

Nasdaq / PHMD
Rating: **Accumulate**
(Initial)

Recent Price: **\$1.00**
(9/26/07)

Price Target: **\$2.50**
(Initial Target)

MARKET DATA

52-Week High/Low	\$1.95- \$0.83
Ave. Daily Volume (6-mos.)	45K
Shares Outstanding	62.9M
Inside Ownership	2.1%
Institutional Ownership	34%
Flotation	61.6M
Short Interest	<1%

FINANCIAL DATA

Market Capitalization	\$62.9 M
- Cash & Equivalents	\$10.7 M
+ Long-term Debt	\$ 4.2 M
Enterprise Value	\$56.4 M
Book Value	\$41.2M
Working Capital	\$13.9M
Dividend Yield	Nil

	SALES	NET	CFO	EPS
2006	\$33.2	(\$7.5)	\$0.1	(\$0.14)
1Q07A	\$ 9.1	(\$1.9)		(\$0.03)
2Q07A	\$ 9.3	(\$1.8)		(\$0.03)
3Q07E	\$ 9.6	(\$1.8)		(\$0.03)
4Q07E	\$ 9.8	(\$1.8)		(\$0.03)
2007E	\$37.8	(\$7.3)	(\$1.2)	(\$0.12)
2008E	\$43.0	(\$6.1)	\$0.2	(\$0.10)

Dollars in millions, except EPS; Fiscal year ends Dec.
VALUATION

Price / Sales	1.8 X
Price / CFO	Neg
Price / Earnings	Neg
Price/Book Value	1.5 X
Consensus EPS Estimate 2007	NA
Forward PE	NA
Consensus EPS Estimate 2008	NA
Forward PE	NA

PhotoMedex, Inc.

Laser Medical Devices and Dermatology Therapies

PhotoMedex is a developer of laser systems and solutions for dermatological and surgical applications. Its flagship product is the patented XTRAC laser for the treatment of psoriasis and vitiligo. Clinicians have responded favorably to PhotoMedex's unique per-treatment fee model, which eliminates upfront capital expenditures. PhotoMedex also serves dermatologists with a line of topical preparations for wound treatment and skin care marketed under the brand name ProCyte.

HIGHLIGHTS

- Synergy.** PhotoMedex operations may appear fragmented with sales of laser equipment and dermatology therapies as well as fees from laser procedures. Yet each of the Company's five business units presents strategic value as the Company seeks to penetrate the dermatology and photo-medicine markets.
- XTRAC Laser.** PhotoMedex has gained significant traction in the U.S. market for laser treatment of psoriasis, in part through successful lobbying by PhotoMedex for insurance reimbursement. Clinical specialists, who train and counsel clinic personnel in the effective use of the laser system, are also proving effective in driving usage rates.
- Market Opportunity.** The aging of the Baby Boomer generation has created a growing market for skin care products and cosmetic surgery. The Company targets dermatologists and plastic surgeons with the ProCyte product line assembled from both internal development and in-licensed products.
- Rating and Price Target.** We have initiated coverage of PHMD with a Buy rating and a \$2.50 price target for risk-oriented investors. Our target represents a 3.7 multiple times our 2008 sales estimate of \$43.0 million. We believe this is a fair valuation based on an analysis of metrics among PhotoMedex's peers in the dermatology and photo-medicine markets.

INVESTMENT THESIS

PhotoMedex is riding the wave of demographics driving demand in the dermatology and photo-medicine markets. Among other products the Company has brought an innovative laser treatment to the market for treatment of psoriasis skin disorder. Between four and five million people in the U.S. suffer from some degree of severity of this chronic and incurable disease. About 1.5 million patients are continuously seeking relief from symptoms, spending between \$1.6 billion and \$3.2 billion annually on ointments, phototherapy or injections.

The Company believes its *XTRAC* excimer laser system offers a treatment modality with significant advantages over traditional treatments such as reduced side effects and longer periods of remission. Furthermore, cost of treatment with the *XTRAC* laser system is apparently lower in some cases than conventional treatments. Among the 11,000 dermatologists in the U.S., the Company has identified about 3,200 top physicians who treat the majority of patients with psoriasis and other skin diseases. PhotoMedex has been successful in placing over three hundred *XTRAC* systems in the U.S. and has sold over one hundred units in international markets.

No “one trick pony,” PhotoMedex has used acquisitions to strengthen its competitive position by expanding into additional skin care and laser product lines. The Company markets a line of skin and wound care products to dermatologists under the *ProCyte* brand name. PhotoMedex also sells surgical lasers and provides mobile laser treatment services to physicians, clinics and hospitals. Diversification has provided extended market reach and cross-selling opportunities among its business units.

PhotoMedex has fought through a series of hurdles to penetrate the dermatology market with its *XTRAC* laser and ramping usage rates are encouraging. More aggressive internal development and in-licensing activity is also beefing up the *ProCyte* brand of topical skin treatments. We believe recent results demonstrate that profitability is within reach. We expect similar results in 2H07 and beyond, which should produce compelling year-over-year comparisons.

Investment Positives:

- **Macro tailwind behind demand.** An aging population is leading to accelerating demand for both over-the-counter and prescription skin care products and therapies.
- **Clear leader in photo-medicine market.** PhotoMedex pioneering work has made the *XTRAC* synonymous with laser treatment in the dermatology market.
- **Barriers to entry in dermatology laser market.** A good head start and strong reputation with dermatologists, PhotoMedex has established good barriers to entry for other laser producers. The competitive edge is derived from experience and performance.
- **Strong growth potential in skin care market.** PhotoMedex modest share in the enormous and fragmented skin care market - low single digits - suggests a large opportunity with an open-ended growth opportunity.
- **Signs of sharpening operating disciplines.** PhotoMedex is maneuvering through its market challenges with increased consistency, posting improved margin trends.
- **Strong cash position.** The Company has \$10.7 million in cash resources on its balance sheet that appears adequate to support the operation through to profitability.

Investment Risks:

- **Lapse in top-line performance.** Our estimates and valuation are dependent upon growth in sales. Aggressive marketing by competitors or the introduction of new products in PhotoMedex various market segments could slow or stop the Company's plans to capture market share.
- **Materially worse-than-expected margin performance.** Profitability is contingent in part on sales growth to provide better coverage of fixed costs. The Company may also incur higher-than-expected expenses in sales and marketing that would reduce operating margins.
- **Changes in health insurance reimbursement policies or rates.** The risk is mitigation by historic trends wherein, coverage policy changes by insurers are infrequent. Typically, once approved a drug therapy or medical devices remains on the approved list, but compensation limits could be revised downward.

Exhibit I: Stock Chart

Source: Stockcharts.com

VALUATION AND OUTLOOK

We have initiated coverage of PHMD with a Buy rating and a \$2.50 price target for investors with a tolerance for risk. Our target represents a 3.7 multiple times our 2008 sales estimate of \$43.0 million. We believe this is a fair valuation based on an analysis of metrics among PhotoMedex peers in the dermatology and photo-medicine markets. (See Table VIII on page 18.) PHMD shares appear undervalued against the two groups in terms of price-to-sales and price-to-book value. Granted the peer group approach has limitations in this case given that several of the group members are large, highly diversified operations, for which valuation is based on factors other than their sales of lasers or skin care products. As an empirical check on our comparative valuation exercise, we also weighed the valuation against the Company's double digit growth rates (15%-20%), tangible assets (\$36.9 million) and patent portfolio (over 120 domestic and foreign patents; 40 pending patent applications).

