PARADIGM MEDICAL INDUSTRIES INC
Form SB-2
July 07, 2003

As filed with the Securities and Exchange Commission on July __, 2003
Commission File No. 333-

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM SB-2
REGISTRATION STATEMENT
UNDER
THE SECURITIES ACT OF 1933

PARADIGM MEDICAL INDUSTRIES, INC.
(Name of small business issuer in its charter)

Delaware	3841	87-0459536
(State of jurisdiction of incorporation or organization)	(Primary Standard Industrial Classification Code Number)	(I.R.S. Employer Identification Number)

2355 South 1070 West
Salt Lake City, Utah 84119
(801) 977-8970
(Address and telephone number of registrant's principal executive offices and principal place of business)

Jeffrey F. Poore, President and Chief Executive Officer,
2355 South 1070 West
Salt Lake City, Utah 84119
(801) 977-8970
(Name, address and telephone number of agent for service)

Copies to:

Randall A. Mackey, Esq.
Mackey Price & Thompson
350 American Plaza II
57 West 200 South
Salt Lake City, Utah 84101-3663
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Approximate date of proposed sale to the public: As soon as practicable after this Registration Statement becomes effective.

If any of the securities being registered on this Form are being offered on a delayed or continuous basis pursuant to Rule 415 under the Securities Act of 1933 (the "Securities Act"), check the following box. |X|

If this Form is filed to register additional securities for an offering pursuant to Rule 462(b) under the Securities Act, please check the following box and list the Securities Act registration statement for the same offering. [ ]

If this Form is a post-effective amendment filed pursuant to Rule 462(c) under the Securities Act, check the following box and list the Securities

Act registration statement number of the earlier effective registration statement for the same offering. [ ]

If delivery of the prospectus is expected to be made pursuant to Rule 434, please check the following box. [ ]

CALCULATION OF REGISTRATION FEE

Title of each class of securities to be registered	Amount to be registered	Proposed maximum offering price per Share(1)	Proposed maximum aggregate offering pric
Common Stock, $.001 par value per share (2)	8,000,000	$.50	$4,000,000

(1) Estimated solely for the purpose of calculating the registration fee pursuant to Rule 457.
(2) Reflects the maximum offering proposed hereunder.

The Registrant hereby amends this Registration Statement on such date or dates as may be necessary to delay its effective date until the Registrant shall file a further amendment which specifically states that this Registration Statement shall thereafter become effective in accordance with Section 8(a) of the Securities Act of 1933 or until this Registration Statement shall become effective on such date as the Commission, acting pursuant to said Section 8(a), may determine.

PROSPECTUS

SUBJECT TO COMPLETION DATED JULY ___, 2003

8,000,000 Shares of Common Stock

PARADIGM MEDICAL INDUSTRIES, INC.

Under this prospectus, we may offer up to 8,000,000 shares of our common stock, par value $.001 per share, utilizing a self-underwritten, best efforts offering of our shares, through the efforts of officers and directors. This means we are offering our shares of common stock directly to qualified investors. In the event that we retain a broker-dealer to assist in the offer and sale of our shares, we will file a post-effective amendment to our registration statement. We will provide a prospectus supplement or amendment, if necessary, to add, update, or change the information contained in this prospectus.

We are offering our shares in one or more transactions at an estimated offering price of $.50 per share. There is no minimum offering of shares that must be sold.

Our common stock and Class A warrants trade on the OTC Bulletin Board under the symbols "PMED.OB" and "PMEDW.OB." On July 2, 2003, the last reported sale price of our common stock was $.245 per share and the last sale price of our Class A Warrants was $.10 per warrant.

We have registered for secondary sales an aggregate of 12,250,167 shares of our common stock currently issued and outstanding through a registration statement the Securities and Exchange Commission declared effective on February 14, 2003.

Investing in the common stock involves risks that are described in the "Risk Factors" section beginning on page 3 of this prospectus.

