, in that event, our business could suffer through lower revenues or higher costs. Additionally, we have limited experience with both the primary and alternative pump and if either pump fails to perform as desired, revenues could be negatively affected.

We are dependent on two third-party contractors for the supply of our generators, and any failure to deliver generators to us could result in lower than expected revenues.

We are dependent on two third-party suppliers to produce our generators. While we have agreements with both of these suppliers, any delay in shipments of generators to us could result in our failure to ship generators to customers and could negatively affect revenues.

Complying with the FDA and other domestic and foreign regulatory authorities is an expensive and time-consuming process, and any failure to comply could result in substantial penalties.

We are subject to a host of federal, state, local and foreign regulations regarding the manufacture and marketing of our products. In particular, our failure to comply with FDA regulations could result in, among other things, seizures or recalls of our products, an injunction, substantial fines and/or criminal charges against our employees and us. The FDA s medical device reporting regulations require us to report any incident in which our products may have caused or contributed to a death or serious injury, or in which our products malfunctioned in a way that would be likely to cause or contribute to a death or serious injury if the malfunction recurred.

Sales of our products outside the United States are subject to foreign regulatory requirements that vary from country to country. The time required to obtain approvals from foreign countries may be longer than that required for FDA approval or clearance, and requirements for foreign licensing may differ from FDA requirements. For example, some of our newer products have not received approval in Japan. Any failure to obtain necessary regulatory approvals for our new products in foreign countries could negatively affect revenues.

Product introductions or modifications may be delayed or canceled as a result of the FDA regulatory process, which could cause our revenues to be below expectations.

Unless we are exempt, we must obtain the appropriate FDA approval or clearance before we can sell a new medical device in the United States. Obtaining this approval or clearance can be a lengthy and time-consuming process. To date, all of our products have received clearances from the FDA through premarket notification

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under Section 510(k) of the Federal Food, Drug and Cosmetic Act. However, if the FDA requires us to submit a new premarket notification under Section 510(k) for modifications to our existing products, or if the FDA requires us to go through a lengthier, more rigorous examination than we now expect, our product introductions or modifications could be delayed or canceled which could cause our revenues to be below expectations. The FDA may determine that future products will require the more costly, lengthy and uncertain premarket approval process. In addition, modifications to medical device products cleared via the 510(k) process may require a new 510(k) submission. We have made minor modifications to our system. Using the guidelines established by the FDA, we have determined that some of these modifications do not require us to file new 510(k) submissions. If the FDA disagrees with our determinations, we may not be able to sell the RITA system until the FDA has cleared new 510(k) submissions for these modifications, or it may require us to recall previously sold products. In addition, we intend to request additional label indications, such as approvals or clearances for the ablation of tumors in additional organs, including lung, uterus and breast, for our current products. The FDA may either deny these requests outright, require additional extensive clinical data to support any additional indications or impose limitations on the intended use of any cleared product as a condition of approval or clearance. Therefore, obtaining necessary approvals or clearances for these additional applications could be an expensive and lengthy process. In addition, in the course of the FDA process leading to clearance or approval for a new indication, the FDA may request an advisory panel meeting or meetings to discuss the clinical data, the appropriate study design or other criteria for clearance or approval. In the event that the advisory panel advises FDA that the clinical data are inadequate or the study design or other criteria are inappropriate, and the FDA concurs, the FDA clearance or approval process could be lengthened and anticipated revenues from that new indication would be delayed.

We may acquire technologies or companies in the future, which could result in the dilution of our stockholders and disruption of our business, and reduce our revenues.

We are continually evaluating business alliances and external investments in technologies related to our business. Acquisitions of companies, divisions of companies, businesses or products entail numerous risks, any of which could materially harm our business in several ways, including:

- diversion of management s attention from our core business objectives and other business concerns;
- failure to integrate efficiently businesses or technologies acquired in the future with our pre-existing business or technologies;
- potential loss of key employees from either our pre-existing business or the acquired business;
- dilution of our existing stockholders as a result of issuing equity securities; and
- assumption of liabilities of the acquired company.

Some or all of these problems may result from future acquisitions or investments. Furthermore, we may not realize any value from such acquisitions or investments.

We may need to raise additional capital in the future resulting in dilution to our stockholders.

We may need to raise additional funds for our business operations and to execute our business strategy. We may seek to sell additional equity or debt securities or to obtain an additional credit facility. The sale of additional equity or convertible debt securities could result in additional

dilution to our stockholders. If additional funds are raised through the issuance of debt securities, these securities could have rights that are senior to holders of common stock and could contain covenants that would restrict our operations. Any additional financing may not be available in amounts or on terms acceptable to us, if at all.

Our executive officers and directors own a large percentage of our voting stock and could exert significant influence over matters requiring stockholder approval.

Because our executive officers and directors, and their respective affiliates, own approximately 10 percent of our outstanding common stock as of December 31, 2003, these stockholders may, as a practical matter, be able

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to exert significant influence over matters requiring approval by our stockholders, including the election of directors and the approval of mergers or other business combinations. This concentration of voting stock could have the effect of delaying or preventing a merger or acquisition or other change of control that a stockholder may consider favorable.

Item 7A. Quantitative and Qualitative Disclosures About Market Risk.

Our exposure to interest rate risk at December 31, 2003 and December 31, 2002 is related to our investment portfolio. We had no interest rate sensitive borrowings as of December 31, 2003 or December 31, 2002. Fixed rate investments and borrowings may have their fair market value adversely impacted from changes in interest rates. Floating rate investments may produce less income than expected if interest rates fall, and floating rate borrowings, should we acquire any, will lead to additional interest expense if interest rates increase. Due in part to these factors, our future investment income may fall short of expectations, and our interest expense may be above our expectations. Further, we may suffer losses in investment principal if we are forced to sell securities that have declined in market value due to changes in interest rates.

We invest our excess cash in debt instruments of the United States government and its agencies and in high quality corporate issuers. The average contractual duration of our investments in 2003 was less than one year. Due to the short-term nature of these investments, we believe that there is no material exposure to interest rate risk arising from our investments.

All of our sales and purchases have historically been denominated in United States dollars. In the future, we may begin to make sales in other currencies such as the Euro. We believe we currently have no significant direct foreign currency exchange rate risk and that such risk in the future will be minimal.

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Item 8. Consolidated Financial Statements and Supplementary Data.

RITA Medical Systems, Inc.

Index to Consolidated Financial Statements

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Report of Independent Auditors

To the Stockholders and Board of Directors

of RITA Medical Systems, Inc.:

In our opinion, the consolidated financial statements listed in the accompanying index present fairly, in all material respects, the financial position of RITA Medical Systems, Inc. and its subsidiaries at December 31, 2003 and 2002, and the results of their operations and comprehensive loss and their cash flows for each of the three years in the period ended December 31, 2003 in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Company s management; our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States of America, which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

/s/ PricewaterhouseCoopers LLP

San Jose, California

March 8, 2004

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RITA MEDICAL SYSTEMS, INC.

