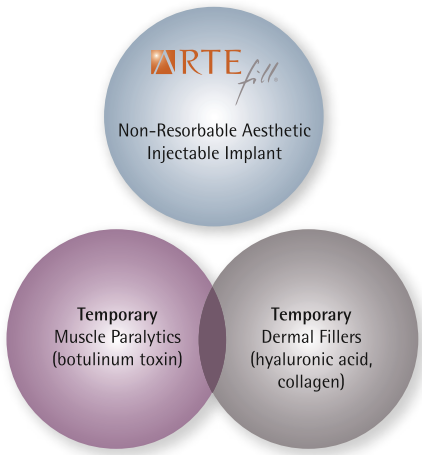
Lasting Solutions

ARTES Medical

2006 Annual Report

Beverly
ArteFill® Clinical Trial Participant in 1999



Lasting Solutions

Artes Medical is focused on developing, manufacturing, and commercializing a new category of aesthetic injectable products for the dermatology and plastic surgery markets. Our flagship product, ArteFill®, received FDA approval in October 2006 as a new treatment option for the correction of nasolabial folds or smile lines. We are evaluating potential research and clinical development activities to explore possible uses of ArteFill for additional aesthetic applications beyond wrinkle correction. Additionally we believe our platform technology can be applied to various therapeutic applications.

In 2006, approximately 5.1 million aesthetic injectable procedures were performed in the U.S.[1] The dermal filler market segment is projected to grow at a compound annual growth rate through 2011 of 25%.[2]

[1] The American Society for Aesthetic Plastic Surgery (ASAPS)
[2] Medical Insight, Inc.

Dear Shareholders,

"We have launched ArteFill® in the U.S. and are pleased by the response this revolutionary new product has received from patients and physicians."

Christopher J. Reinhard
Executive Chairman of the Board of Directors

"We believe that ArteFill® addresses the desire of both physicians and patients for a long-lasting dermal filler."

Diane S. Goostree
President & Chief Executive Officer

This has been a transformational year for Artes Medical. We evolved from a small, private R&D organization into a public commercial-stage organization marketing the first and only FDA-approved non-resorbable dermal filler, ArteFill®, in the U.S.

During the year, we accomplished a number of milestones at Artes Medical and implemented several key transitions:

- We successfully completed the FDA inspection of our manufacturing facilities in San Diego, California and Frankfurt, Germany in April 2006.
- We received FDA approval for our PMA for ArteFill for the correction of nasolabial folds, or smile lines, on October 27, 2006.
- We hired an experienced national sales force in November 2006.
- We completed our Initial Public Offering and became a public company in December 2006, raising an additional $29.5 million.
- We transitioned our executive management team to prepare for our commercial launch of ArteFill.
- We hired Diane S. Goostree as President and COO in March of 2006, and then promoted her to our President and CEO in November 2006. We also hired two executives with extensive experience in the dermal filler market to head our Sales and Marketing organizations.

The aesthetics market is large and rapidly growing. In 2006, according to the American Society for Aesthetic Plastic Surgery (ASAPS), there were nearly 11.5 million surgical and nonsurgical cosmetic procedures performed in the U.S. Nonsurgical procedures, which include dermal filler procedures, made up 83% of the total. The top two nonsurgical procedures were Botox® injections and hyaluronic acid (dermal filler) injections. Aesthetic injectable products such as Botox and dermal fillers generated over $2.5 billion in physician fees. Dermal filler procedures grew 25% in 2006 compared to 2005, and independent market research reports project continued growth at a similar rate over the next five years.

ARTEfill®

THE FIRST TO LAST™

"Unlike any other dermal filler on the market, ArteFill® has demonstrated long-term wrinkle enhancement, with significant improvement in wrinkle correction at 1 year and 5 years after treatment."

ArteFill, as the first and only non-resorbable dermal filler, meets the desires of physicians and patients for a long-lasting filler. Patients may experience "injection fatigue" and "credit card fatigue" with temporary fillers that typically require re-injection every 3-6 months, with patients often dropping out of this re-injection cycle. ArteFill provides an opportunity for the physician to re-engage these patients and provide a long-lasting solution to their desire for wrinkle correction. ArteFill may also drive expansion of the dermal filler market, which is currently 95% female, by attracting male patients. We expect that men will be interested in the convenience of a one-time treatment, without the need for numerous repeat visits.

ArteFill is a highly differentiated product with a novel formulation that provides both immediate correction of smile line wrinkles, as well as continued improvement over time. We recently completed our 5-year follow-up study of patients in our pivotal clinical trial. This study demonstrated that patients not only maintained their wrinkle correction at the 5-year point, but also actually improved in wrinkle correction at 5-years compared to the 6-month assessment. These landmark data were presented at the American Academy of Dermatology meeting and we have submitted the information to the FDA to enhance our product labeling.