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved these securities or determined if this prospectus is truthful or complete. Any representation to the contrary is a criminal offense.

The date of this prospectus is July ___, 2003.

PROSPECTUS SUMMARY

This summary highlights some information from this prospectus. It may not contain all of the information that is important to you. To understand this offering fully, you should read the entire prospectus carefully, including the risk factors and the financial statements.

The Company

We develop, manufacture, source, market and sell ophthalmic surgical and diagnostic instrumentation and related accessories, including disposable products. Our surgical equipment is designed for minimally invasive cataract treatment. A cataract is a condition, which largely affects the elderly population, in which the natural lens of the eye hardens and becomes cloudy, thereby reducing visual acuity. Treatment consists of removal of the cloudy lens and replacement with a synthetic lens implant, which restores visual acuity. Cataract surgery is the single largest volume and revenue producing outpatient surgical procedure for ophthalmologists worldwide. The Health Care Finance Administration reports that in the United States approximately two million cataract removal procedures are performed annually, making this the largest outpatient procedure reimbursed by Medicare. Most cataract procedures are performed using a method called phacoemulsification or "phaco", which employs a high frequency (40 kHz to 60 kHz) ultrasonic probe needle device to fragment the cataract while still in the eye and remove it in pieces by suction through a small incision.

We market three cataract surgery systems with related accessories and disposable products. Our flagship cataract removal system, the Photon(TM) laser system, is a laser cataract surgery system marketed as the next generation of cataract removal. The Photon(TM) product is currently under review by the Food Drug and Administration ("FDA"). The Photon(TM) is available for sale in many

markets outside of the United States. Both the Photon(TM) and the Precisionist ThirtyThousand (TM) are manufactured as an Ocular Surgery Workstation(TM). We plan to market the Ocular Surgery Workstation(TM) as a plug-in module for the Photon(TM) and other lasers for use in eye care and other medical specialties. We also offer the SIStem(TM), a mid-range priced ultrasonic phaco, and competes in the market segment that only desires an ultrasonic phaco.

Our diagnostic products include a pachymeter, an A-Scan, an A/B Scan, an UBM biomicroscope, a perimeter, a corneal topographer and the Blood flow Analyzer (TM). The diagnostic ultrasonic products, including the pachymeter, the A-Scan, the A/B Scan and the UBM biomicroscope were acquired from Humphrey Systems, a division of Carl Zeiss, Inc. in 1998. We developed and offered for sale in the fall of 2000 the P45 which combines the A/B scope and the UBM in one machine. The perimeter and the corneal topographer were added when we acquired the outstanding shares of the stock of Vismed, Inc. d/b/a/ Dicon(TM) in June 2000. We acquired Ocular Blood Flow, Ltd. in June of 2000, whose principal product is the Blood Flow Analyzer(TM). This product is designed for the measurement of intraocular pressure and pulsatile ocular blood flow volume for detection and treatment of glaucoma. We are currently developing additional applications for all of our diagnostic products.

We rely upon several products for revenues. For the three months ended March 31, 2003, 36% of our revenues were derived from the Dicon (TM) diagnostic products sales (the perimeter and corneal topographer), 22% of revenues from Blood Flow Analyzer(TM) sales, 6% of revenues from UBM biomicroscope sales, 13% of revenues from Humphrey Systems diagnostic product sales (the pachymeter, the A-Scan and the A/B Scan), 4% of revenues from cataract removal surgery sales and disposables, and 19% of revenues from service and other sales. For the fiscal year ended December 31, 2002, 27% of our revenues were derived from the Dicon(TM) diagnostic products sales (the perimeter and the corneal topographer), 9% of revenues from Blood Flow Analyzer(TM) sales, 25% of revenues from UBM biomicroscope sales, 11% of revenues from Humphrey systems diagnostic products sales (the pachymeter, the A-Scan and the A/B Scan), 11% of revenues from cataract removal surgery sales, and 17% of revenues from services, disposables and other sales. For the fiscal year ended December 31, 2001, 26% of our revenues were derived from the Dicon(TM) diagnostic products sales (the perimeter and the corneal topographer), 25% of revenues from Blood Flow Analyzer(TM) sales, 22% of revenues from UBM biomicroscope sales, 8% of revenues from Humphrey Systems diagnostic products sales (the pachymeter, the A-Scan and the A/B Scan), 8% of revenues from cataract removal surgery sales and disposables, and 11% of revenues from service and other sales. Our principal executive offices are located at 2355 South 1070 West, Salt Lake city, Utah 84119 and our telephone number is (801) 977-8970.