CONSOLIDATED BALANCE SHEETS

(in thousands, except per share data)

	December 31,	
	2003	**2002**
ASSETS		
Current assets:		
Cash and cash equivalents	$ 4,580	$ 6,888
Marketable securities	4,022	5,427
Accounts and note receivable, net of allowance for doubtful accounts of $1,117 at December 31, 2003 and $1,353 at December 31, 2002	2,990	2,798
Inventories	2,192	3,521
Prepaid assets and other current assets	1,028	995
Total current assets	14,812	19,629
Long term marketable securities	933	520
Long term note receivable, net of collection allowance of $45 at December 31, 2003 and $141 at December 31, 2002	338	381
Property and equipment, net	1,089	1,565
Intangibles and other assets	4,861	2,071
Total assets	$ 22,033	$ 24,166
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 757	$ 1,053
Accrued liabilities	2,169	2,510
Total current liabilities	2,926	3,563
Deferred maintenance revenue, less current portion	23	
Total liabilities	$ 2,949	$ 3,563
Commitments (Note 4)		
Stockholders equity :		
Preferred stock, $0.001 par value:		
Authorized: 2,100 shares at December 31, 2003		
Issued and outstanding: No shares at December 31, 2003 and 2002		
Common stock, $0.001 par value:		
Authorized: 100,000 shares at December 31, 2003		
Issued and outstanding: 17,975 shares at December 31, 2003 and 15,155 shares at December 31, 2002	18	15
Additional paid-in capital	98,037	88,525
Stockholder notes receivable		(50)
Accumulated other comprehensive income	2	7

Accumulated deficit	(78,973)	(67,894)
Total stockholders equity	19,084	20,603
Total liabilities and stockholders equity	$ 22,033	$ 24,166

The accompanying notes are an integral part of these consolidated financial statements.

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RITA MEDICAL SYSTEMS, INC.

CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE LOSS

(in thousands, except per share data)

	Years Ended December 31,		
	2003	2002	2001
Sales	$ 16,607	$ 17,393	$ 14,791
Cost of goods sold (including stock-based compensation of $0, $42 and $558 in 2003, 2002 and 2001, respectively)	6,166	6,908	6,132
Gross profit	10,441	10,485	8,659
Operating expenses:			
Research and development (including stock-based compensation of $0, $216 and $465 in 2003, 2002 and 2001, respectively)	4,294	5,052	6,489
Selling, general and administrative (including stock-based compensation of $0, $196 and $349 in 2003, 2002 and 2001, respectively)	17,418	19,366	16,646
Total operating expenses	21,712	24,418	23,135
Loss from operations	(11,271)	(13,933)	(14,476)
Interest income	201	473	1,610
Interest expense		(12)	(86)
Other expense, net	(9)	(27)	(8)
Net loss	(11,079)	(13,499)	(12,960)
Other comprehensive income (expense):			
Change in unrealized gain (loss) on marketable securities	(5)	(63)	57
Comprehensive loss	$ (11,084)	$ (13,562)	$ (12,903)
Net loss per common share, basic and diluted	$ (0.63)	$ (0.91)	$ (0.90)
Shares used in computing net loss per common share, basic and diluted	17,647	14,890	14,353

The accompanying notes are an integral part of these consolidated financial statements.

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RITA MEDICAL SYSTEMS, INC.

CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY

(in thousands)

	Common Stock		Additional	Deferred	Stockholder	Accumulated Other Compre-hensive		Total Stockholders
	Shares Issued	Amount	Paid-in Capital	Stock-based Compensation	Notes Receivable	Income	Accumulated Deficit	Equity
Balances, December 31, 2000	13,970	$ 14	$ 88,421	$ (4,202)	$ (164)	$ 13	$ (41,435)	$ 42,647
Issuance of common stock	89		324					324
Stock options and warrants exercised	551	1	406					407
Cancellation of common stock	(19)		(31)		31			
Issuance of common stock warrants for services received			264					264
Deferred stock-based compensation			(925)	925				
Amortization of deferred stock-based compensation				1,372				1,372
Forgiveness of stockholder note receivable					34			34
Change in unrealized gain on marketable securities						57		57
Net loss							(12,960)	(12,960)
Balances, December 31, 2001	14,591	15	88,459	(1,905)	(99)	70	(54,395)	32,145
Issuance of common stock	125		421					421
Stock options and warrants exercised	466		1,130					1,130
Cancellation of common stock	(27)		(15)		15			
Revaluation of common stock warrant			(19)					(19)
Deferred stock-based compensation			(1,451)	1,451				
Amortization of deferred stock-based compensation				454				454
Forgiveness of stockholder note receivable					34			34
Change in unrealized gain on marketable securities						(63)		(63)
Net loss							(13,499)	(13,499)
Balances, December 31, 2002	15,155	15	88,525		(50)	7	(67,894)	20,603
Issuance of common stock.	2,126	2	8,605					8,607
Stock options exercised .	714	1	1,028					1,029
Cancellation of common stock	(20)		(20)		20			

Revaluation of common stock warrant			(101)					(101)
Forgiveness of stockholder note receivable					30			30
Change in unrealized gain on marketable securities						(5)		(5)
Net loss							(11,079)	(11,079)
Balances, December 31, 2003	17,975	$ 18	$ 98,037	$	$	$ 2	$ (78,973)	$ 19,084

The accompanying notes are an integral part of these consolidated financial statements.

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RITA MEDICAL SYSTEMS, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

	Years Ended December 31,		
	2003	2002	2001
Cash flows from operating activities:			
Net loss	$ (11,079)	$ (13,499)	$ (12,960)
Adjustments to reconcile net loss to cash used in operating activities:			
Depreciation and amortization	1,713	1,401	1,018
Loss on disposal of property and equipment	275		
Issuance and revaluation of common stock warrants for services received	(101)	(19)	264
Allowance for doubtful accounts	(99)	865	526
Provision for obsolete inventories	551	670	137
Amortization of stock-based compensation		454	1,372
Changes in operating assets and liabilities:			
Accounts and note receivable	(190)	1,534	(3,145)
Inventories	778	(546)	(2,144)
Prepaid and other current assets	(33)	287	(459)
Accounts payable and accrued liabilities	(637)	66	1,177
Deferred warranty revenue	23		
Net cash used in operating activities	(8,799)	(8,787)	(14,214)
Cash flows from investing activities:			
Purchase of property and equipment	(1,003)	(893)	(1,648)
Purchase of investments	(9,387)	(404)	(19,451)
Sales and maturities of investments	10,374	10,634	30,650
Capitalization of patent litigation costs	(621)	(1,802)	(332)
Acquisition of intangibles	(2,650)		
Note receivable and other assets	142	(516)	6
Net cash provided by (used in) investing activities	(3,145)	7,019	9,225
Cash flows from financing activities:			
Proceeds from issuance of common stock	9,636	1,551	731
Proceeds from revolving term loan			25
Payments on revolving term loan			(858)
Payments on capital lease obligations		(192)	(288)
Net cash provided by (used in) financing activities	9,636	1,359	(390)
Net decrease in cash and cash equivalents	(2,308)	(409)	(5,379)
Cash and cash equivalents at beginning of year	6,888	7,297	12,676

Cash and cash equivalents at end of year	$ 4,580	$ 6,888	$ 7,297
Supplemental disclosures of cash flow information:			
Cash paid for taxes	$ 9	$ 27	$ 8
Cash paid for interest	$	$ 12	$ 75

The accompanying notes are an integral part of these consolidated financial statements.