Our commercial team has now launched ArteFill into the U.S. market and we are very pleased with the reception we have received from both patients and physicians. We believe we are filling an unmet need for a long-lasting dermal filler. As we look forward, we are excited about the future for Artes Medical. We have a clear, focused direction in the aesthetics market in the U.S., and a highly differentiated product as our first entry into this growing market. We also have the management team in place to execute on our strategy and we believe we are positioned for success.

We accomplished many milestones in 2006 as we transitioned Artes Medical to a public, commercial-stage organization. We want to thank our Board of Directors for their continued guidance, and all of our dedicated employees for their commitment and many contributions. Finally, we thank you—our shareholders—for your loyalty and continued support.

Sincerely,

Christopher J. Reinhard
Executive Chairman of the Board of Directors

Diane S. Goostree
President & Chief Executive Officer

Growing Market Opportunity

The following key opinion leaders will provide their thoughts and opinions about the impact ArteFill® will have on this market.

Patients

Members of the baby boom generation, who range in age from 43 to 61 years old, are turning to plastic surgeons and dermatologists to erase the signs of aging from their faces. Many patients are seeking minimally invasive aesthetic procedures, such as injectable aesthetic products, to reduce lines and wrinkles. The women who currently make up 92%[1] of this market often view the repeat injections of such aesthetics every three to six months as an unpleasant, but necessary activity to maintain their appearance. Other potential candidates, particularly men, view that requirement as a barrier to initiating treatment. For those patients who do decide to undergo these procedures, as many as 50%[2] drop out after the first injection because of the pain and cost. Clearly, there is a market opportunity for longer lasting aesthetic injectable products including dermal fillers.

Physicians

Plastic surgeons, cosmetic surgeons, and dermatologists are expanding their treatment options by adding a variety of injectable aesthetic procedures and continue to seek new and differentiated products. ArteFill is a noninvasive treatment that provides immediate and enduring results without extended recovery time. Unlike temporary injectable aesthetic products that typically require repeat injections every three to six months, ArteFill provides lasting wrinkle correction.

[1] ASAPS

[2] Alster, Tina S., M.D., *et. al. Dermatologic Surgery,* February 2006

Steven R. Cohen, M.D., F.A.C.S.
Clinical Professor, Division of Plastic Surgery,
University of California, San Diego School of Medicine;
Board Certified Plastic and Reconstructive Surgeon

Jean D. Carruthers, M.D., F.R.C.S. (C), F.R.C. (Ophth)
Clinical Professor, Department of Ophthalmology,
University of British Columbia
Fellow American Society of Ophthalmic Plastic
and Reconstructive Surgery

Mark G. Rubin, M.D.
Assistant Clinical Professor of Dermatology,
University of California, San Diego, Division of Dermatology
Board Certified Dermatologist

John H. Joseph, M.D.
Assistant Clinical Professor, Department of Head and Neck Surgery,
University of California, Los Angeles
Board Certified Facial Plastic Surgeon

Q. *Is there a long-lasting solution to erasing smile lines that doesn't involve surgery?*

A: Steven R. Cohen, M.D.
"Until recently, most dermal fillers were made of materials such as collagen and hyaluronic acid, compounds that are ultimately metabolized by the body.

In my clinical experience, traditional dermal fillers offer temporary solutions to filling in smile lines, and typically provide shorter-term aesthetic correction.

Unlike other products, ArteFill® uses collagen as the primary delivery vehicle for small polymer microspheres. Together with the body's own collagen-producing cells, these microspheres provide the permanent structural support to deliver long-lasting smile line correction."

Novel ArteFill Technology

ArteFill® consists of a proprietary combination of microspheres evenly suspended in a carrier gel containing highly purified and partly denatured bovine collagen with an anesthetic for patient comfort. The microspheres are made of polymethylmethacrylate (PMMA), one of the most commonly used artificial implant materials in medicine. Each tiny microsphere is so small that it is invisible to the naked eye and cannot be felt in the ArteFill gel. The microspheres comprise 20% of the formulation and the other 80% is the carrier gel.

To ensure both safety and quality, we use a proprietary manufacturing process to produce a highly purified and partly denatured bovine collagen solution. We believe this process results in a low incidence rate of allergic reactions in patients. In fact, none of the 400-plus patients participating in our ArteFill U.S. clinical trials experienced an allergic reaction to our purified bovine collagen.

Long-Lasting Wrinkle Correction

Because of its novel formulation, ArteFill is a dual-acting injectable wrinkle filler. First, the injected ArteFill immediately corrects the wrinkle, by filling in the smile line. Second, the microspheres provide a scaffold for long-lasting correction. As with other dermal fillers that use resorbable materials, the ArteFill carrier collagen is gradually reabsorbed by the body. We believe the PMMA microspheres stimulate the patient's own cells to produce collagen. This natural collagen joins the microspheres around the injection site beneath the smile line to take over the job of wrinkle correction.