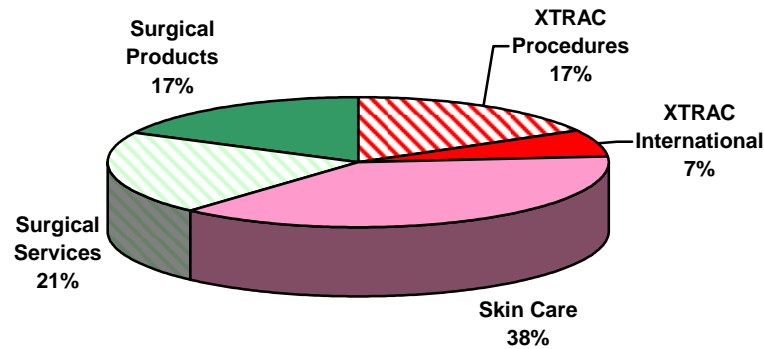
In recent months the stock has been impacted by apparent disorderly reductions in positions by major stakeholders, although trading has returned to more normal patterns in the weeks prior to this report. As a consequence, we believe the stock is egregiously undervalued given the value of its proprietary intellectual property in lasers and skin care compounds. This presents a particularly compelling entry point to establish new positions or add to existing positions in PHMD.

BUSINESS DESCRIPTION

At first look, PhotoMedex operations may appear fragmented with sales of laser equipment and dermatology therapies as well as fees from laser procedures. Yet each of the Company's five business units presents strategic value as the Company seeks to penetrate the dermatology and photo-medicine markets. The Company derives 62% of its revenue from the dermatology market through its proprietary XTRAC laser treatment of psoriasis skin disorder and the sale of skin care products. The Company's expertise in lasers extends to the surgical market where PhotoMedex sells lasers and provides mobile laser surgical services.

The Company turned \$35.2 million in sales in the twelve months ending June 2007. This compares to \$3.3 million in 2002. The five-year ramp in sales was accomplished through a combination of internal product development and acquisitions. PhotoMedex expanded the laser product offering through the acquisition of Surgical Laser Technologies, Inc. (SLT) in late 2002. The deal also added surgical services in the urology, gynecology and neurosurgery areas. The move dramatically increased production capacity and provided a new cash flow source. More recently in March 2005, PhotoMedex acquired ProCyte Corp., a developer and marketer of topical skincare products such as wound care, hair treatment and skin health products. The ProCyte line is distributed through dermatology offices and clinics, many of which are potential partners for the XTRAC laser system.

Chart I: Sales Mix in 2006



Surgical category in green and dermatology category in red tones.

Source: Company Reports

TARGET MARKETS

The Company's long-term strategy is to become a leading provider of photo-medicine and skin-care solutions. Thus the dermatology market is PhotoMedex's oyster. The Company uses a direct sales force composed of sixty-five sales personnel to represent its products. Twelve sales reps are dedicated to the *XTRAC* laser system placements and nineteen are devoted to the skin care product line. Lasers are also sold through distribution partners in foreign markets. In the following sections we discuss market opportunities for each of the Company's product areas.

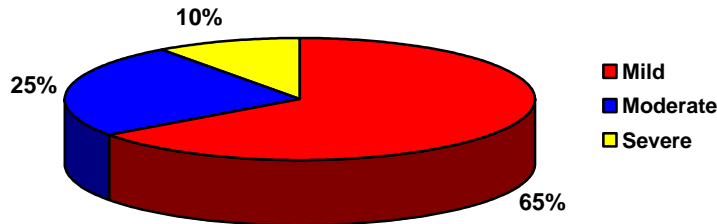
THE XTRAC LASER SYSTEM AND SERVICES

The *XTRAC* laser system combines an excimer or "cold" laser system with ultraviolet light. The system consists of a laser and a hand piece attached by a fiber optic cable. The system applies ultraviolet light at a higher intensity than traditional light therapy. The *XTRAC* system utilizes a 308nm light wavelength, which studies have shown to be the optimal wavelength to treat psoriasis and other skin diseases effectively.

The Company believes its *XTRAC* laser system for treating psoriasis has several advantages over alternative psoriasis treatment modalities:

- Higher efficiency - utilizes the ultraviolet light that has historically proven effective for treating psoriasis; treatment can be focused on the affected areas of the skin through the proprietary light delivery system; permits the use of higher intensity light dose than with traditional ultraviolet light therapies.
- Wider applicability - the highly concentrated, localized application of light allows physicians to use the laser treatment modality on a wider range of patients, from mild to moderate cases.
- Fewer side effects - treatment is applied on the affected areas of the skin and minimizes the side effects of traditional phototherapy.
- Convenience - highly focused, more intense doses reduces the number of therapy sessions and shortens treatment time.

Fees from *XTRAC* procedures performed in participating U.S. clinics and hospitals were \$5.6 million in 2006. Outside the U.S., PhotoMedex sells the *XTRAC* system directly to dermatologists through distributors. Sales of the dermatology laser systems in international markets were \$2.2 million in 2006.

Chart II: Psoriasis Patient Population - based on market size of 4.5 million cases

Source: National Psoriasis Foundation

Psoriasis Market and Demand Drivers

Although the *XTRAC* laser system can be used for a variety of skin disorders such as vitiligo (loss of pigmentation), eczema (skin rash) and leukoderma (stretch marks), psoriasis has been the Company's focus during initial market penetration. Psoriasis is a persistent skin disease characterized by inflamed, red thickened areas with silvery scales, most often on the scalp, elbows, knees, and lower back. While the cause of the disease is not known with certainty, it has been determined that it is not contagious. According to the American Academy of Dermatology, two out of every one hundred people in the U.S. has psoriasis - about four to five million people. Approximately 150,000 new cases occur each year. Between \$1.6 billion and \$3.2 billion is spent annually in treating and comforting psoriasis sufferers.

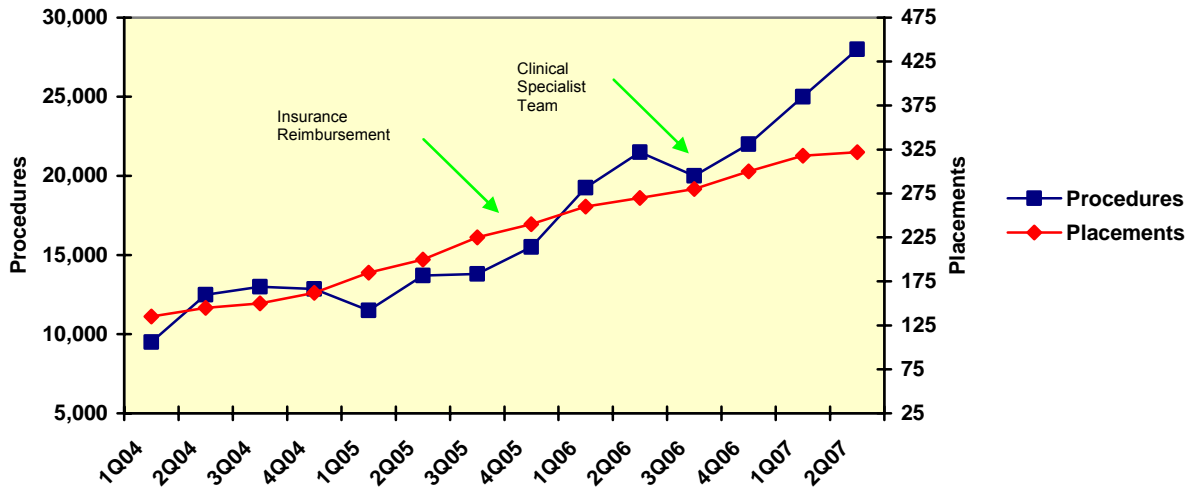
To fully penetrate the dermatology market with its flagship product, the *XTRAC* laser, the Company has adopted a novel economic model based on per-procedure fees. Unlike most other medical laser companies, PhotoMedex retains ownership of most of its lasers in the U.S. market and charges the clinician or medical facility on a per-treatment basis. The Company's strategy is to create attractive economics for health care service providers that will accelerate market penetration. The Company believes that with an increase in the installed base of *XTRAC* systems and wider consumer awareness of the number of procedures will increase and drive revenue.