Unaudited revenues for the three months ended March 31, 2003, were $727,000 as compared to $1,537,000 for the comparable period for 2002, and audited revenues for the fiscal year ended December 31, 2002 were $5,368,000 as compared to $7,919,000 for the comparable period for fiscal 2001.

On March 23, 2003, our board of directors appointed Dr. Jeffrey F. Poore as President and Chief Executive Officer of the company, replacing Thomas F. Motter, who resigned as Chairman of the Board and Chief Executive Officer on August 30, 2002. On June 23, 2003, our board of directors appointed Gregory Hill as Vice President of Finance, Treasurer and Chief Financial Officer of the company, replacing Heber C. Maughan, who resigned as Vice President of Finance, Treasurer and Chief Financial Officer.

The Offering

Common stock offered	8,000,000 shares
Common stock outstanding prior to the offering (1).....	24,147,744 shares
Common stock outstanding after the offering (1).....	32,147,744 shares.
Use of proceeds.....	The net proceeds of the offering will be used for sales and marketing, research and development, acquisition of capital equipment, repayment of debt, and working capital.
Risk factors.....	The offering involves a high degree of risk.
OTC Bulletin Board	
Common stock.....	PMED.OB
Class A warrants.....	PMEDW.OB

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(1) Does not include 6,753 shares of common stock issuable upon conversion of 5,627 shares of Series A preferred stock, 10,783 shares of common stock issuable upon conversion of 8,986 shares of Series B preferred stock, 8,750 shares of common stock issuable upon the conversion of 5,000 shares of Series D preferred stock, 80,000 shares of common stock issuable upon the conversion of 1,500 shares of Series E preferred stock, 298,867 shares of common stock issuable upon conversion of 5,603.75 shares of Series F preferred stock, options to purchase a total of 3,895,132 shares of common stock issuable upon the exercise of stock options at prices ranging from $.16 to $6.00 per share, and warrants to purchase 3,719,659 shares of common stock issuable upon the exercise of warrants at prices ranging from $.16 to $8.125 per share.

Summary Financial Information

	For the year ended December 31, 2001	2002	For three mon March 2002
Statement of Operations Data:			(Unaudited)
Net Sales.....	$ 7,919,000	$ 5,368,000	$ 1,537,000
Net cost of sales.....	4,370,000	4,210,000	841,000
Operating expenses.....	12,834,000	12,277,000	2,763,000
Operating loss.....	(9,285,000)	(11,119,000)	(2,067,000)
Other income (expense).....	(858,000)	(36,000)	(6,000)
Net loss	(10,143,000)	(11,155,000)	(2,073,000)
Net loss per common share.....	(.98)	(.63)	(.13)
Shares used in computing net loss per share	13,245,000	17,736,000	15,775,000

	As of December 31, 2002	As of March 31, 2003	As of
Balance Sheet Data:			

Current assets	$ 3,868,000	$ 3,444,000	$
Current liabilities	2,362,000	2,519,000	
Working capital	1,506,000	925,000	
Total assets	5,289,000	4,744,000	
Accumulated deficit	(53,656,000)	(54,359,000)	
Stockholder's equity	2,847,000	2,145,000	

(1) The columns "As Adjusted" give effect to the net proceeds received from the sale of 8,000,000 shares of Common Stock offered hereby at an estimated offering price of $.50 per share and the application of the proceeds therefrom, as set forth in the Use of Proceeds, including repayment of $400,000 of debt.