ArteFill thus creates a support structure for continued wrinkle correction that naturally improves over time, something that traditional dermal fillers are incapable of providing. It is the only dermal filler on the market that provides a long-lasting solution to correcting smile lines.

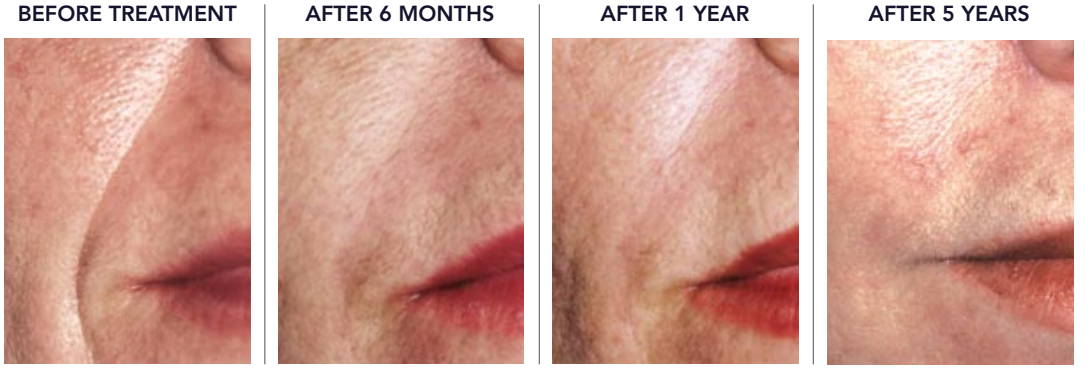
"I just didn't have the time or the patience to go to the doctor for repeat injections every few months. I was looking for a dermal filler that was hassle-free and provided the long-term correction of my smile lines. I found it in ArteFill."

Beverly
Clinical trial participant in 1999

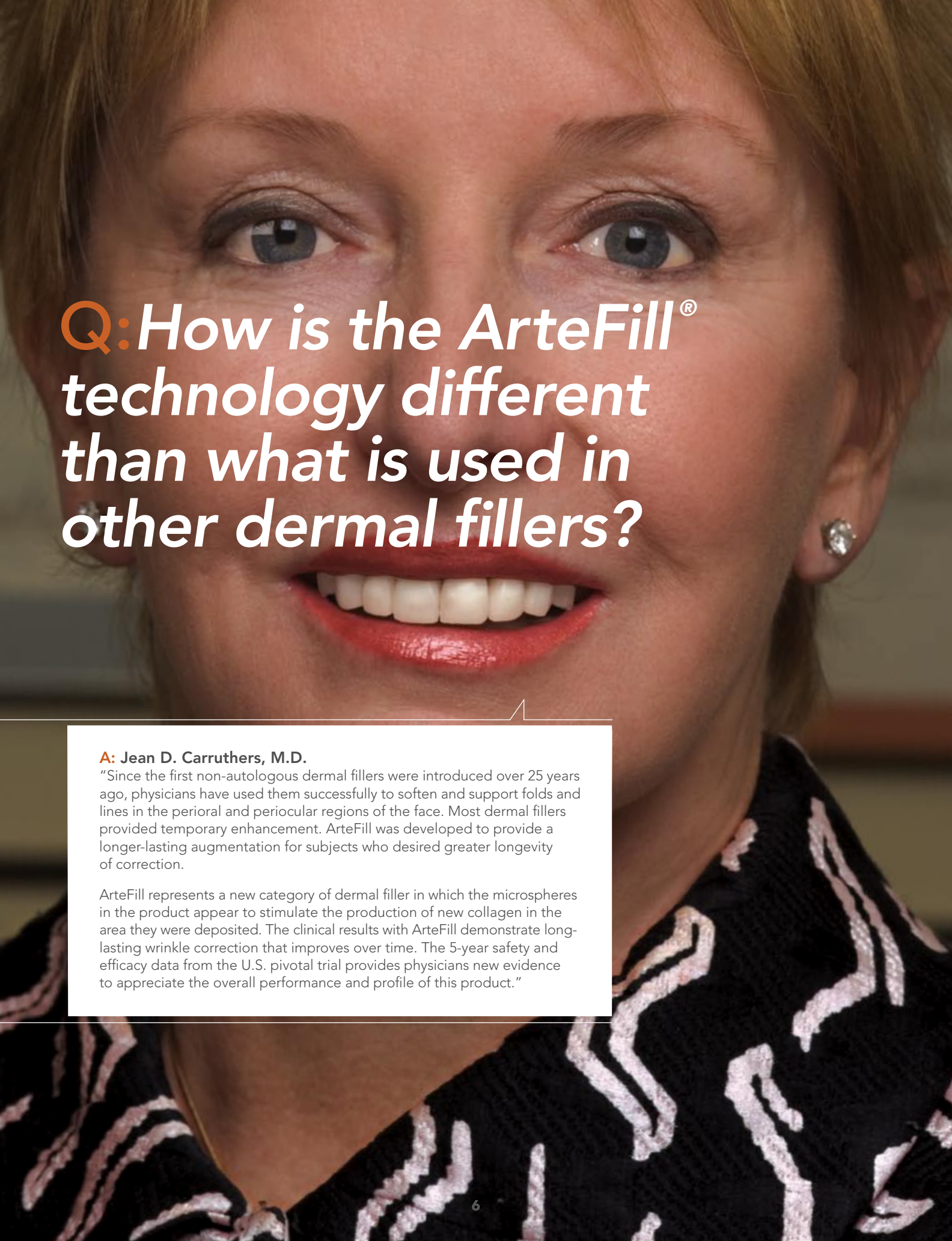
65 years young — Lives in Phoenix metropolitan area, dancer, bridge player and traveler