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RITA MEDICAL SYSTEMS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1: FORMATION AND BUSINESS OF THE COMPANY

RITA Medical Systems, Inc. (the Company) was incorporated in January 1994. The Company is engaged in developing, manufacturing and marketing innovative products that use radiofrequency energy to treat patients with solid cancerous or benign tumors. Products include radiofrequency generators and disposable needle electrode devices that deliver controlled thermal energy to targeted tissue.

NOTE 2: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The accompanying consolidated financial statements include the accounts of RITA Medical Systems, Inc. and its wholly owned subsidiaries, RITA Medical Systems Netherlands, BV, and Rita Medical Systems France, S.A.R.L. Intercompany transactions and accounts have been eliminated.

Liquidity

As of December 31, 2003, the Company s total assets were $22.1 million, total liabilities were $2.9 million, working capital was $11.9 million and cash and cash equivalents totaled $4.6 million. Current and anticipated demand for the Company s products as well as procurement and production affect the need for capital. Changes in these or other factors could have a material impact on capital requirements and may require the Company to raise additional capital. While the Company believes that its existing cash resources, including short-term and long-term marketable securities, will be sufficient to fund its operating needs for the next twelve months, additional financing may be required for the Company s currently envisioned long term needs. There can be no assurance that any additional financing will be available on terms acceptable to the Company, or at all. In addition, future equity financings could result in dilution to shareholders, and future debt financings could result in certain financial and operational restrictions.

Use of estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that effect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Significant estimates include those required in the assessment of allowances for doubtful accounts and for potentially excess and obsolete inventory. Actual

results could differ from those estimates.

Concentration of credit risk and other risks and uncertainties

The Company s products include components subject to rapid technological change. Certain components used in manufacturing the product have relatively few alternative sources of supply and establishing additional or replacement suppliers for such components cannot be accomplished quickly. The Company has been constrained by supply issues in the past, but was not affected by supply constraints as of December 31, 2003. While the Company has ongoing programs to minimize the adverse effect of such changes and considers technological change in estimating its allowances, such estimates could change in the future.

Financial instruments that potentially subject the Company to a concentration of credit risk consist of cash and cash equivalents, marketable securities, accounts receivable and notes receivable. Cash and cash equivalents are deposited in demand and money market accounts in three financial institutions in the United States, one

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RITA MEDICAL SYSTEMS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

financial institution in the Netherlands and one financial institution in France. Deposits held with financial institutions may exceed the amount of insurance provided on such deposits. The Company has not experienced any losses on its deposits of cash, cash equivalents or marketable securities.

The Company extends credit to its customers, which are primarily comprised of accounts of private companies in the United States, Europe and Asia. The Company performs ongoing credit evaluations of its customers financial conditions and generally requires no collateral. The Company maintains an allowance for doubtful accounts receivable and/or notes receivable based on the expected collectibility of individual accounts. For the year ended December 31, 2003, the Company reduced its allowance for doubtful accounts by approximately $99,000. For the years ended December 31, 2002 and 2001, provisions to the allowance for doubtful accounts were made in the approximate amounts of $902,000 and $535,000, respectively. Charges against the allowance were approximately $233,000, $37,000 and $9,000 for the years ended December 31, 2003, 2002 and 2001, respectively.

Cash and cash equivalents

All highly liquid investments with original maturities of ninety days or less from the date of purchase, if not restricted, are considered to be cash equivalents. The Company has reported approximately $117,000 in restricted cash accounts as other current assets.

Marketable securities

The Company s marketable securities are categorized as available-for-sale. Marketable securities with original maturities greater than three months and remaining maturities of no more than one year are classified as short-term investments. Marketable securities with remaining maturities greater than one year are classified as long-term investments. Unrealized holding gains and losses are reflected as a net amount in a separate component of stockholders equity until realized. For the purpose of computing realized gains and losses, cost is identified on a specific identification basis.

Fair Value of Financial Instruments

The carrying amounts of some of the Company s financial instruments including cash and cash equivalents, accounts receivable and accounts payable approximate fair value due to their short maturities.

Inventories

Inventories are stated at the lower of cost (determined on a first-in, first-out basis) or market. The Company records provisions to write down its inventory for estimated obsolescence or unmarketable inventory equal to the difference between the cost of the inventory and its estimated market value based upon assumptions about future market demand and market conditions. If future demand or market conditions are less favorable than currently expected, additional inventory provisions may be required. Provisions to the allowance for excess and obsolete inventory were approximately $551,000, $733,000 and $355,000 for the years ended December 31, 2003, 2002 and 2001, respectively. Charges against the allowance were approximately $277,000, $63,000 and $218,000 for the years ended December 31, 2003, 2002 and 2001, respectively.

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RITA MEDICAL SYSTEMS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Property and Equipment

Property and equipment is stated at cost less accumulated depreciation and amortization. Depreciation and amortization of property and equipment is computed using the straight-line method over the estimated useful lives of the respective assets as follows:

Machinery and equipment	1 to 5 years
Computers and software	3 to 5 years
Furniture and fixtures	5 years

Leasehold improvements are amortized over their estimated useful lives, or the remaining lease term, whichever is shorter, using the straight-line method. Upon sale or retirement, the asset s cost and related accumulated depreciation are removed from the accounts and any related gain or loss is reflected in operations.

Long-lived assets

The Company periodically assesses the impairment of its long-lived assets in accordance with the provisions of Statement of Financial Accounting Standards (SFAS) No. 141, Accounting for the Impairment or Disposal of Long-Lived Assets. An impairment review is performed whenever events or changes in circumstances indicate that the carrying value of the Company s long-lived assets may not be recoverable. Indicators which could trigger an impairment review include, but are not limited to, significant underperformance relative to past or planned operating results, significant changes in the strategy for the overall business, significant negative industry trends and/or a significant decline in the stock price of the Company for a sustained period of time. When it is determined, based on one or more of these indicators, that the carrying value of the Company s long-lived assets may not be recoverable, impairment is measured using the projected discounted cash flow method and charged to operations.

Intangible assets

Litigation costs incurred in defense of the Company s patent positions have been capitalized and are carried at cost less accumulated amortization. Amortization of these costs is computed using the straight-line method over the remaining life of the related patents, which was approximately ten years as of December 31, 2003.