PhotoMedex has gained significant traction in the market for laser treatment of psoriasis, in part through successful lobbying by the Company for insurance reimbursement. The Company has supported clinical studies that establish efficacy and commission a study that established cost comparisons with established treatment modalities. This persuasive material, along with guidance for filing claims and appealing claim denials, has been provided by the Company to participating physicians. The Company has also put a program into place to support physicians whose patients have been denied insurance reimbursement.

We estimate that nearly three-quarters of insured lives are now eligible for reimbursement for *XTRAC* laser treatment either through formal policies or informal practices. The Company believes that several other insurers are considering reimbursement of the *XTRAC* procedure. Coverage is available but not universal in all other states, but remains below expectations in three key states, California, Illinois and Texas. If adopted, those insurance plans would add an additional 20 million lives, bringing the eligibility rate near 80% to 90% of total insured lives.

Clearly insurance coverage by private carriers is a critical aspect of the Company's ability to penetrate the dermatology disease market. Insurance coverage expands the addressable patient population and provides incentives for physicians to use the *XTRAC* as the preferred treatment modality. As the reimbursement became more widespread by late 2005, usage rates accelerated as shown in Chart III on the following page. An affirmative decision by additional major insurance providers should have a catalyzing effect on sales growth and profitability.

Chart III: XTRAC Utilization Rates



Source: Company Presentations

The second major obstacle PhotoMedex has faced is managing usage rates in clinics where the XTRAC is in place. The Company recently added a team of nine of clinical specialists who train and counsel doctors, nurses and other clinic personnel in the effective use of the laser system. Through added layer of support personnel, PhotoMedex is taking an active roll in aiding their partner physicians in machine use and marketing in order to drive usage rates. Usage rates have noticeably climbed since 3Q06 when the clinical specialists first went into the field as shown in Chart III above.

Psoriasis Treatment Alternatives

Psoriasis has no cure, but a wide range of treatments can give people control over their disease. Treatment is typically based on a patient’s health, age, lifestyle, and the severity of the psoriasis. There are several treatment modalities for psoriasis: 1) topical treatments such as skin creams and ointments, 2) phototherapy such as ultraviolet B radiation (UVB) and ultraviolet A (PUVA), and 3) systemic drugs. The various alternatives are typically followed in a step approach beginning with topical treatments and ending with the stronger systemic drug as simpler modalities fail. To penetrate the dermatology market, PhotoMedex has had to prove the efficacy of the XTRAC laser solution as one additional alternative in the hierarchy of treatment modalities.

The low success rates and side effects for existing solutions have opened the door for PhotoMedex. The National Psoriasis Foundation recently completed a survey of adults with the disease. As many as a fourth of the participants surveyed were very dissatisfied with their overall treatment program. At least three quarters of the people with moderate to severe psoriasis do not use the more aggressive therapies to treat their disease because of the side effects and lack of effectiveness.

For example, existing topical treatments are typically used for patients with mild to moderate cases and have shown efficacy for short periods in about 45% of these patients. The most common of these topical treatments are corticosteroids, which sometimes cause thinning skin, discoloration and light sensitivity. Patient compliance is an issue, particularly since success even for a limited period of time requires a high number of treatments. After many months of treatment, psoriasis may become resistant to steroid preparations.

Traditional phototherapy modalities (UVB and PUVA) have shown much higher success, temporarily clearing about 75% of patients. These phototherapy modalities, however, have some negative side

affects since they require a patient to enter a booth and receive whole body radiation that exposes healthy skin to UVB radiation. To avoid potentially severe burns or the risk of cancer, physicians limit the intensity of the dosage and over a longer treatment cycle to 20 to 40 sessions. As a consequence, patients must commit significant time for a successful outcome.

Systemic drugs include prescription drugs methotrexate, cyclosporine and oral retinoids. While use of methotrexate and cyclosporine result in a high success rate of 80%, side effects are numerous and serious, including nausea, fatigue, liver damage and kidney dysfunction.

A new class of treatment called biologics may also have value in treating psoriasis. Biologics are injected or infused rather than taken orally to target specific parts of the immune system. There are five such treatments approved to treat psoriasis, including alefacept (brand name Amevive), efalizumab (brand name Raptiva), adalimumab (brand name Humira), infliximab (brand name Remicade) and etanercept (brand name Enbrel).

PhotoMedex believes that its laser system is emerging as an important treatment alternative. Excimer lasers such as the XTRAC emit a high-intensity beam of ultraviolet (UV) light similar to the light in narrow-band UVB units. The beam can be targeted at selected areas of the skin. Between six to eight sessions with the XTRAC system are required for successful treatment, which are usually done twice a week. Each treatment lasts just a few minutes, depending upon the size of the area being treated. For example, an elbow lesion would take about one minute to treat.

Table I: Clinical and Economic Outcomes Study*

<u>Treatment Modality</u>	<u>Expected Cost</u>	<u>Expected TF Days</u>	<u>Expected R Days</u>	<u>Expected Cost/TFD</u>	<u>Expected Cost/RD</u>
Corticosteroid Injection	\$ 591.53	359.273	264.727	\$ 1.65	\$ 2.23
Excimer Laser	\$2,280.56	350.435	316.522	\$ 6.51	\$ 7.21
UVB	\$4,805.90	291.200	218.400	\$16.50	\$22.01
PUVA	\$4,861.09	312.000	222.444	\$15.58	\$21.85
Anthralin + Corticosteroid	\$ 838.78	-0-	225.333	N/A	\$ 3.72
Tazarotene + Corticosteroid	\$2,053.26	82.105	249.053	\$25.01	\$ 8.24

TF Days - Treatment Free Day

R Days - Remission Day

*Outcomes for Model D - One Second Line of Defense Therapy with assumption of successful outcome and without therapy rotation. Other models were included in the study resulting in other expected cost, treatment free day and remission free day results.

Source: Clinical and Economic Outcomes Study, Thomson Health Economics Research

Barriers to Entry

In our view, PhotoMedex's lead time in the dermatology laser market may be as valuable as patent protection in building barriers to entry for new competitors. For example, the new biologics that are coming along the pharmaceutical pipeline could prove more effective than laser treatment, but at current cost levels of \$10,000 to \$20,000 annually, it would seem that considerably more work must be done before these drugs are commercially viable.