Before and After

Unlike temporary dermal fillers, ArteFill microspheres create a permanent support matrix for enduring wrinkle correction. Patients treated with ArteFill showed sustained aesthetic improvements throughout the pivotal, multi-center U.S. clinical trial and for five years post-initial injection.



Clinical Trial Participant (Lynn)

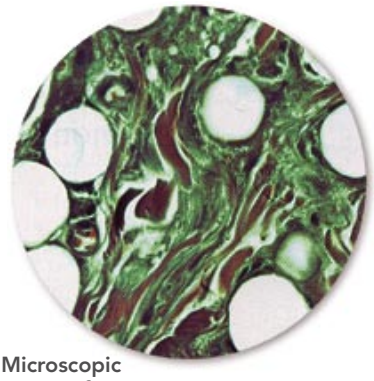


Q: How is the ArteFill® technology different than what is used in other dermal fillers?

A: Jean D. Carruthers, M.D.

"Since the first non-autologous dermal fillers were introduced over 25 years ago, physicians have used them successfully to soften and support folds and lines in the perioral and periocular regions of the face. Most dermal fillers provided temporary enhancement. ArteFill was developed to provide a longer-lasting augmentation for subjects who desired greater longevity of correction.

ArteFill represents a new category of dermal filler in which the microspheres in the product appear to stimulate the production of new collagen in the area they were deposited. The clinical results with ArteFill demonstrate long-lasting wrinkle correction that improves over time. The 5-year safety and efficacy data from the U.S. pivotal trial provides physicians new evidence to appreciate the overall performance and profile of this product."



Microscopic image of PMMA microspheres after injection into human skin

Microsphere Technology

The tiny microspheres in ArteFill are made of polymethylmethacrylate (PMMA), one of the most widely used synthetic implant materials in medicine. They remain intact at the injection site, providing a permanent structural support to correct the wrinkle and keep it from returning.

FDA-Approved

In October 2006, the U.S. Food and Drug Administration (FDA) approved ArteFill® as the first and only non-resorbable injectable dermal filler. The approval was based on the safety and efficacy ArteFill demonstrated in a 12-month controlled clinical trial in eight clinics across the U.S. The 251-person trial compared the outcomes of patients receiving ArteFill with those of patients treated with the leading bovine collagen-based dermal filler for the treatment of wrinkles.

At the 6-month evaluation point, the ArteFill patients treated for nasolabial folds (smile lines) showed statistically significant improvement in wrinkle correction when compared to the control patients. In fact, the smile lines of patients receiving the collagen-based control had returned to their pretreatment status at the 6-month point while the smile lines of ArteFill patients were still fully corrected. Throughout the clinical trial, there was no significant difference in the safety profiles of ArteFill and the collagen control, and there were fewer side effects in the ArteFill patient group. As provided in the study protocol, we offered all control group patients the opportunity to be treated with ArteFill at their six-month evaluation and 91% accepted the offer.

5-year Clinical Data

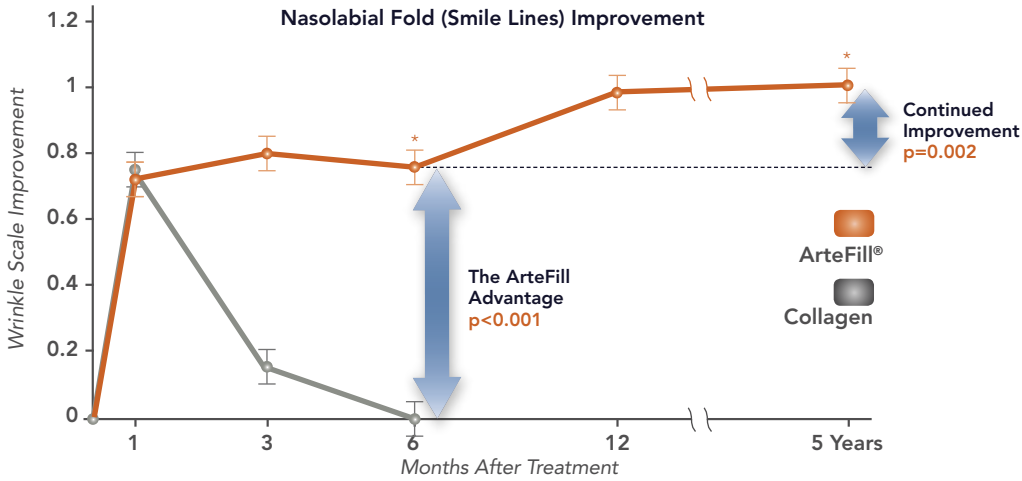
While the 6-month efficacy evaluation period was the primary efficacy endpoint of the clinical trial, we chose to conduct follow-up assessments of patients, becoming the first company to complete a long-term study that evaluated safety and efficacy of dermal fillers beyond one year.