The costs of patent rights acquired in settlement of litigation have been capitalized and are carried at cost less accumulated amortization. Amortization of these costs is computed using the straight-line method over the remaining lives of the related patents, which ranged from

approximately six to eleven years as of December 31, 2003.

Revenue recognition

Product-related revenue is recognized upon receipt of a customer purchase order and subsequent product shipment, provided no significant obligations remain and collection of the associated receivable is reasonably assured. The Company s customers, including distributors, have no price protection or return rights on product purchased. Revenue related to maintenance contracts is deferred and recognized ratably over the terms of underlying contracts. Maintenance contract terms range from 12 to 36 months.

Research and Development

Research and development costs are expensed as incurred. Research and development costs consist of direct and indirect internal costs related to specific projects as well as fees paid to other entities that conduct certain research activities on behalf of the Company.

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RITA MEDICAL SYSTEMS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Advertising

Advertising production costs are expensed as incurred. Media for print placement costs are expensed in the period the advertising appears. Total advertising and promotional expenses were approximately $71,000, $119,000 and $169,000 for the years ended December 31, 2003, 2002 and 2001, respectively.

Income Taxes

Income taxes are accounted for using the liability method under which deferred tax assets and liabilities are determined based on the difference between the financial statement and tax bases of assets and liabilities using enacted tax rates in effect for the year in which the differences are expected to affect taxable income. Valuation allowances are established when necessary to reduce deferred tax assets to the amount expected to be realized.

Accounting for stock-based compensation

During the year ended December 31, 2002, the Company adopted SFAS No. 148, Accounting for Stock-Based Compensation, Transition and Disclosure. The Company accounts for stock-based employee compensation arrangements in accordance with provisions of Accounting Principles Board (APB) Opinion No. 25, Accounting for Stock Issued to Employees. Financial Accounting Standards Board Interpretations (FIN) No. 28, Accounting for Stock Appreciation Rights and Other Variable Stock Option or Award Plans and complies with the disclosure provisions of SFAS No. 123, Accounting for Stock-Based Compensation.

Under APB Opinion No. 25, compensation expense is based on the difference, if any, on the date of the grant between the fair value of the Company s stock and an option s exercise price. SFAS No. 123 defines a fair value based method of accounting for an employee stock option or similar equity instruments.

The following table illustrates the effect on net loss and net loss per common share if the Company had applied the fair value recognition provisions of SFAS No. 123 to stock-based employee compensation (in thousands, except per share amounts):

	Years ended December 31,

	2003	2002	2001
Net loss, as reported	$ (11,079)	$ (13,499)	$ (12,960)
Add: Stock-based employee compensation expense included in reported net loss		454	1,372
Deduct: Total stock-based employee compensation determined under fair value based method for all awards	(1,914)	(2,274)	(2,491)
Pro forma net loss	$ (12,993)	$ (15,319)	$ (14,079)
Basic and diluted net loss per common share:			
As reported	$ (0.63)	$ (0.91)	$ (0.90)
Pro forma	$ (0.74)	$ (1.03)	$ (0.98)

Such pro forma disclosure may not be representative of future compensation cost because options vest over several years and additional grants are anticipated each year.

The Company accounts for equity instruments issued to non-employees in accordance with the provisions of SFAS No. 123 and Emerging Issues Task Force (EITF) Issue No. 96-18, Accounting for Equity Instruments That Are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling, Goods or Services.

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RITA MEDICAL SYSTEMS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Under EITF Issue No. 96-18, the fair value of an equity instrument is calculated using the Black-Scholes valuation model each reporting period, with charges amortized to the results of operations over the instrument s vesting period.

Net loss per share

Basic earnings per share is calculated based on the weighted-average number of common shares outstanding during the period less the weighted average number of any common shares subject to repurchase by the Company. Diluted earnings per share further includes the dilutive effect of potential common stock consisting of stock options, warrants and shares issuable upon conversion of preferred stock provided that the inclusion of such securities is not antidilutive; the Company has reported net losses since its inception and therefore excludes such potentially dilutive securities from its calculation of diluted earnings per share.

The reconciliation of total outstanding common shares to shares used in determining net loss per share is as follows (in thousands):

	Years ended December 31,		
	2003	2002	2001
Net loss, basic and diluted	$ 11,079	$ 13,499	$ 12,960
Weighted-average shares of common stock outstanding	17,651	14,923	14,419
Less: weighted-average shares subject to repurchase	4	33	66
Weighted-average shares used in basic and diluted net loss per common share	17,647	14,890	14,353

The following numbers of shares represented by options and warrants (prior to application of the treasury stock method), and shares subject to repurchase were excluded from the computation of diluted net loss per share as their effect was antidilutive (in thousands):

	December 31,		
	2003	2002	2001
Effect of potential common stock:			

Unvested common stock subject to repurchase		28	55
Options outstanding	2,675	2,725	2,657
Warrants outstanding	25	25	61
Total potential common stock excluded from the computation of earnings per common share	2,700	2,778	2,773

Recent accounting pronouncements

In November 2002, the EITF reached a consensus on Issue No. 00-21, Revenue Arrangements with Multiple Deliverables. EITF Issue No. 00-21 provides guidance on how to account for arrangements that involve the delivery or performance of multiple products, services and/or rights to use assets. The provisions of EITF Issue No. 00-21 apply to revenue arrangements entered into in fiscal periods beginning after June 15, 2003. Adoption of this statement has had no material impact on the Company s financial position or results of operations.

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RITA MEDICAL SYSTEMS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

In December 2003, the SEC issued Staff Accounting Bulletin (SAB) No. 104, Revenue Recognition, which codifies, revises and rescinds certain sections of SAB No. 101, Revenue Recognition, in order to make this interpretive guidance consistent with current authoritative accounting and auditing guidance and SEC rules and regulations. The changes noted in SAB No. 104 did not have a material effect on the Company s financial position or results of operations.

NOTE 3: BALANCE SHEET COMPONENTS

Marketable securities (in thousands):

The cost and fair value of available-for-sale securities at December 31, 2003 were as follows:

Short term marketable securities	Cost Value	Unrealized Gain	Fair Value
Corporate notes	$ 2,221	$	$ 2,221
United States government agency notes	1,000	1	1,001
Market auction preferred	800		800
	$ 4,021	$ 1	$ 4,022

Long term marketable securities	Cost Value	Unrealized Gain	Fair Value
Corporate notes (maturing in 2005)	$ 539	$ 2	$ 541
United States government agency notes (maturing in 2005)	393	(1)	392
	$ 932	$ 1	$ 933

The cost and fair value of available-for-sale securities at December 31, 2002 were as follows:

Short term marketable securities

	Cost Value	Unrealized Gain	Fair Value
Corporate notes	$ 4,220	$ 7	$ 4,227
Market auction preferred	1,200		1,200
	$ 5,420	$ 7	$ 5,427

Long term marketable securities	Cost Value	Unrealized Gain	Fair Value
Corporate notes (maturing in 2004)	$ 520	$	$ 520

Inventories (in thousands):

	December 31,	
	2003	2002
Raw materials	$ 719	$ 1,039
Work in progress	214	341
Finished goods	1,259	2,141
	$ 2,192	$ 3,521

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RITA MEDICAL SYSTEMS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Property and equipment, net (in thousands):

	December 31,	
	2003	**2002**
Computer equipment and software	$ 1,202	$ 973
Furniture and fixtures	195	193
Leasehold improvements	794	794
Machinery and equipment	4,261	4,002
	6,452	5,962
Less: accumulated depreciation and amortization	(5,363)	(4,397)
	$ 1,089	$ 1,565

Depreciation expense was approximately $1,203,000, $1,262,000 and $968,000 for the years ended December 31, 2003, 2002 and 2001, respectively.