A second excimer laser has received FDA approval for use in treating psoriasis. However, we believe this could present a greater threat to the UVB and pulse dye laser producers than to PhotoMedex. Our reasoning is that a second advanced laser could serve to further solidify the excimer laser modality as the preferred phototherapy choice for skin disease versus other treatments that appear to be more costly or

less effective. This could facilitate *XTRAC* penetration rates rather than hinder it. As it is, the *XTRAC* is becoming so closely identified with psoriasis laser treatment, it is possible that “*XTRACing*” could become part of the dermatologists’ vernacular much like “*Xeroxing*” become synonymous with making photocopies of documents.

XTRAC Economic Model

Laser units are placed by PhotoMedex in the offices of dermatologists with high-volume psoriasis practices at no up-front capital cost. The dermatologist is charged on a per-treatment basis for use of the *XTRAC* laser system through a pre-paid treatment card that is applicable for the same or different patients and for any FDA approved skin disorder. The dermatologist then retains any revenue received from patients or medical insurance providers. Currently the Company is receiving approximately \$65.00 per treatment from participating physicians in the U.S.

We believe the revenue sharing program is a competitive advantage in the U.S. dermatology laser market. Physicians typically do not share in the revenue stream from topical treatments or internal medications, since these treatment modalities are prescribed by the dermatologist but are then purchased outside the physician’s offices. Some dermatologists purchase equipment for the ultraviolet light box alternative, but the capital requirement for adding light box or laser treatment modalities for skin diseases to the dermatology practice is thought to hold back some physicians despite the appeal of a new revenue stream.

International Dermatology Market

PhotoMedex management believes they have developed an economic model that is attractive to a broad spectrum of dermatology practices across the U.S. However, in the international market, principally in Europe, the Company has been challenged by low insurance reimbursement rates for psoriasis treatment and competition from lower priced equipment from foreign producers. Accordingly, the Company turned to equipment sales in markets outside the U.S. using a network of distribution partners. In the last year, PhotoMedex has moved more aggressively in international markets by selling refurbished *XTRAC* laser systems and introducing the new *VTRAC* lamp-based, alternative UVB light source. The *VTRAC* price-point is more competitive with similar laser products and from non-laser lamps that are prevalent in Europe and Asia.

SKIN CARE PRODUCTS

The Baby Boomer generation has created a growing market for skin care products as well as cosmetic surgery to mitigate the effects of aging. The Company targets dermatologists and plastic surgeons with *ProCyte* product line assembled from both internal development and in-licensed products. The product line includes the *GraftCyte* System for tissue repair following hair transplant surgery and *Complex Cu3 System* for post-procedure care. The line also includes the *Neova Therapy* group of anti-aging products and *Tricomin Copper Complex* group of hair care products for patients with thinning hair.

The Company’s patented manganese and copper peptide compounds are key ingredients in most of the skin care products. Copper peptide has been found to stimulate collagen synthesis, new blood vessel growth and tissue repair. Manganese is an essential mineral that provides a defense against UV-induced photo-aging. The Company expects to build on *ProCyte*’s twenty years of research in this area to building its skin care product line. In Fall 2007, the Company plans to unveil the *Neova Manganese Skin Brightening Serum*, an anti-aging formula based on its *GHK Manganese Peptide Complex*.

The Company recently licensed technology for another one of its recent product introductions, *MD Lash Factor*, an eye-lash conditioner. The product is targeted at patients with alopecia areata (recurrent hair loss) and those receiving chemotherapy.

In addition to sales of its own *ProCyte* branded products, PhotoMedex also licenses its formulations to other producers of skin care products. For example, Johnson & Johnson sells Visibly Firm with Active Copper among other Neutrogena branded products based on the Company's copper peptide compound. The relationship appears to be in a period of transition as Neutrogena maneuvers through its product cycles. PhotoMedex management remains confident that Neutrogena will remain a licensee and additional license relationships are possible.

Skin Care Market

The skin care market is highly fragmented and the various competing products are diverse in composition and product claims. The *ProCyte* brand is positioned on the high-end of the market and is offered only through dermatologists.

A number of players in the physician-dispensed market are substantially larger than PhotoMedex such as Allergan (AGN: NYSE) and Obagi Medical Products (OMPI: Nasdaq). Obagi sells Obagi Nu-Derm System for sun damaged skin and Professional-C Serums for antioxidant protection. Dermatology is one of four primary product areas for Allergan, which positions itself as a leader in retinoid therapies. In addition to anti-oxidants Allergan also markets acne and topical treatments for psoriasis that are dispensed by prescription. Other competitors in the physician-dispensed market include BioMedic from La-Roche Posay, TNS from Skin Medica, Inc., certain products from SkinCeuticals of L'Oreal, S.A., and Kinerase from Valeant Pharmaceuticals (VRX: NYSE).

ProCyte dermatologist distribution partners face competition from numerous products in the retail channel. For example, Murad, Inc. (private) has a broad product line which addresses the effects of aging, sun damage, and acne among other skin care issues. Murad markets its products through salons and distributors and has therefore developed strong brand name recognition in the retail market. Other premium skin care brands available in the retail market include Dr. Brandt, Freeze 24/7, and Garnier Nutritioniste among many others. These products typically have lower price points often afforded by lower active ingredient content. The Company competes indirectly in the lower-priced retail by licensing its compounds to other manufacturers, such as the long-standing relationship with Johnson & Johnson's Neutrogena Corp.

SURGICAL LASERS AND SURGICAL SERVICES

Surgical laser division revenue is generated primarily from technician services and the sale of surgical laser systems. The laser product line includes the *LaserPro Diode Laser System* and *LaserProCO2*. The *LaserPro Diode* is designed to be portable with a small form-factor and rugged construction. The *LaserPro CO2* is also transportable, but delivers 30 watts of power versus 20 watts for the Diode laser. The *Contact Laser Delivery System* combines a proprietary delivery system with a laser unit, which is capable of cutting, coagulating or vaporizing tissue. The beam is either delivered directly or through one of six interchangeable *Laser Probes* or *Laser Scalpels*, which are based on the Company's patented *Wavelength Conversion Effect* treatments.

Surgical services are provided to clinics, hospitals and physicians through a technician on a per-treatment basis utilizing PhotoMedex's various surgical laser technologies. Most of the service operations are in the southeastern U.S., Milwaukee and the Baltimore-Washington, D.C. areas. The Company intends to expand its surgical services to new markets where adequate compensation agreements with hospitals and surgery patient populations support investment in clinical support specialists and the operating infrastructure necessary to offer quality services. In 2006, the Company entered into an agreement with a nationwide consortium of hospitals and has begun what management has called a "staged rollout" to member hospitals.