Each patient was evaluated for efficacy and safety at one year and at a mean of 5.4 years after their last ArteFill treatment to correct nasolabial folds. The results were statistically significant, with ArteFill showing continued wrinkle correction after one and five years compared to baseline. In addition, the results showed that patients continued to improve throughout the study and demonstrated a statistically significant improvement in wrinkle correction at the 5-year point compared to the original 6-month evaluation period. We submitted this long-term data to the FDA for review in order to enhance the product labeling for ArteFill.

As part of the follow-up study, physician investigators who participated in the clinical trial provided their assessment of treatment success with ArteFill. Over 90% of the physician assessments were either “very successful” or “completely successful.” In addition, over 90% of the patients indicated that they were either “very satisfied” or “satisfied” with the ArteFill treatment.

ArteFill® Landmark 5-Year U.S. Efficacy Data

One month after treatment, both ArteFill and the control collagen had a similar effect on improving the wrinkle. At the three-month and six-month evaluations, ArteFill maintained its effect while the control collagen gradually lost its effect. Unlike any other dermal filler on the market, ArteFill continues to show wrinkle improvement over the span of several years.



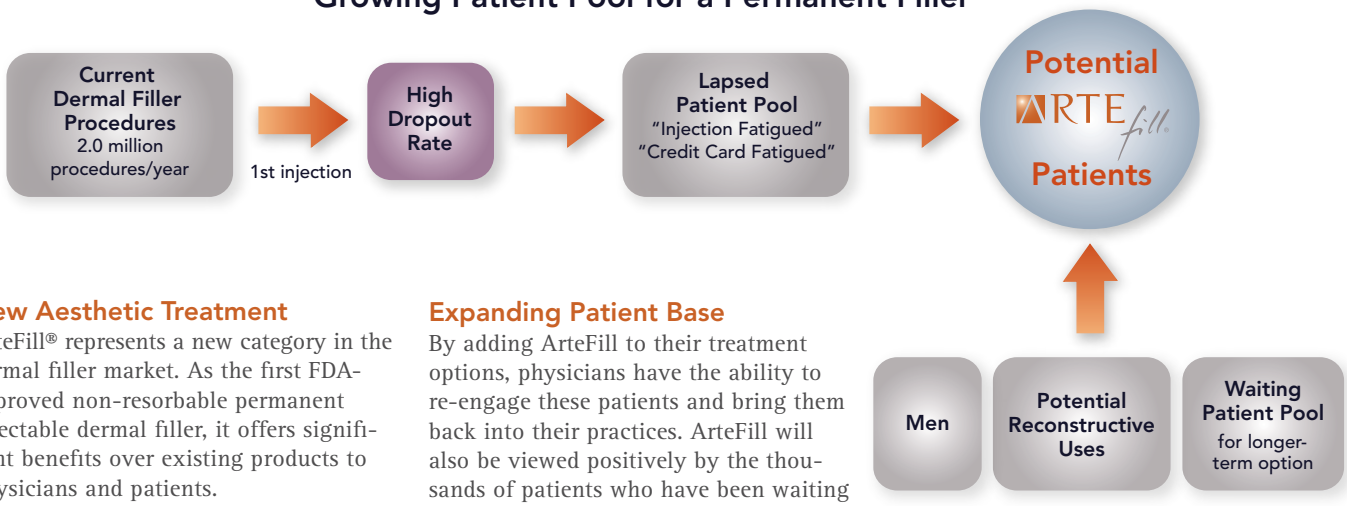
Q: *What benefits does ArteFill® provide to a physician over existing short-term injectable aesthetic products?*

A: Mark G. Rubin, M.D.

"We are always interested in new products and technologies that are true advances in aesthetic treatment. By being the first-and-only FDA-approved dermal filler to offer long-lasting wrinkle correction, ArteFill certainly represents such a product.

As one of the first practices to offer it in our area, ArteFill has already sparked an upswing in new patients since it received FDA approval in October 2006. In addition to bringing in new patients, we believe it will enable us to reach out to those patients who do not return for repeat dermal filler injections because of 'injection fatigue' or 'credit card fatigue.' It will also help us meet the needs of a traditionally underserved part of our patient base – men. We will finally be able to meet the desire of men and women for an aesthetic procedure that erases smile lines, without the need for repeat treatments."