Intangibles and other assets (in thousands):

	December 31,	
	2003	**2002**
Capitalized patent defense litigation costs	$ 2,755	$ 2,134
Capitalized patent rights	2,650	
Deposits	46	46
Other non-current assets	1	2
	5,452	2,182
Less: accumulated amortization	(591)	(111)
	$ 4,861	$ 2,071

The capitalized patent defense litigation costs relate to the Company s suit against RadioTherapeutics, a division of Boston Scientific Corporation. For the year ended December 31, 2003, the Company capitalized approximately $621,000 in such costs, and amortization expense associated with this asset was approximately $240,000. The future minimum amortization expense associated with this asset is approximately $242,000 for each of the next five years ended December 31, 2004 through 2008.

The capitalized patent rights relate to the settlement of the Company s suit against RadioTherapeutics and of suits brought against the Company by Boston Scientific Corporation and several related parties. In April of 2003 the Company capitalized $2,650,000 in payments made to acquire patent rights from Boston Scientific and the other opposing litigants. For the year ended December 31, 2003, amortization associated with this asset was approximately $240,000. The future minimum amortization expense associated with this asset is approximately $320,000 for each of the next five years ended December 31, 2004 through 2008.

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RITA MEDICAL SYSTEMS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Accrued liabilities (in thousands):

	December 31,	
	2003	**2002**
Payroll and related expenses	$ 687	$ 771
Accrued vacation	226	323
Accrued legal expenses	40	255
Product received but not yet invoiced	367	258
Other accrued liabilities	849	903
	$ 2,169	$ 2,510

Deferred maintenance revenue (in thousands):

Revenue for maintenance contracts is recognized on a pro-rata basis over the period of the applicable maintenance contract, ranging from 12 to 36 months. Costs are recognized as incurred. Changes in the Company s deferred maintenance revenue during the year ended December 31, 2003 were as follows:

Balance as of January 1, 2003	$
Add: maintenance contract billings	48
Less: Revenue recognized	(3)
Balance as of December 31, 2003	45
Less: current portion	(22)
Deferred maintenance revenue, less current portion	$ 23

NOTE 4: COMMITMENTS

Operating Leases

The Company leases manufacturing and office space under a 60 month noncancelable operating lease terminating in August 2004. The base rent increases according to the CPI formula as stipulated in the lease agreement. Under the terms of the lease, the Company is responsible for property taxes, insurance and maintenance costs. Rent expense was approximately $539,000, $529,000 and $475,000 for the years ended December 31, 2003, 2002 and 2001 respectively. Future minimum annual rental payments are approximately $356,000 for the year ended December 31, 2004, the year in which the lease expires.

From time to time, the Company may become involved in litigation relating to additional claims arising from the ordinary course of business. Management is not currently aware of any matters that will have a material adverse effect on the financial position, results of operations or cash flows of the Company.

NOTE 5: STOCKHOLDERS EQUITY

Warrants

In December 2001, the Company issued a warrant to BEKL Corporation under the terms of a clinical data and patent license agreement. The warrant is exercisable for 25,000 shares of the Company s common stock at a price of $6.10 per share and expires in December 2006. Its aggregate fair value of approximately $110,000 as of December 31, 2001, based on the Black-Scholes valuation model, was charged to operations in 2001. This warrant is outstanding as of December 31, 2003. Further, BEKL Corporation was to have been awarded additional performance based warrants in the future based on achievement of milestones under the clinical data and patent license agreement. In December 2001, the Company recorded charges to operations of approximately $120,000, representing the Black-Scholes fair value of a second warrant the Company expects to issue to BEKL Corporation in 2003. During the year ended December 31, 2002, the Company revalued the warrant using the Black-Scholes valuation method and recorded a $19,000 reduction of previously recorded amounts. During the year ended

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RITA MEDICAL SYSTEMS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

December 31, 2003, the Company s clinical data and patent license agreement with BEKL was terminated, and the remaining $101,000 balance recorded in regard to the prospective warrant award was reversed.

Private placement of common shares

In January of 2003, the Company issued 2,045,453 shares of unregistered common stock at a price of $4.40 per share, netting approximately $8.3 million after issuance fees and expenses. The issuance was deemed to be exempt from registration under the Securities Act in reliance upon Section 4(2) thereof as transactions by an issuer not involving any public offering. On February 14, 2003, the Company s Registration Statement on Form S-3, which registered the shares of common stock sold to SF Capital Partners Ltd., Riverview Group, LLC, Baystar Capital II, L.P., and Baystar International II, L.P., became effective.

NOTE 6: STOCK OPTIONS

Stock Options: 1994 Incentive Stock Plan, 2000 Director s Stock Option Plan and 2000 Stock Plan

Under the 1994 Incentive Stock Plan, options were granted to employees and non-employees at prices determined by the board of directors to be not lower than 85% of the fair market value of the common stock for non-statutory stock options or 100% of the fair market value of the common stock for incentive stock options. (For individuals who at the time of grant owned stock representing more than 10% of the voting power of all classes of outstanding stock, options were granted at prices not lower than 110% of the fair value of the common stock for both non-statutory and incentive stock options.) Options granted under this plan become exercisable and vest on a cumulative basis at the discretion of the board of directors and generally expire ten years from the date of grant. The Company s board of directors has determined that no future grants will be made under this plan.

Under the 2000 Director s Stock Option Plan, shares of common stock have been reserved for issuance to non-employee directors. Option grants have been and will continue to be made at the fair market value of the common stock on the date of the grant. Options granted under this plan become exercisable, vest on a cumulative basis and generally expire ten years from the date of grant.

The 2000 Stock Plan provides for the grant of incentive stock options to employees and non-statutory stock options and stock purchase rights to employees and consultants. A total of 2,000,000 common shares were originally reserved for issuance under this plan at its inception in 2000. A total of 796,473 common shares were available for issuance as of December 31, 2003. Future increases to the shares available for issuance will occur on the first day of each fiscal year through 2010 in the amount of the lesser of 1,000,000 shares, 7% of the Company s outstanding common stock on the last day of the preceding fiscal year or a lower number as determined by the board of directors. Incentive stock options granted under this plan must have an exercise price of at least 100% of the fair market value of the common stock on the date of the grant, and at

least 110% of the fair market value of the common stock if the options are awarded to an employee who holds more than 10% of the total voting power of all classes of the Company s stock. Options granted under this plan become exercisable and vest on a cumulative basis at the discretion of the board of directors and generally expire ten years from the date of grant.