Table II: Medical Laser Peer Group

Name	TICKER	Revenue Sources							Applications						INSURANCE REIMBURSEMENT	
		Equipment Sales	Equipment Rental	Disposable Sales	Services	License Fees	Care Centers	Procedures	Dermatology - Cosmetic	Dermatology - Disease	Vascular	Cardiovascular	Vision Correction	Eye, Ear & Nose		Urology & GYN
Lumenis	LUME	X			X				Z	Z	Z	Z	Z	Z	Z	Some reimbursement
Visx	EYE	X	X		X	X	X					Z				None
Candela Corporation	CLZR	X			X		X		Z	Z						Unreported
Laserscope-AmerMed	AMMD	X			X				Z					Z		Medicare
Palomar Medical	PMTI	X				X			Z	Z						Unreported
Iridex	IRIX	X			X				Z			Z	Z			Generally reimbursed
Spectranetics Corp.	SPNC		X	X						Z						Generally reimbursed
Cardiogenesis Corp.	CGCP	X		X							Z					Medicare
PLC Systems	PLC	X		X	X						Z					Medicare
Trimedyne	TMED	X											Z	Z	Z	None
Cell Robotics	CRII	X							Z					Z		None
Surgilight	SRGL	X				X						Z				None
Diomed Holdings	DIO	X		X	X					Z					Z	Generally reimbursed
PhotoMedex	PHMD	X	X	X	X	X	X	X	Z	Z	Z	Z	Z	Z	Z	Generally reimbursed

Source: Company Reports and Web-sites

Laser System Developers

There are a number of players in the medical laser system market, several of which are noted in Table II below. In the dermatology market we highlight Lumenis, Inc. (LUME: Nasdaq), which produces a middle-wave ultraviolet laser system called BClear, and Candela Corp. (CLZR: Nasdaq), which produces a pulse dye laser branded C-Beam. Lumenis, along with Trimedyne (TMED: Nasdaq) and Diomed Holdings (DIO: NYSE) are also players in the vascular, urology and surgical laser markets.

LEADERSHIP AND OWNERSHIP

PhotoMedex benefits from a seasoned leadership team headed by CEO, Jeffrey O'Donnell. O'Donnell is a veteran of the medical device industry and has held a series of senior marketing and management positions in both established industry players (Boston Scientific and Guidant) as well as smaller, growing operations (Radiance Medical Systems and Kensey Nash). O'Donnell has been with the Company since 1999 and is a member of the board of directors.

The operations and finance functions are headed by Michael Stewart and Dennis McGrath, respectively. McGrath first joined the Company in 2002, bringing a strong background in corporate finance, M&A, and accounting. Stewart was added to the team through the 2002 acquisition of SLT.

There have been recent changes over in personnel in key marketing and business development positions. A new director of marketing is the most recent addition to the team following the departure of former ProCytex executives in the last half of 2006. While the transition in leadership may have led to a period of uncertainty, a faster pace and keener focus appears to be building in the revitalized team.

Table III: Scientific Advisory Board

Member	Current Industry Position
R. Rox Anderson, MD, Chairman Kenneth Arndt, M.D.	Research Director, Massachusetts General Hospital Laser Center Co-director, Cosmetic Surgery and Laser Center, Harvard Medical Faculty Physicians at Beth Israel Deaconess Medical Center, Boston
Steven R. Feldman, M.D.	Professor of Dermatology, Pathology and Public Health, Wake Forest University School of Medicine
Richard Fitzpatrick, M.D.	Associate Clinical Professor at UCSD and Mercy Hospital in San Diego, private practice with Dermatology Associates of San Diego County
Roy Geronemus, M.D. Lajos Kemeny, M.D.	Director of the Laser & Skin Surgery Center of New York Head of the Department of Dermatology and Allergology, University of Szeged, Hungary
John Y.M. Koo, M.D.	Vice Chairman and Associate Clinical Professor, Department of Dermatology, University of California San Francisco Medical Center
Warick Morison, M.D.	Professor of Dermatology at Johns Hopkins School of Medicine; practicing dermatologist at John Hopkins Greenspring Medical Center
Daniel Siegel, M.D. James Spencer, M.D.	Professor of Clinical Dermatology at State University of New York Clinical Professor in the Department of Dermatology at Mount Sinai

Source: PhotoMedex corporate website at www.photomedex.com

PhotoMedex also benefits from the work of a scientific advisory board. The group has been expanded to ten members from among the most respected dermatologists around the world. We believe these advisors bring valuable expertise and knowledge to PhotoMedex as well as serve as valuable sources of credibility in the industry.

Ownership

Insider ownership is a modest 2.1% of outstanding shares, although an equity compensation program lends to aligning management's interest with shareholders. PhotoMedex has benefited from strong sponsorship by professional investors and institutions have bought up 33% of the Company. Top institutional holders include Lehman Brothers, Goldman Capital Management, and Corsair Capital Management, each one of which holds more than 5% of outstanding shares.

The Company has 6.1 million options and 4.7 million warrants outstanding, representing 17.2% potential dilution to existing shareholders. We believe most of the derivative securities are out-of-the money with weighted average exercise prices of \$2.09 for the options and \$1.75 for the warrants.

FINANCIAL PERFORMANCE

Revenue

Sales reached in \$33.2 million in 2006, increasing 16.9% over the prior year. Although profitability has eluded the Company during its developmental period, it is clear that net losses are diminishing as sales climb. The Company appears poised to record another year of sales growth in 2007.

PhotoMedex has five primary revenue sources: 1) XTRAC per-procedure fees in the domestic market, 2) dermatology equipment sales in foreign markets, 3) surgical laser per procedure fees, 4) the sale of surgical laser systems and related maintenance service agreements, and 5) the sale of skincare products in the dermatology market and license fees for skincare compounds.

Domestic XTRAC Laser Services. Revenue from the domestic XTRAC laser program is impacted by the number of systems in use, the number of procedures that are performed, and the average revenue per procedure. The Company's partners performed 95,944 billed procedures (100,000 total procedures) the

twelve months ending June 2007 with the XTRAC laser system compared to 83,276 in the year 2006. Procedures increased year-over-year partly due to the addition of 47 net new XTRAC systems in the last twelve months from 275 at the end of June 2006 to 322 at the end of June 2007. We estimate billed procedures per machine per day averaged 1.4 in the first six months of 2007 compared to an average of 1.2 in the same period a year ago. Usage rates were 2.9 procedures per machine per day for the top one hundred placement sites, while the top five locations average 7.1 treatments per day. The average revenue per billed procedure was unchanged near \$65.00.

Improved usage rates increased sales by 66.7% in the first half of 2007 compared to the prior year period. Besides the increase in system placement, the Company attributes the dramatic increase to the addition of clinical specialists in late 2006.

International Dermatology Laser System Sales. A more focused marketing and distribution approach to foreign markets as well as the addition of the new VTRAC Laser System to the product line has added to international equipment sales. International sales grew 57.1% in 2006 over the prior year to \$2.2 million. In 1H07 sales were \$1.3 million compared to \$800,000 in the prior-year period.

Surgical Lasers Systems and Services. Sales of surgical lasers and accessories have inched upward over the past three years reaching \$5.8 million in 2007. However, revenue dipped slightly in 1H07 compared to the prior year period to \$2.6 million. The decrease in revenue is due in part to shift in the sales mix to the lower priced diode laser, which is replacing older models. Year-over-year comparisons were also muddled by an exceptional order for disposables in the prior year period that was not repeated in the most recent.

Skin Care Products. Revenue is composed of product sales to dermatology practices as well as license fees. The ProCyte skin care product line provided \$6.6 million or 36% of sales in the first six months of 2007. This represents a small improvement in the pace after a sluggish year 2006 when sales were flat compared to the prior year. The improvement can be attributed to completion of the integration of the ProCyte operation into the PhotoMedex parent, new product introductions and a revitalized marketing and sales program.