Growing Patient Pool for a Permanent Filler



New Aesthetic Treatment

ArteFill® represents a new category in the dermal filler market. As the first FDA-approved non-resorbable permanent injectable dermal filler, it offers significant benefits over existing products to physicians and patients.

Physicians in the aesthetics marketplace need to differentiate themselves from competitors by offering the latest, most effective, and most technologically advanced procedures to their treatment offerings. ArteFill fulfills all these requirements and represents a new treatment option in a market filled with temporary "me-too" products, all of which are comprised of materials that are metabolized and absorbed by the body. We intend to further differentiate our product from the competition by seeking enhanced labeling that incorporates our 5-year safety and efficacy clinical results.

Market penetration of injectable aesthetic products has grown over the last decade, despite patient resistance to the requirement for repeat injections every few months to maintain the aesthetic correction they provide. Whether due to "injection fatigue" or "credit card fatigue," a large percentage of patients have ultimately tired of the routine. This drop out rate is as high as 50% according to some reports*.

* Alster, Tina S., M.D., *et. al.* *Dermatologic Surgery,* February 2006

Expanding Patient Base

By adding ArteFill to their treatment options, physicians have the ability to re-engage these patients and bring them back into their practices. ArteFill will also be viewed positively by the thousands of patients who have been waiting in the wings for a long-lasting treatment to correct smile lines. These patients are eager to learn about a product that eliminates their smile lines and does not require a life-long commitment to dermal filler injections every 3 to 6 months.

Women represented 95% of the patients undergoing dermal filler procedures in 2006. Men have resisted jumping on the aesthetics bandwagon because of their preference to avoid procedures that result in significant recovery time (such as plastic surgery) or involve a commitment to repeat treatments. ArteFill meets their concerns on both fronts and will enable physicians to expand the male segment of their patient base.

Q: How is Artes Medical bringing this new category of dermal filler to market?

A: John H. Joseph, M.D.
"I was one of the first physicians to receive ArteFill® training. The injection technique is very similar to what we use for other dermal fillers, and I believe the duration of ArteFill wrinkle correction will be superior to any product I have ever used before. I have been very pleased with ArteFill's performance so far, and my patients are thrilled.

We are focused on providing patients with aesthetic solutions that are the most effective and that will deliver the best long-term results. The 5-year clinical data for ArteFill makes this product very compelling to our patients."

Physician Education

Within the dermatology and plastic surgery markets, there are approximately 24,000 physicians in the U.S. Of those, about 1,000 perform the majority of injectable aesthetic procedures each year. Soon after receiving FDA approval for ArteFill® in October 2006, we began targeting these physicians in preparation for the market launch of the product in the first quarter of 2007.

In February 2007, we began shipping product across the country to physicians who completed our comprehensive training program. Our training program, which consists of a combination of web-based and in-office training, is designed to increase physician familiarity with the product and the tunneling injection technique required for its successful administration. Ultimately, we plan to establish a peer-training program, through which physicians who are highly skilled in the tunneling injection technique and who have completed our training program may participate in training other physicians. Advanced training symposia will also be available for those physicians interested in refining their technique.

We will continue to reach out to physicians through scientific presentations and peer-reviewed journal articles. For example, our ArteFill 5-year interim clinical data was published in the September 2006 issue of *Plastic and Reconstructive Surgery* and the final data was presented at the 2007 American Academy of Dermatology Annual Meeting. These and future educational activities will expand physician awareness of ArteFill and support our ongoing marketing efforts.

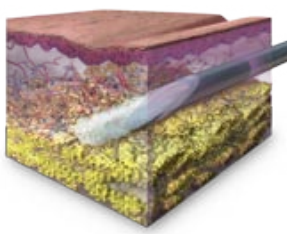
We have also developed programs to support physicians and their practices. In addition to offering support to physicians who are running ArteFill ads in local and national health and lifestyle magazines, we are providing physicians with ArteFill office promotional materials, and coordinating targeted marketing programs to help them educate their patients about ArteFill and its benefits. Together with inclusion in our web-based physician locator service, these activities add another marketing dimension to a physician's practice, helping them to expand their medical practices.

"ArteFill® has created a new product category in the marketplace as the first-and-only FDA-approved dermal filler that is successfully meeting the needs of patients and physicians by providing value, convenience, and long-lasting results. We have geared our launch materials and ongoing marketing campaigns to highlight these benefits and to successfully brand ArteFill as 'The First to Last™.'"

