

## GAAP TO NON-GAAP RECONCILIATION

### Use of Non-GAAP Financial Measures

In addition to disclosing financial results calculated in accordance with U.S. generally accepted accounting principles (GAAP), this earnings release contains non-GAAP financial measures that exclude the effects of share-based compensation and the requirements of Statement of Financial Accounting Standards No. 123(R), or “SFAS No. 123R”.

**Stock-based compensation related to stock options, restricted stock and stock awards is excluded from our Non-GAAP costs of revenue, Non-GAAP gross profit, Non-GAAP gross profit margin percent, Non-GAAP product margin percent, Non-GAAP total operating expenses (research and development, sales and marketing and general and administrative), Non-GAAP income from operations, Non-GAAP income before income taxes, Non-GAAP income before income taxes per diluted share, Non-GAAP income tax expense, Non-GAAP effective income tax rate, Non-GAAP net income, Non-GAAP diluted earnings per share:**

Stock-based compensation expenses consist of expenses for stock options, restricted stock and stock awards under SFAS No.123R. The Company excludes these stock-based compensation expenses and the related tax effects from non-GAAP measures primarily because they are non-cash expenses, the complexity and considerable judgment involved in calculating their values, and that they have in the past and are expected in the future to be driven by a different set of factors than other expenses in this category.

**• The manner in which management uses the Non-GAAP financial measure to conduct or evaluate its business:**

The non-GAAP financial measures used by management and disclosed by the Company exclude the income statement effects of all forms of share-based compensation. Reconciliations of the GAAP to non-GAAP income statement financial measures for the three and six months ended June 30, 2007 and July 1, 2006 and expected net income before taxes per diluted share and net income per diluted share for the third quarter of 2007 are set forth in the financial tables attached to this earnings release and the reconciliations to those GAAP financial measures should be carefully considered.

The Company applied the modified prospective method of adoption of SFAS No. 123R, under which the effects of SFAS No. 123R are reflected in the Company’s GAAP financial statement presentations for the three and six months ended June 30, 2007 and July 1, 2006. Gross profit, gross profit margin, product margin, costs of revenue, total operating expenses (research and development, sales and marketing, general and administrative), operating income, net income before taxes per share, net income and net income per share (referred to as earnings per share, or EPS) are the primary financial measures management uses for planning and forecasting future periods that are affected by share-based compensation. Because management reviews these financial measures calculated without taking into account the effects of SFAS No.123R, these financial measures are treated as “non-GAAP financial measures” under Securities and Exchange Commission rules. Management uses the non-GAAP financial measures for internal managerial purposes, including as a means to compare period-to-period results on a consolidated basis and as a means to evaluate the Company’s results on a consolidated basis compared to those of other companies. In addition, management uses certain of these

measures when publicly providing forward-looking statements on expectations regarding future consolidated financial results. Management and the Board of Directors will continue to compare the Company's historical consolidated results of operations (revenue, costs of revenue, gross profit, gross profit margin percent, product margin percent, research and development expenses, sales and marketing expenses, general and administrative expenses, total operating expenses, operating margin, income before income taxes, income before income taxes per share, operating income as well as net income and EPS), excluding stock-based compensation, to financial information prepared on the same basis during the Company's budget and planning process, to assess the business, make resource allocation decisions and to compare consolidated results to the objectives identified for the Company. The Company's budget and planning process culminates with the preparation of a consolidated annual budget that includes these non-GAAP financial measures. This budget, once finalized and approved, serves as the basis for allocation of resources and management of operations. While share-based compensation is a significant expense affecting the Company's results of operations, management excludes share-based compensation from the Company's consolidated budget and planning process to facilitate period to period comparisons and to assess changes in gross margin, net income and earnings per share targets in relation to changes in forecasted revenue.

Profit-dependent cash incentive pay to employees, including senior management, also is calculated using formulae that incorporate the Company's annual results excluding share-based compensation expense.