The license and supply agreements with Neutrogena represent a significant portion of this segment's sales - \$1.3 million or 10.3% of the segment sales in 2006. Royalty rates under this agreement were reduced in recent months and Neutrogena has signaled the conclusion of normal product cycles for some items using ProCyte compounds.

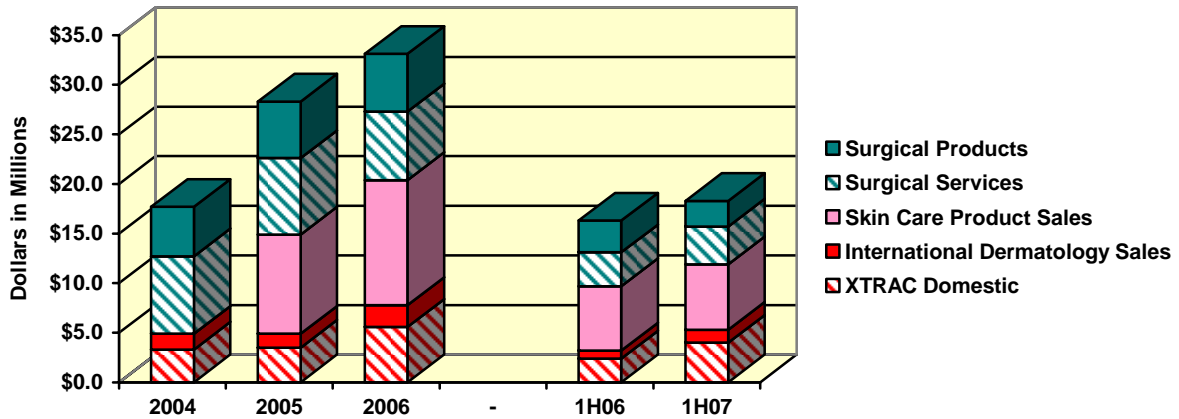
Table IV: Dermatology Laser Procedures and Equipment Sales in Units

	2004	2005	2006	1H06	1H07
XTRAC Procedures					
XTRAC Domestic Laser Placements*	170	247	300	275	322
XTRAC Billed Procedures	47,915	54,255	83,276	40,125	52,793
XTRAC Procedure Average Price	\$66.42	\$65.63	\$65.58	\$65.53	\$65.72
Equipment Sales					
XTRAC Domestic Sales	- 0 -	- 0 -	11	- 0 -	23
XTRAC/VTRAC International Sales	26	26	46	18	25

*XTRAC domestic laser placements represent the number of lasers installed in participating clinics at the end of the period.

Source: Company Reports

Chart IV: Historic Sales Mix



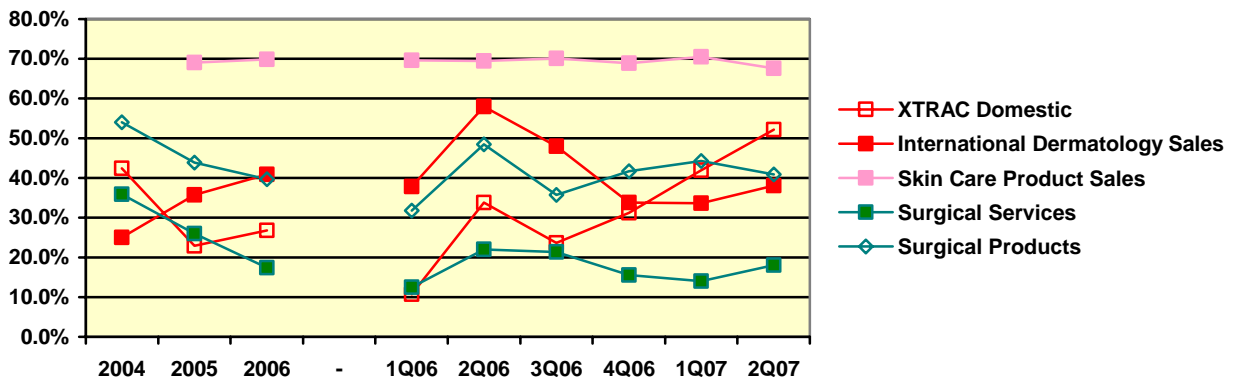
Source: Company Reports

Profit Margins

Combined profit margins in the first half of 2007 improved significantly to 47.5% compared to 45.4% in the prior year period. The primary contributor to the advance in profitability came from a dramatic leap in the margin on domestic XTRAC revenue to 47.6% in 1H07 compared to 23.5% in the same period a year ago. Sales of XTRAC lasers domestically were a key contributor as margins were 84% on these units. Otherwise increasing procedure volumes generated higher revenue and better coverage of fixed costs. Excluding sales of XTRAC equipment, we estimate the profit margin on XTRAC procedures increased to 35.2% in 1H07 compared to 23.5% in the prior-year period.

In the other segments, reductions in average selling prices have put downward pressure on profits in the Surgical Products segment. A shift in the sales mix also impacted Surgical Product margins in 1H07 compared to the prior year period. The inclusion of royalties against which the Company incurs few costs, drives profit margins in the Skin Care Products segment. Profit margins on skin care products remain stable near 70%.

Chart V: Segment Gross Profit Margins



Sources: Company Reports

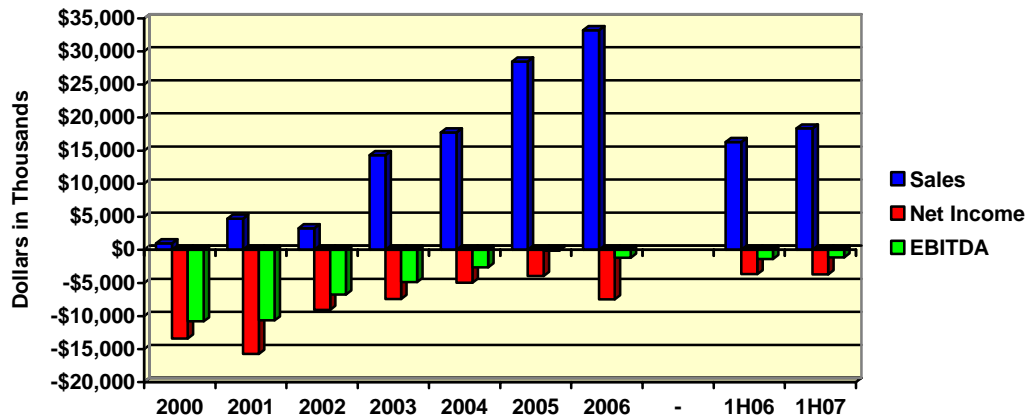
Operating Structure

While the PhotoMedex operating structure might not be characterized as lean, the Company has benefited from operating leverage in the past couple of years. Sales grew 41.9% in 2006 over the prior year, but management kept operating expense growth at 23.3%. However, the benefits of leverage appear to have stall in the first half of 2007. Operating expenses increased 12.0% year-over-year to \$12.1 million in 1H07, just under the 12.9% increase in sales. This is largely due to investments in new sales, marketing and clinical specialists to drive placements and usage rates for its XTRAC system. We expect benefits from operating leverage to resume in the second half of 2007.