Frank M. Fazio
Vice President,
Marketing and International Markets

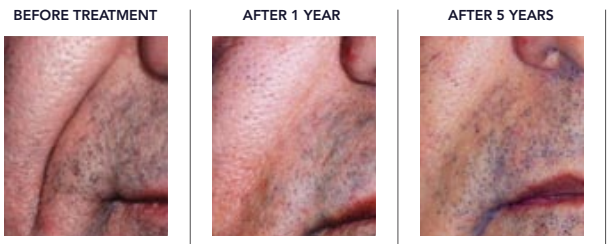
"Our specialized sales force is targeting the leading physicians across the country responsible for the majority of injectable aesthetic procedures performed each year. We believe their experience and large patient bases, combined with our training and marketing support, will help us to grow market share."

Susan A. Brodsky-Thalken
Vice President,
U.S. Sales and Training

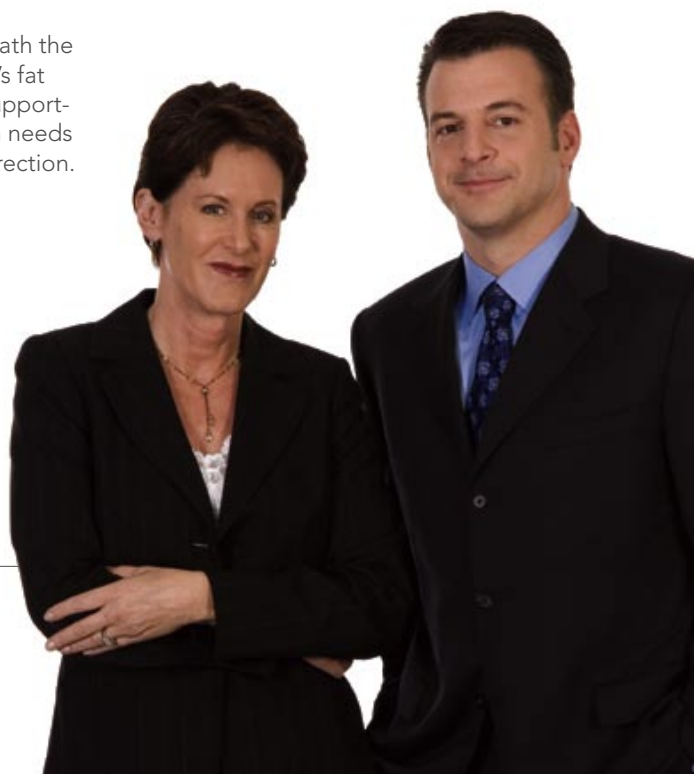


The Injection Process

ArteFill is injected underneath the wrinkle, just above the skin's fat layer. It provides the soft supportive foundation that the skin needs for long-lasting wrinkle correction.



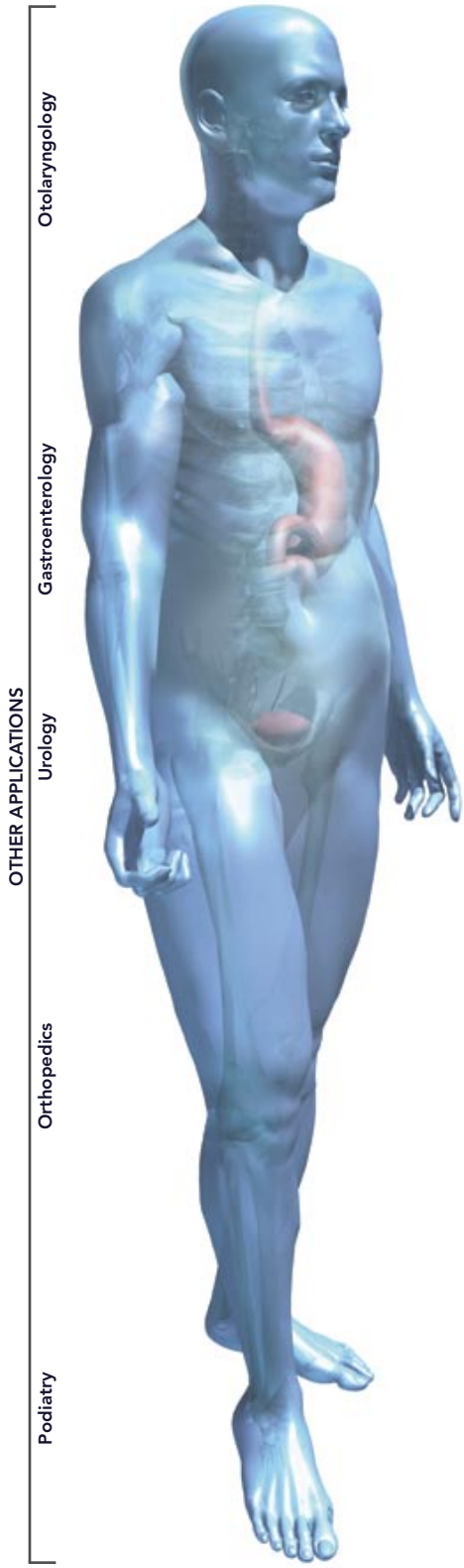
Clinical Trial Participant



Potential applications of the ArteFill® technology

Microscopic image of polymethylmethacrylate (PMMA) microspheres

Microscopic image of PMMA microspheres after injection into human skin



Our ArteFill technology may be used for soft tissue augmentation in a broad range of medical specialties, including otolaryngology (ear, nose and throat), gastroenterology, urology, orthopedics and podiatry.