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RITA MEDICAL SYSTEMS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Combined activity under these plans has been as follows (in thousands, except per share data):

		Options Outstanding		
	Shares Available	Shares	Aggregate Price	Weighted Average Exercise Price
Balances, December 31, 2000	2,520	1,993	$ 4,263	$ 2.14
Additional shares reserved	500			
Options granted	(1,458)	1,458	6,601	4.53
Options exercised		(499)	(407)	0.82
Options canceled	75	(295)	(940)	3.19
Shares removed from plan	(171)			
Balances, December 31, 2001	1,466	2,657	9,517	3.58
Options granted	(868)	868	5,422	6.25
Options exercised		(435)	(1,053)	2.42
Options canceled	293	(365)	(1,857)	5.09
Balances, December 31, 2002	891	2,725	12,029	4.41
Shares reserved	1,000			
Options granted	(1,724)	1,724	5,118	2.97
Options exercised		(714)	(1,029)	1.44
Options canceled	1,001	(1,060)	(5,607)	5.29
Balances, December 31, 2003	1,168	2,675	$ 10,511	$ 3.93

Stock Options: Options outstanding and exercisable

Options outstanding, from all plans, and exercisable as of December 31, 2003 are as follows by exercise price ranges (in thousands, except per share data):

	Options Outstanding			Options Exercisable	
Range of Exercise Prices	Number Outstanding	Weighted-	Weighted-	Number Outstanding	Weighted-

		Average Remaining Contractual Life	Average Exercise Price		Average Exercise Price
$ 0.50 to $ 2.52	750	9.28 years	$ 2.40	58	$ 1.00
$ 2.70 to $ 3.10	625	9.24 years	$ 2.90	99	$ 2.90
$ 3.12 to $ 3.97	412	8.76 years	$ 3.32	90	$ 3.55
$ 4.00 to $ 5.41	400	8.20 years	$ 4.67	182	$ 4.76
$ 5.45 to $ 6.75	301	7.00 years	$ 5.84	163	$ 5.83
$ 9.50 to $11.63	187	7.33 years	$ 10.00	148	$ 10.01
	2,675	8.64 years	$ 3.93	740	$ 5.36

2000 Employee Stock Purchase Plan

The Company s 2000 employee stock purchase plan was adopted in the second quarter of 2000. A total of 650,000 common shares were initially reserved for issuance under this plan. Automatic increases occurred on the first day of 2002, 2003 and 2004, in amounts equal to the lesser of 650,000 shares, 4% of the Company s outstanding common stock on the last day of the preceding year, or such lesser number that board of directors

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RITA MEDICAL SYSTEMS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

determines. This plan permits employees to purchase common shares at a price equal to the lower of 85% of the fair market value of the common stock at the beginning of each offering period or the end of each offering period. Employee purchases are nonetheless limited to 15% of eligible cash compensation, and other restrictions regarding the amount of annual purchases also apply. As of December 31, 2003, there have been 279,571 shares issued under this plan.

Stock-based compensation

The weighted average per share fair values of options granted during 2003, 2002 and 2001 were $1.87, $4.10 and $4.53 respectively. The value of each option grant was estimated on the date of grant using the Black-Scholes valuation model with the following weighted average assumptions:

	Years ended December 31,		
	2003	2002	2001
Volatility	75%	79%	80%
Risk-free interest rate	3.16%	3.93%	4.54%
Expected life	5 years	5 years	5 years
Expected dividends	0%	0%	0%

The corresponding assumptions for the 2000 Employee Stock Purchase Program were as follows:

	Years ended December 31,		
	2003	2002	2001
Volatility	70%	79%	80%
Risk-free interest rate	2.95%	3.29%	5.42%
Expected life	1.3 years	0.7 years	0.5 years
Expected dividends	0%	0%	0%

During the year ended December 31, 2003, the Company recorded no deferred stock-based compensation in accordance with APB Opinion No. 25, SFAS No. 123 or EITF Issue No. 96-18, and recognized no stock compensation expense. During the years ended December 31, 2002 and 2001, the Company recognized stock compensation expense of approximately $454,000 and $1,372,000, respectively. Stock compensation expense was recognized in accordance with FIN No. 28 over the vesting periods of the related options, generally four years. Option grants to non-employees in 2003 were insignificant. No option grants were made to non-employees in 2002 or 2001.

NOTE 7: INCOME TAXES

No provisions for federal income taxes were recorded during the years ended December 31, 2003 and 2002, as the Company incurred net operating losses during these years.

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RITA MEDICAL SYSTEMS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The tax effects of temporary differences that give rise to significant portions of deferred tax assets are as follows (in thousands):

	December 31,	
	2003	2002
Net operating loss carryforwards	$ 23,771	$ 20,849
Capitalized startup and research and development costs	909	170
Research and development credit	1,392	1,214
Other	2,546	1,842
Total deferred tax assets	28,618	24,075
Less: valuation allowance	(28,618)	(24,075)
	$	$

At December 31, 2003, the Company had federal and state net operating loss carryforwards of approximately $66.1 million and $22.0 million, respectively, available to offset future taxable income. The Company s federal and state operating loss carryforwards expire between 2008 and 2022 and between 2004 and 2013, respectively, if not utilized.

Due to the uncertainty surrounding the realization of the favorable tax attributes in future tax returns, the Company has placed a valuation allowance against its deferred tax assets. At such time as it is determined that it is more likely than not that the deferred tax assets are realizable, the valuation allowance will be reduced. Provisions to the allowance were approximately $4,543,000, $6,138,000 and $3,419,000 for the years ended December 31, 2003, 2002 and 2001, respectively.

The Tax Reform Act of 1986 limits the use of net operating loss and tax credit carryforwards in certain situations where changes occur in the stock ownership of a company. In the event the Company has a change in ownership, utilization of the carryforwards could be restricted.

Reconciliation of the statutory federal income tax to the Company s effective tax rate follows:

	2003	2002
	%	%

Tax at federal statutory rate	34.0%	34.0%
State, net of federal benefit	6.0%	6.0%
Other	0.0%	1.0%
Deferred tax assets not benefited	-38.0%	-39.0%
Federal research and development credit	-2.0%	-2.0%
Provision for taxes	0.0%	0.0%

NOTE 8: RELATED PARTY TRANSACTIONS

In August 1994, the Company entered into a cross-license agreement (the Agreement) with VIDAMed (a company whose founder was also one of the founders of the Company) whereby the Company granted VIDAMed and exclusive royalty-free license to use the Company s technology for certain applications. In return, VIDAMed granted the Company an exclusive license to use VIDAMed s technology for certain applications. The Company is required to pay a royalty of 2.5% of net sales on products developed incorporating the VIDAMed technology. This obligation terminates on the earlier of ten years from the effective date of the Agreement or when payments by the Company to VIDAMed total $500,000. To date, the Company has made no payments under this agreement. During 2002, VIDAMed was acquired by Medtronic, Inc.