RISK FACTORS

Before you invest in our common stock, you should be aware of the risks described below which constitute all material risks to potential investors. You should consider carefully these risk factors together with all of the other information included in this prospectus before you decide to invest in our common stock. If any of the following risks actually occurs, our business, financial condition and results of operations could suffer, in which case the trading price of our common stock could decline. No investment should be made by any person who is not in a position to lose the entire amount of his investment.

Special Note Regarding Forward-Looking Statements

Some of the information in this prospectus may contain forward-looking statements. Such statements can be identified by the use of forward-looking terminology such as "may," "will," "expect," "anticipate," "estimate," "continue" or other similar words. These statements discuss future expectations, contain projections of results of operations or of financial condition or state other "forward-looking" information. When considering such forward-looking statements, you should keep in mind the risk factors and other cautionary statements in this Prospectus. The risk factors noted in this section and other factors noted throughout this prospectus, including certain risks and uncertainties, could cause our actual results to differ materially from those contained in any forward-looking statement.

We have limited working capital, a limited operating history, have accumulated significant losses, and expect our losses to continue.

As of December 31, 2002, we had limited working capital of $1,506,000. As of March 31, 2003, our working capital was $925,000. Our company and its predecessors have only been in operation since 1989. Our accumulated deficit was $42,501,000 as of December 31, 2001,$53,656,000 as of December 31, 2002, and $54,359,000 as of March 31, 2003. Our net loss was $10,143,000 for the fiscal year ended December 31, 2001, $11,155,000 for the fiscal year ended December 31, 2002, and $703,000 for the three months ended March 31, 2003. Such losses have resulted principally from costs incurred in connection with research and development, including clinical trials, of the laser surgery system. Medical products were not sold by us until late 1992. Our ability to become profitable largely depends on successfully developing clinical applications and obtain regulatory approvals for our laser surgery products, including the Photon(TM)

laser system, and to effectively market such products. The problems and expenses frequently encountered in developing new products and the competitive industry in which we operate will impact whether we are successful. We may never achieve profitability. Furthermore, we may encounter substantial delays and unexpected expenses related to research, development, production, marketing, regulatory matters or other unforeseen difficulties.

Our securities have been delisted from the Nasdaq SmallCap Market and currently trade on the OTC Bulletin Board

As of June 26, 2003, our shares trade on the OTC Bulletin Board. As a result, it may be more difficult for an investor to dispose of our securities, or to obtain accurate quotations on their market value. Furthermore, the prices for our securities may be lower than might otherwise be obtained. On October 8, 2002, we received a notice from Nasdaq's Listing Qualifications staff that for the previous 30 consecutive trading days, the price of our common stock closed below the minimum $1.00 per share requirement for continued inclusion on Nasdaq under Marketplace Rule 4310(c)(4). The notice further provided that if at anytime before April 7, 2003, the bid price of our common stock closed at $1.00 or more for a minimum of 10 consecutive trading days, we would be notified by the staff that we comply with such rule.

On April 15, 2003, we received notice of a determination by Nasdaq's Listing Qualifications staff that we failed to comply with the minimum bid price rules for continued listing set forth in Marketplace Rule 4310(c)(4) and do not meet the Rule 4310(c)(2)(A) inclusion requirements. Specifically, the notice stated that we have not regained compliance with the minimum $1.00 closing bid price per share requirement (noting that pursuant to the October 8, 2002, notice from the Nasdaq Listing Qualifications staff, we were provided 180 calendar days, or until April 7, 2003, to regain compliance with this requirement) and we do not qualify with the $5,000,000 shareholders equity, $50,000,000 market value of listed securities or $750,000 net income from continuing operations requirement for an additional 180 calendar day compliance period to comply with Marketplace Rule 4310(c)(4). The April 15, 2003, notice further stated that as of December 31, 2002, we reported stockholders' equity of $2,847,000 and net losses from continuing operations of approximately $11,155,000, and as of April 14, 2003, the market value of our listed securities was $4,208,108. Accordingly, our common stock would be delisted from the Nasdaq SmallCap Market at the opening of business on April 24,2003. Separately, Nasdaq informed us that listing fees of $22,500 and $18,000 under Rule 4310(c)(13) are owed to the Nasdaq SmallCap Market.