Aesthetic Applications for Medical Conditions

We are evaluating potential research and clinical development activities to explore possible uses of ArteFill for aesthetic applications beyond wrinkle correction, including the use of ArteFill in reconstructive surgery. ArteFill may also be beneficial in the repair of facial scars, caused by either trauma or severe acne. Temporary dermal fillers occasionally have been used to address these conditions, but the short-term duration of these products limits their use in these areas. Physicians and patients have been waiting for a long-lasting solution and we believe ArteFill may be the treatment of choice for a variety of these types of medical conditions.

Partnering Potential Therapeutic Indications

We intend to work with strategic partners to develop applications of our ArteFill technology that fall outside our core focus of aesthetics. Potential products for two such applications, ArteFlux™ and ArteSure™, leverage our technology to create injectable bulking agents for soft tissue augmentation. We have completed animal studies that confirm the feasibility of the use of our technology for soft tissue augmentation.

ArteFlux is designed for the treatment of gastroesophageal reflux disease (GERD), more commonly known as heartburn. GERD afflicts approximately 50 million Americans.[1] In GERD patients, the sphincter muscle between the stomach and the lower esophagus is impaired. The symptoms of heartburn develop due to the chronic exposure of the esophagus to the irritating acidic contents of the stomach. In this indication, ArteFlux would be injected into the lower esophagus to narrow the opening and prevent or reduce acid reflux.

ArteSure is designed for the treatment of urinary incontinence, a major health problem affecting an estimated 25 million people in the U.S., the majority of them women.[2] Stress urinary incontinence is caused by changes in the pelvic floor support, usually associated with childbearing or simply as a result of aging. ArteSure would be injected into the bladder neck to increase the resistance to urine flow and restore bladder control.

The applications of the ArteFill technology discussed on this page are still in development and have not been FDA-approved or cleared for marketing in the U.S.

[1] Locke GR III, et. al. Prevalence and clinical spectrum of gastroesophageal reflux: a population-based study in Olmsted County, Minnesota. *Gastroenterology*, 1997; 112:1224-56.

[2] National Association for Continence

Corporate Information

Executive Management

Christopher J. Reinhard
Executive Chairman

Diane S. Goostree
President and Chief Executive Officer

Peter C. Wulff
Executive Vice President and
Chief Financial Officer

Karla R. Kelly, J.D.
Chief Legal Officer, General Counsel
and Corporate Secretary

Russell J. Anderson
Vice President, New Products
Engineering

Larry J. Braga
Vice President, Manufacturing

Susan A. Brodsky-Thalken
Vice President, U.S. Sales and Training

Frank M. Fazio
Vice President, Marketing and
International Markets

Adelbert L. Stagg, Ph.D.
Vice President, Regulatory Affairs
and Quality

Board of Directors

Christopher J. Reinhard
Executive Chairman of the Board
of Directors

Diane S. Goostree
President and Chief Executive Officer

Daren J. Barone
Chief Executive Officer
The Barone Group

John R. Costantino
Managing General Partner
NGN Capital, LLC

Lon E. Otremba
Principal Managing Partner
Lon E. Otremba, Strategic and
Operational Management Advisory

Independent Auditors

Ernst & Young, LLP
San Diego, California

Securities Counsel

Heller Ehrman, LLP
San Diego, California

Common Stock Information

The Company's Common Stock trades on the NASDAQ Global Market under the symbol "ARTE". The Company has not declared any dividends and does not expect to pay any common stock dividends in the foreseeable future.

Transfer Agent and Registrar

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Safe Harbor

Statements made in our annual report to stockholders include forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. All statements, other than statements of historical fact, are statements that could be deemed forward-looking statements, including, but not limited to, statements regarding our future financial position, business strategy and plans and objectives of management for future operations. Forward-looking statements involve known and unknown risks, uncertainties and other factors that may cause our actual results, performance or achievements to be materially different from any future results, performance or achievements expressed or implied by the forward-looking statements. Factors that could cause or contribute to such differences include, but are not limited to, those discussed in Item 1A. "Risk Factors" of our accompanying Annual Report on Form 10-K and those discussed in other documents we subsequently file with the Securities and Exchange Commission. In light of these risks, uncertainties and assumptions, readers are cautioned not to place undue reliance on such forward-looking statements. These forward looking statements represent beliefs and assumptions only as of the date of this report. Except as required by applicable law, we do not intend to update or revise forward-looking statements contained in this report to reflect future events or circumstances.

Not all models shown are actual patients.

Designed and produced by Mentus, San Diego, California. www.mentus.com

ARTES
Medical

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