Interest expense on the Company's long-term debt was \$238,386 in 1H07 compared to \$258,990 in the prior year period.

Operating losses during have decreased each year since 2001. Comparisons between 2006 and the previous year are skewed by the inclusion of stock compensation expense that was not recognized in prior years. Results in 2005 included proceeds from a litigation settlement, which reduced the 2005 net loss by \$1.3 million. Excluding stock compensation expense of \$1.3 million in 2006, the loss before interest, depreciation and amortization would have been \$1.5 million and reported net loss would have been an estimated \$6.2 million. This compares to the 2005 adjusted net loss of \$5.2 million.

Chart VI: Historic Sales and Earnings



Source: Company Reports

Cash Flow and Balances

PhotoMedex achieved cash flow neutrality in 2006 and has since used \$1.0 million in cash during the first six months of 2007. This is a critical achievement after several years of net losses and negative cash flows from operations. Cash balances at the end of June 2007 were \$10.7 million, originating primarily from the private placement of common stock and warrants in November 2006. The Company issued 9.8 million shares of common stock at \$1.17 per share and 2.4 million warrants with an exercise price of \$1.60. The offering raised \$9.8 million in capital net of transaction costs.

Property plant and equipment balances include lasers in service for the domestic XTRAC segment. At the end of June 2007, the gross carrying value of these lasers was \$17.7 million, of which we estimate approximately half has been depreciated.

Table V: Historic Balance Sheet and Cash Flows - Selected Items (dollars in thousands)

Dollars in Thousands	2004	2005	2006	6/30/07
CURRENT ASSETS				
Cash & cash equivalents	3,997	5,403	12,730	10,563
Total current assets	13,102	18,929	25,721	25,334
LONG-TERM ASSETS				
Property, plant & equipment, net	4,997	7,045	9,054	9,582
TOTAL ASSETS	22,962	48,675	57,482	57,003
CURRENT LIABILITIES				
Total current liabilities	6,983	7,808	9,651	11,370
LONG-TERM LIABILITIES				
Long-term debt & notes payable	1,372	2,438	3,728	4,210
STOCKHOLDER'S EQUITY				
Retained earnings (deficit)	(76,247)	(80,183)	(87,675)	(91,394)
Total stockholders' equity	14,580	38,417	44,103	41,302
TOTAL LIABILITIES AND EQUITY	22,962	48,675	57,482	57,003

Dollars in Thousands	2004	2005	2006	1H07
CASH FLOW STATEMENT				
Cash used by operations	(2,665)	(1,730)	61	(969)
Cash used in investment activities	(2,678)	1,993	(5,026)	(2,125)
Cash provided by financing activities	2,694	1,255	12,892	(2,167)
ENDING CASH BALANCES	3,885	5,403	12,730	10,563

Source: Company Reports

EARNINGS MODEL

The earnings model shown in Table VI demonstrates our view that the Company should be able to accelerate penetration of the psoriasis market, increase fees from surgical services and XTRAC procedures, and reduce cash usage by operations. However, our model may appear conservative to some investors with top-line growth held at 17% and net losses through the end of 2008.

Our model is based on the following assumptions:

- Continued modest growth in 2H07 and 2008 in Surgical Services, Surgical Product, International Dermatology Equipment and Skin Care Product sales similar to recent rates
- Placement of an additional 28 XTRAC lasers in 2H07 and 50 XTRAC lasers in 2008
- Increases in average domestic XTRAC usage rates by 10% to 15% in 2008
- Stable reimbursement rates and average payments per procedure near \$65.00
- Modest operating leverage in 2H07 and 2008 resulting from better coverage of fixed costs

The combination of our assumptions results in 2007 and 2008 estimated sales of \$37.8 million and \$43.0 million. Estimated net losses per share are \$0.12 and \$0.10, respectively. Importantly, we estimate cash usage by operations at \$1.2 million in 2007 and neutral to positive cash flow in 2008.

There is considerable room for upside in our scenario. First, there could be additional progress with insurers in California, Texas and Illinois in gaining coverage of *XTRAC* procedures. These states have high patient populations and numerous well-qualified dermatologists. We expect some pent up demand from these clinicians, who by now are aware of the merits of laser treatments for psoriasis. Second, there could be additional improvement in *XTRAC* usage rates from the clinical specialists who are now working on a continuous basis with participating clinics. We believe this group is just now beginning to explore the various networking options that could drive awareness and interest among psoriasis patients and their physicians.

The Company is also at an early stage in marketing its new *VTRAC* laser in foreign markets. An expansion in unit volumes also presents upside to our model, which assumes only nominal growth in International Dermatology Equipment sales.

We may have also short-changed the impact of the Company's two most recent product introductions in its Skin Care product line, *Neova Manganese Skin Brightening Serum* and *MD Lash Factor*. These two products appear to be well-timed in terms of demand and could contribute significantly to 2008 sales.

There is also upside from our cost and expense assumptions, particularly if sales exceed our expectations. We have forecast a 330 basis point improvement in the operating profit margin, which could prove conservative if the Company either realizes higher sales levels or is able control expenses.

Table VI: Segment Sales Estimates

	3Q07	4Q07	Year 2007	Year 2008
XTRAC Domestic	\$2.5	\$2.6	\$ 9.7	\$12.2
International Dermatology Sales	\$0.6	\$0.6	\$ 2.5	\$ 2.7
Skin Care Products	\$3.1	\$3.1	\$12.8	\$14.3
Surgical Services	\$2.0	\$2.0	\$ 7.8	\$ 7.8
Surgical Products	\$1.4	\$1.5	\$ 5.5	\$ 6.0
Total	\$9.6	\$9.8	\$38.3	\$43.0

Source: Crystal Equity Research

Additional information is available upon request.