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RITA MEDICAL SYSTEMS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

During the years ended December 31, 2003, 2002 and 2001, and from time to time prior to 2001, the Company has received professional services relating to the administration of its clinical trials as well as regulatory advice from a firm in which one of the Company s directors serves as an officer. The Company has recognized expenses relating to the services received from this firm of approximately $55,000, $160,000 and $109,000 for the years ended December 31, 2003, 2002 and 2001, respectively.

In April 2003, a member of the Company s Board of Directors began providing consulting services to the Company. This board member was paid approximately $164,000 and was granted options to purchase 35,000 shares of the Company s common stock in connection with his consulting services.

NOTE 9: SEGMENT INFORMATION

The Company operates in one business segment. The Company sells its products and systems directly to customers in the United States, Europe and Asia.

Sales for geographic regions reported below are based upon the customers locations. Following is a summary of the geographic information related to revenues, long-lived assets and information related to significant customers for the years ended December 31, 2003, 2002 and 2001 (in thousands, except percentage data):

	Years Ended December 31,		
	2003	2002	2001
Sales:			
United States	$ 13,274	$ 12,898	$ 8,032
Italy	726	789	1,137
Japan	535	2,331	1,879
Other	2,072	1,375	3,743
Total	$ 16,607	$ 17,393	$ 14,791

	Years Ended December 31,		
	2003	2002	2001

Long-lived assets:			
United States	$ 1,089	$ 1,501	$ 1,802
Europe		64	132
Total	$ 1,089	$ 1,565	$ 1,934

	Years Ended December 31,		
	2003	**2002**	**2001**
Significant customers: Revenue			
Customer A	4%	14%	14%
Customer B	4%	5%	8%

	December 31,	
	2003	**2002**
Significant customers: Accounts and Notes Receivable		
Customer A	12%	14%
Customer B	7%	12%
Customer C	1%	10%

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RITA MEDICAL SYSTEMS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 10: EMPLOYEE BENEFIT PLAN

The Company sponsor s a 401(k) defined contribution plan covering all employees. Contributions made by the Company are determined annually by the board of directors. To date, there have been no company contributions to the plan.

NOTE 11: QUARTERLY RESULTS OF OPERATIONS (UNAUDITED):

The following table sets forth selected items from our consolidated statements of operations for each of the eight quarters ended December 31, 2003. This data has been derived from unaudited consolidated financial statements that, in the opinion of the Company s management, include all adjustments, consisting only of normal recurring adjustments, necessary for a fair presentation of such information when read in conjunction with our annual audited consolidated financial statements and notes thereto appearing elsewhere in this Form 10-K. The operating results for any quarter are not necessarily indicative of results for any future period.

	Quarter Ended							
	Dec. 31, 2003	Sept. 30, 2003	June 30, 2003	Mar. 31, 2003	Dec. 31, 2002	Sept. 30, 2002	June 30, 2002	Mar. 31, 2002
Sales	$ 4,196	$ 3,865	$ 4,049	$ 4,497	$ 3,715	$ 4,454	$ 4,806	$ 4,418
Gross profit	2,559	2,612	2,347	2,923	2,580	2,724	2,766	2,415
Net loss	$ (2,241)	$ (2,514)	$ (3,400)	$ (2,924)	$ (3,053)	$ (2,720)	$ (3,733)	$ (3,993)
Net loss per common share, basic and diluted	$ (0.12)	$ (0.14)	$ (0.19)	$ (0.17)	$ (0.20)	$ (0.18)	$ (0.25)	$ (0.27)
Shares used in computing net loss per common share, basic and diluted	17,971	17,807	17,578	17,223	15,109	14,996	14,835	14,614

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Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure.

Not applicable.

Item 9A. Controls and Procedures.

We carried out an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer and our Chief Financial Officer, of the effectiveness of the Company s disclosure controls and procedures, as defined in Rules 13a-14(c) and 15d-14(c) of the Securities Exchange Act of 1934. Based upon that evaluation, our Chief Executive Officer and our Chief Financial Officer have concluded that as of December 31, 2003, the Company s disclosure controls and procedures are effective. Our disclosure controls and procedures are designed to provide a reasonable level of assurance of reaching our desired disclosure control objectives and are effective in doing so.

There were no significant changes in the Company s internal controls or in other factors that could significantly affect these internal controls during the latest fiscal quarter.

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PART IV

Item 15. Exhibits, Financial Statement Schedules and Reports on Form 8-K.

(a) The following documents are filed as part of this report:

(1) Financial Statements and Report of PricewaterhouseCoopers, LLP

(2) Exhibits are incorporated herein by reference or are filed in accordance with item 601 of Regulation S-K.

(b) Reports on Form 8-K:

A report on Form 8-K was filed with the SEC on October 7, 2003.

A report on Form 8-K was filed with the SEC on October 23, 2003.

A report on Form 8-K was filed with the SEC on November 5, 2003.

A report on Form 8-K was filed with the SEC on November 13, 2003.

A report on Form 8-K was filed with the SEC on December 3, 2003.

A report on Form 8-K was filed with the SEC on December 5, 2003.

(c) Exhibits:

Number	Description

2.1(1)	Form of Agreement and Plan of Merger between the Registrant and RITA Medical Systems, Inc., a Delaware corporation.
3.2(1)	Amended and Restated Certificate of Incorporation of RITA Medical Systems, Inc., a Delaware corporation.
3.4(1)	Amended and Restated Bylaws of RITA Medical System, Inc.
4.1(2)	Preferred Shares Rights Agreement, dated as of July 31, 2001, between RITA Medical Systems, Inc. and U.S. Stock Transfer Corporation, including the Certificate of Designation, the form of Rights Certificate and the Summary of Rights attached thereto as Exhibits A, B and C, respectively.
4.2(7)	Stock Purchase Agreement with SF Capital Partners Ltd., dated January 24, 2003.
4.3(7)	Stock Purchase Agreement with RIVERVIEW GROUP, LLC, dated January 24, 2003.
4.4(7)	Stock Purchase Agreement with BAYSTAR CAPITAL GROUP II, dated January 24, 2003.
4.5(7)	Stock Purchase Agreement with BAYSTAR INTERNATIONAL II, Ltd., dated January 24, 2003.
10.1(1)	Sixth Amended and Restated Shareholder Rights Agreement dated June 20, 2000 by and among the Registrant and certain security holders.
10.2(1)	1994 Incentive Stock Plan (as amended) and form of option agreement.
10.3(4)	2000 Stock Plan (as amended) and form of option agreement.