**• The economic substance behind management's decision to use such Non-GAAP financial measures:**

The Company discloses non-GAAP information to the public to enable investors to more easily assess the Company's performance on the same basis applied by management and to ease comparison on both a GAAP and non-GAAP basis among other companies that separately identify share-based compensation expenses. In particular, the Company believes that it is useful to investors to understand how the expenses and other adjustments associated with the application of SFAS No. 123R are being reflected on the Company's income statements.

**• Why management believes the Non-GAAP financial measure provides useful information to investors:**

Management believes that each of the non-GAAP measures reveals important information about the economic model of the Company and we discuss each of these items with investors on a regular basis on both a GAAP and non-GAAP basis. The Company discloses this information to the public to enable investors to more easily assess the Company's past performance and estimate future performance on the same basis applied by management and to ease comparison on both a GAAP and non-GAAP basis among other companies that separately identify share-based compensation expense. In particular, the Company believes that it is useful to investors to understand how the expenses and other adjustments associated with the application of SFAS No. 123R are being reflected on the Company's income statements.

**• The material limitations associated with use of Non-GAAP financial measure as compared to the use of the most directly comparable GAAP financial measures:**

The non-GAAP financial measures disclosed by the Company are not meant to be considered superior to or a substitute for results of operations prepared in accordance with GAAP. The non-GAAP financial measures disclosed by the Company may be different from, and therefore may not be comparable to, similar measures used by other companies.

Although these non-GAAP financial measures adjust expense, and diluted share items to exclude the accounting treatment of share-based compensation, they should not be viewed as a pro-forma presentation reflecting the elimination of the underlying share-based compensation programs, as those programs are an important element of the Company's compensation structure and generally accepted accounting principles indicate that all forms of share-based payments should be valued and included as appropriate in results of operations.

**• The manner in which management compensates for these limitations when using Non-GAAP financial measures:**

Management takes into consideration this aspect of the non-GAAP financial measures by evaluating the dilutive effect of the Company's share-based compensation arrangements on the Company's basic and diluted earnings per share calculations and by reviewing other quantitative and qualitative information regarding the Company's share-based compensation arrangements. Management also uses these non-GAAP measures in conjunction with GAAP measures to assess the impact of share based compensation.

**ASPECT MEDICAL SYSTEMS, INC.**

**UNAUDITED RECONCILIATION OF GAAP to NON-GAAP FINANCIAL MEASURES**

**(In Thousands, Except Per Share Amounts and Percentages)**

	Three Months Ended		Six Months Ended	
	June 30, 2007	July 1, 2006	June 30, 2007	July 1, 2006
GAAP costs of revenue	\$5,767	\$5,411	\$11,846	\$10,757
Stock-based compensation expense	(141)	(106)	(286)	(211)
Non-GAAP costs of revenue	<u>\$5,626</u>	<u>\$5,305</u>	<u>\$11,560</u>	<u>\$10,546</u>
GAAP gross profit margin	\$20,874	\$17,220	\$38,914	\$33,762
Stock-based compensation expense	141	106	286	211
Non-GAAP gross profit margin	<u>\$21,015</u>	<u>\$17,326</u>	<u>\$39,200</u>	<u>\$33,973</u>
GAAP profit margin percent	78.4%	76.1%	76.7%	75.8%
Stock-based compensation expense	-	-	-	-
Non-GAAP profit margin percent	78.9%	76.6%	77.2%	76.3%
GAAP product margin percent	75.0%	74.5%	74.0%	74.2%
Stock-based compensation expense	-	-	-	-
Non-GAAP product margin percent	75.6%	75.0%	74.6%	74.7%
GAAP research and development expenses	\$4,194	\$3,568	\$8,414	\$7,215
Stock-based compensation expense	(490)	(373)	(1,014)	(743)
Non-GAAP research and development expenses	<u>\$3,704</u>	<u>\$3,195</u>	<u>\$7,400</u>	<u>\$6,472</u>
GAAP sales and marketing expenses	\$10,199	\$9,072	\$20,244	\$17,805
Stock-based compensation expense	(789)	(623)	(1,597)	(1,251)
Non-GAAP sales and marketing expenses	<u>\$9,410</u>	<u>\$8,449</u>	<u>\$18,647</u>	<u>\$16,554</u>
GAAP general and administrative expenses	\$4,016	\$3,203	\$7,680	\$6,141
Stock-based compensation expense	(717)	(551)	(1,457)	(1,089)
Non-GAAP general and administrative expenses	<u>\$3,299</u>	<u>\$2,652</u>	<u>\$6,223</u>	<u>\$5,052</u>
GAAP total operating expenses	\$18,409	\$15,843	\$36,338	\$31,161
Stock-based compensation expense	(1,996)	(1,547)	(4,068)	(3,083)
Non-GAAP total operating expenses	<u>\$16,413</u>	<u>\$14,296</u>	<u>\$32,270</u>	<u>\$28,078</u>
GAAP income from operations	\$2,465	\$1,377	\$2,576	\$2,601
Stock-based compensation expense	2,137	1,653	4,354	3,294
Non-GAAP income from operations	<u>\$4,602</u>	<u>\$3,030</u>	<u>\$6,930</u>	<u>\$5,895</u>
GAAP operating margin	9.3%	6.1%	5.1%	5.8%
Stock-based compensation expense	-	-	-	-
Non-GAAP operating margin	17.3%	13.4%	13.7%	13.2%
GAAP income before income tax	\$3,370	\$2,158	\$4,462	\$4,118
Stock-based compensation expense	2,137	1,653	4,354	3,294