Table VII: Historic and Projects Sales and Earnings

Dollars in Thousands	2004	2005	1Q06	2Q06	3Q06	4Q06	2006	1Q07	2Q07	3Q07E	4Q07E	2007E	2008E
Net sales													
Product sales	6,497	16,545	5,244	5,009	5,166	4,934	20,353	7,253	5,676	5,820	5,870	24,619	25,640
Services	11,248	11,840	2,837	3,215	3,126	3,659	12,837	1,776	3,643	3,758	3,956	13,133	17,360
Total Net Sales	17,745	28,385	8,081	8,224	8,292	8,593	33,190	9,029	9,319	9,578	9,826	37,752	43,000
Cost of sales													
Product costs	3,325	7,220	2,322	1,955	2,098	2,254	8,629	2,137	2,283	2,357	2,377	9,154	9,487
Services costs	7,039	8,456	2,386	2,269	2,561	2,627	9,843	2,644	2,622	2,706	2,848	10,820	12,152
Total cost of sales	10,363	15,676	4,708	4,224	4,659	4,881	18,472	4,781	4,905	5,063	5,226	19,975	21,639
Gross profit	7,382	12,709	3,373	4,000	3,633	3,712	14,718	4,248	4,414	4,515	4,600	17,778	21,361
Operating expenses:													
Selling and marketing	10,426	16,477	2,953	2,605	2,678	3,264	11,500	3,329	3,292	3,352	3,390	13,363	14,620
General and administrative			2,407	2,342	2,221	2,212	9,182	2,478	2,566	2,586	2,604	10,234	11,180
Research, development & engineering	1,802	1,128	242	255	267	243	1,007	248	230	239	246	963	1,118
Total operating expenses	12,228	17,605	5,602	5,202	5,166	5,719	21,689	6,055	6,088	6,178	6,239	24,560	26,918
Operating income (loss)	(4,846)	(4,896)	(2,229)	(1,202)	(1,533)	(2,007)	(6,971)	(1,807)	(1,674)	(1,663)	(1,639)	(6,783)	(5,557)
Total other income (expense)	(138)	960	(121)	(138)	(159)	(104)	(522)	(76)	(162)	(150)	(150)	(538)	(550)
Net income (loss)	(4,984)	(3,936)	(2,350)	(1,340)	(1,692)	(2,111)	(7,493)	(1,883)	(1,836)	(1,813)	(1,789)	(7,321)	(6,107)
Net earnings (loss) per share, diluted	\$ (0.13)	\$ (0.08)	\$ (0.05)	\$ (0.03)	\$ (0.03)	\$ (0.03)	\$ (0.14)	\$ (0.03)	\$ (0.03)	\$ (0.03)	\$ (0.03)	\$ (0.12)	\$ (0.10)
Weighted shares outstanding, diluted	38,835	48,786	52,174	52,622	52,659	54,000	54,189	62,536	62,702	62,900	62,900	62,760	63,500
SELECTED MEASURES:													
Sales growth, yr/yr	23.9%	60.0%					16.9%					13.7%	13.9%
Net income growth, yr/yr	33.0%	21.0%					-90.4%					2.3%	16.6%
EPS growth, yr/yr	39.4%	37.1%					-71.4%					15.6%	17.6%
Gross margin	41.6%	44.8%	41.7%	48.6%	43.8%	43.2%	44.3%	47.0%	47.4%	47.1%	46.8%	47.1%	49.7%
Operating margin	-43.1%	-41.4%	-78.6%	-37.4%	-49.0%	-54.9%	-54.3%	-101.7%	-46.0%	-44.2%	-41.4%	-51.6%	-32.0%
Net margin	-44.3%	-33.2%	-82.8%	-41.7%	-54.1%	-57.7%	-58.4%	-106.0%	-50.4%	-48.2%	-45.2%	-55.7%	-35.2%
Products direct costs, % sales	51.2%	43.6%	44.3%	39.0%	40.6%	45.7%	42.4%	29.5%	40.2%	40.5%	40.5%	37.2%	37.0%
Services direct costs, % sales	62.6%	71.4%	84.1%	70.6%	81.9%	71.8%	76.7%	148.9%	72.0%	72.0%	72.0%	82.4%	70.0%
Sales & marketing expense, % of sales	58.8%	58.0%	36.5%	31.7%	32.3%	38.0%	34.6%	36.9%	35.3%	35.0%	34.5%	35.4%	34.0%
G&A expense, %sales			29.8%	28.5%	26.8%	25.7%	27.7%	27.4%	27.5%	27.0%	26.5%	27.1%	26.0%
RD&E expense, % of sales	10.2%	4.0%	3.0%	3.1%	3.2%	2.8%	3.0%	2.7%	2.5%	2.5%	2.5%	2.6%	2.6%
EBITDA, \$\$	(3,080)	(1,679)					(2,772)					(2,483)	(1,057)
EBITDA margin	-27.4%	-14.2%					-21.6%					-18.9%	-6.1%

*Sales & marketing expense includes General & administrative expenses in 2004 and 2005.

Source: Company Reports and Crystal Equity Research estimates

Table VIII: Laser and Skin Care Peer Groups

Name	TICKER	RECENT PRICE	TRLNG REV	OPER MARGIN	DEBT / EQUITY	ROE	MARKET CAP	PRICE/ SALES	PRICE/ CSH FL	PRICE/ EARN	PRICE/ BK VAL
Laser Group											
American Medical Systems	AMMD	\$17.48	\$430.8	-2.9%	2.17	-11.2%	\$1,260.0	2.9	Neg	Neg	4.0
Candela Corporation	CLZR	\$8.03	\$148.6	2.3%	0.00	6.2%	\$185.7	1.3	Neg	30.6	1.8
Cardiogenesis Corporation	CGCP	\$0.23	\$13.7	-8.6%	0.17	-31.2%	\$10.4	0.8	Neg	Neg	3.3
Diomed Holdings, Inc.	DIO	\$0.72	\$24.1	-0.5%	0.18	-303.9%	\$21.7	1.0	Neg	Neg	2.5
Cutera, Inc.	CUTR	\$26.33	\$1,102.7	-2.6%	0.00	13.2%	\$350.8	3.4	23.9	27.5	3.0
Iridex, Inc.	IRIX	\$4.20	\$46.1	-13.3%	0.31	-30.8%	\$34.5	0.8	Neg	Neg	1.1
Palomar Medical Technologies	PMTI	\$29.05	\$131.7	34.2%	0.00	38.3%	\$533.9	4.1	13.0	14.4	4.0
PLC Systems, Inc.	PLC	\$0.48	\$6.7	12.7%	0.00	-16.5%	\$14.6	2.2	10.3	Neg	2.4
Spectranetics Corporation	SPNC	\$13.75	\$71.6	-5.0%	0.00	7.2%	\$430.7	6.0	43.2	78.9	4.9
Surgilight, Inc.	SRGL	\$0.02	\$0.2	-52.0%	0.00	-846.9%	\$1.2	5.1	Neg	Neg	Neg
Trimedyn, Inc.	TMED	\$0.76	\$5.4	-6.7%	0.00	-2.2%	\$14.0	2.9	175.4	Neg	2.0
Visx, Inc.	EYE	\$29.77	\$1,020.0	19.8%	2.66	-12.6%	\$1,800.0	1.8	348.8	1.8	3.0
Skin Care Group											
Allergan, Inc.	AGN	\$63.91	\$3,510.0	0.0%	0.48	13.6%	\$19,550.0	5.5	28.6	45.4	5.7
Obagi Medical Products	OMPI	\$19.54	\$91.2	22.8%	0.38	11.4%	\$426.0	4.6	47.3	37.0	16.4
Valeant Pharmaceuticals	VRX	\$15.98	\$921.7	0.0%	1.66	2.2%	\$1,470.0	1.6	14.4	169.6	3.2
	Laser Group	Average	\$250.1	-1.9%	0.46	-99.2%	\$388.1	2.7	102.4	30.6	2.9
	Skin Care Group	Average	\$1,507.6	7.6%	0.84	9.1%	\$7,148.7	3.9	30.1	84.0	8.4
Photomedex, Inc.	PHMD	\$1.00	\$35.2	-21.3%	0.21	-19.3%	\$62.9	1.8	Neg	Neg	1.5

Dollars in millions.

Source: Bloomberg, LP and Crystal Equity Research estimates

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Sells	0	0%
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HISTORICAL RECOMMENDATIONS AND TARGET PRICE: PhotoMedex, Inc. / PHMD

<u>Report</u>	<u>Date</u>	<u>Price</u>	<u>Rating</u>	<u>Target Price</u>
Initial	9/27/07	\$1.00	Accumulate	\$2.50

DISCLOSURES

<u>Name</u>	<u>Symbol: Exchange</u>	<u>Disclosures</u>
PhotoMedex, Inc.	PHMD: Nasdaq	D

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