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Number	Description
#10.4(4)	2000 Directors Stock Option Plan (as amended) and form of option agreement.
10.5(1)	2000 Employee Stock Purchase Plan and form of subscription agreement.
10.6(a)(1)	Master Lease Agreement with Brown Mountain View Joint Venture dated July 12, 1994 and extension of Master Lease Agreement dated May 12, 1999.
#10.7(1)	Form of Indemnification Agreement between the Registrant and its officers and directors.
#10.11(1)	Form of Change of Control Agreement entered into between the Company and it officers.
*10.13(1)	Distribution Agreement with Nissho Iwai Corporation (now named ITX Corporation) for South Korea dated March 12, 1999.
*10.15(1)	Manufacturing Agreement with Plexus Corporation dated February 17, 2000.
*10.16(1)	Manufacturing Agreement with Apical Instruments dated February 23, 2000.
*10.18(3)	Amendment of Distribution Agreement with Nissho Iwai Corporation (now named ITX Corporation) for Japan dated May 11, 2001.
*10.19(5)	Distribution Agreement with MDH s.r.l. Forniture Ospedaliene for Italy dated December 31, 2001.
10.22(5)	Amendment to Master Lease Agreement with Brown Mountain View Joint Venture dated June 4, 2001.
#10.23(6)	Form of Change of Control Agreement entered into between the Company, Trent Reutiman on November 16, 2001, between the Company and Donald Stewart on April 16, 2001.
#10.25(6)	Form of Indemnification Agreement between the Company and Trent Reutiman on November 16, 2001, and between the Company and Donald Stewart on April 16, 2001.
**10.32(8)	Litigation settlement agreement, dated April 4, 2003, between RITA Medical Systems, Inc., RadioTherapeutics Corporation, Boston Scientific Corporation, Scimed Life Systems, Inc., The Board of Regents of the University of Nebraska, Unemed Corporation, University of Kansas d/b/a/ University of Kansas Medical Center and University of Kansas Medical Center Research Institute.
#10.33(8)	Form of Indemnification Agreement between the Company and Randy Lindholm on April 25, 2003 and between the Company and Lynn Saccoliti on May 1, 2003.
10.34(8)	Consulting Agreement with Randy Lindholm dated April 25, 2003.
#10.35(8)	Amendment to Offer Letter to Donald Stewart dated as of May 1, 2003.
#10.36(8)	Offer Letter to Lynn Saccoliti dated as of May 1, 2003.
#10.37(9)	Amended and Restated Consulting Agreement with Randy Lindholm dated August 5, 2003.
#10.38(9)	Form of Indemnification Agreement between the Company and Joseph DeVivo dated August 18, 2003, Wes Johnson dated August 5, 2003, Stephen Pedroff dated September 2, 2003 and Darrin Uecker dated January 12, 2004.

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Number	Description
#10.39(9)	Form of Change of Control Agreement entered into between the Company and Joseph DeVivo dated August 18, 2003, Stephen Pedroff dated September 10, 2003 and Darrin Uecker dated January 12, 2004.
#10.40(9)	Offer letter between the Company and Joseph DeVivo dated July 23, 2003.
#10.41(9)	Offer letter between the Company and Stephen Pedroff dated August 22, 2003.
#10.42	Change of Control Agreement entered into between the Company and Juan J. Soto dated as of September 3, 2003.
#10.43	Contract of Employment between RITA Medical Systems Netherlands BV of DeBoelelaan 7 and Juan J. Soto dated October 15, 2003.
#10.44	Indemnification Agreement between the Company and Juan J. Soto dated November 1, 2003
#10.45	Offer letter between the Company and Darrin Uecker dated January 9, 2004.
23.1	Consent of PricewaterhouseCoopers LLP, Independent Accountants.
24.1	Power of Attorney (See Signature Page).
31.1	Rule 13a-14(a)/15(d)-14(a) Certification of Chief Executive Officer.
31.2	Rule 13a-14(a)/15(d)-14(a) Certification of Chief Financial Officer.
32.1	Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 of Chief Executive Officer.
32.2	Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 of Chief Executive Officer.

* Confidential treatment granted with respect to certain portions of this Exhibit.
** Material has been omitted pursuant to a request for confidential treatment and such material has been filed separately with the SEC.
# Management contract or compensatory plan or arrangement.
(1) Incorporated by reference to our registration statement on Form S-1 (File No. 333-36160) initially filed with the SEC on May 3, 2000.
(2) Incorporated by reference to our registration statement on Form 8-A (File No. 000-30959) filed with the SEC on August 7, 2001.
(3) Incorporated by reference to our report on Form 10-Q (File No. 000-30959) filed with the SEC on August 8, 2001.
(4) Incorporated by reference to our report on Form 10-Q (File No. 000-30959) filed with the SEC on November 14, 2001.
(5) Incorporated by reference to our report on Form 10-K (File No. 000-30959) filed with the SEC on March 28, 2002.
(6) Incorporated by reference to our report on Form 10-Q (File No. 000-30959) filed with the SEC on May 15, 2002.
(7) Incorporated by reference to our report on Form S-3 (File No. 333-102896) filed with the SEC on January 31, 2003.
(8) Incorporated by reference to our report on Form 10-Q (File No. 000-30959) filed with the SEC on August 13, 2003.
(9) Incorporated by reference to our report on Form 10-Q (File No. 000-30959) filed with the SEC on November 13, 2003.

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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Date: March 15, 2004

RITA MEDICAL SYSTEMS, INC.

By: /s/ JOSEPH DEVIVO

Joseph DeVivo

President, Chief Executive Officer and Director

POWER OF ATTORNEY

KNOW ALL PERSONS BY THESE PRESENTS, that each person whose signature appears below constitutes and appoints Joseph DeVivo and Donald Stewart, jointly and severally, his or her attorneys-in-fact, each with the power of substitution, for him or her in any and all capacities, to sign any amendments to this Report on Form 10-K, and to file the same, with exhibits thereto and other documents in connection therewith with the Securities and Exchange Commission, hereby ratifying and confirming all that each of said attorneys-in-fact, or his or her substitute or substitutes may do or cause to be done by virtue hereof.

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

Signature	Title	Date
/s/ JOSEPH DEVIVO **Joseph DeVivo**	President, Chief Executive Officer and Director (Principal Executive Officer)	March 15, 2004
/s/ DONALD STEWART **Donald Stewart**	Chief Financial Officer and Vice President, Finance and Administration (Principal Financial and Accounting Officer)	March 15, 2004
/s/ VINCENT BUCCI **Vincent Bucci**	Director	March 15, 2004
/s/ RANDY LINDHOLM **Randy Lindholm**	Director	March 15, 2004

/s/ JOHN GILBERT **John Gilbert**	Director	March 15, 2004
/s/ SCOTT HALSTED **Scott Halsted**	Director	March 15, 2004
/s/ WESLEY JOHNSON **Wesley Johnson**	Director	March 15, 2004