Non-GAAP income before income tax	<u>\$5,507</u>	<u>\$3,811</u>	<u>\$8,816</u>	<u>\$7,412</u>
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**ASPECT MEDICAL SYSTEMS, INC.**

**UNAUDITED RECONCILIATION OF GAAP to NON-GAAP FINANCIAL MEASURES (CONT.)**

**(In Thousands, Except Per Share Amounts and Percentages)**

	Three Months Ended		Six Months Ended	
	June 30, 2007	July 1, 2006	June 30, 2007	July 1, 2006
GAAP income before taxes per diluted share	\$0.15	\$0.09	\$0.20	\$0.17
Stock-based compensation expense	0.09	0.07	0.19	0.14
Non-GAAP income before taxes per diluted share	<u>\$0.24</u>	<u>\$0.16</u>	<u>\$0.39</u>	<u>\$0.31</u>
GAAP income tax expense	\$1,882	\$33	\$2,458	\$56
Stock-based compensation expense	108	-	801	-
Non-GAAP income tax expense	<u>\$1,990</u>	<u>\$33</u>	<u>\$3,259</u>	<u>\$56</u>
GAAP effective income tax rate	56%	2%	55%	2%
Stock-based compensation expense	(20%)	(1%)	(18%)	(1%)
Non-GAAP effective income tax rate	<u>36%</u>	<u>1%</u>	<u>37%</u>	<u>1%</u>
GAAP net income	\$1,488	\$2,125	\$2,004	\$4,062
Stock-based compensation expense	2,029	1,653	3,553	3,294
Non-GAAP net income	<u>\$3,517</u>	<u>\$3,778</u>	<u>\$5,557</u>	<u>\$7,356</u>
GAAP diluted earnings per share	\$0.07	\$0.09	\$0.09	\$0.17
Stock-based compensation expense	0.08	0.07	0.15	0.14
Non-GAAP diluted earnings per share	<u>\$0.15</u>	<u>\$0.16</u>	<u>\$0.24</u>	<u>\$0.31</u>

**Guidance for Q3 2007**

GAAP net loss per diluted share	(\$0.01) – (\$0.02)
Stock-based compensation expense	\$0.07 - \$0.08
Non-GAAP net income per diluted share	\$0.05 – \$0.07
GAAP net loss before taxes per diluted share	(\$0.01) – (\$0.03)
Stock-based compensation expense	\$0.10 - \$0.12
Non-GAAP net income before taxes per diluted share\	\$0.09 - \$0.11