We requested an oral hearing before a Nasdaq Listing Qualifications Panel to review the staff's determination. The request automatically stayed the delisting of our common stock. On April 23, 2003, we received formal notice from Nasdaq that a hearing to consider our appeal would be held on May 29, 2003. On May 29, 2003, Dr. Jeffrey F. Poore, our President and Chief Executive Officer; Randall A. Mackey, our Chairman of the Board; and Dr. David M. Silver, a director of the company, attended an oral hearing before a Nasdaq Listing Qualifications Panel in Washington, D.C. At the hearing Dr. Poore presented to the panel a definitive plan both for regaining compliance with the particular

deficiencies cited in the April 15, 2003, letter from the Nasdaq Listing Qualifications staff and sustaining long term compliance with the Nasdaq Marketplace Rules, including all applicable maintenance criteria. On June 24, 2003 we received notification from the Nasdaq Listing Qualifications Panel that we were to be delisted from the Nasdaq Stock Market effective June 26, 2003. Our securities trade on the OTC Bulletin Board effective June 26, 2003. Because our securities are delisted from the Nasdaq SmallCap Market and now trade on the OTC

Bulletin Board, additional sales requirements on broker-dealers would adversely effect the ability of purchasers to sell our securities and the trading price of our securities could decline.

Because our securities currently trade on the OTC Bulletin Board, they are subject to Rule 15g-9 promulgated under the Securities Exchange Act of 1934, as amended (the "Exchange Act"), which imposes additional sales practice requirements on broker-dealers that sell securities governed by Rule 15g-9 to persons other than established customers and "accredited investors" (generally, individuals with a net worth in excess of $1,000,000 or annual individual income exceeding $200,000 or $300,000 jointly with their spouses). For transactions covered by Rule 15g-9, the broker-dealer must determine whether such persons that are not established customers or accredited investors qualify under the rule for purchasing such securities and must receive that person's written consent to the transaction prior to sale. Consequently, Rule 15g-9 may adversely effect the ability of purchasers to sell our securities and otherwise affect the trading market in our securities.

The Commission has adopted regulations which generally define a "penny stock" to be any non-Nasdaq equity security that has a market price (as therein defined) less than $5.00 per share or with an exercise price of less than $5.00 per share, subject to certain exceptions. For any transactions by broker-dealers involving a penny stock (unless exempt), rules promulgated under the Exchange Act require delivery, prior to a transaction in a penny stock, of a risk disclosure document relating to the penny stock market. Disclosure is also required to be made about compensation payable to both the broker-dealer and the registered representative and current quotations for the securities. Finally, monthly statements are required to be sent disclosing recent price information for the penny stocks.

We are offering our shares on a best efforts basis and there is no guarantee that we will sell the maximum shares offered.

No underwriter has been retained to purchase the shares offered in connection with this prospectus. There can be no assurance that all of the shares offered will be sold and that we will receive all of the estimated net proceeds generated from such a sale of all of the common stock. If all of the 8,000,000 shares offered are not sold, we may be unable to fund all of the intended uses for the net proceeds anticipated from this offering without obtaining funds from alternative sources. Alternative sources of funds may not be available to us at a reasonable cost.

If the litigants in the class action lawsuits succeed on any of their claims, it could adversely effect our financial condition and operations.

On May 14, 2003, a complaint was filed in the United States District Court, District of Utah, captioned Richard Meyer, individually and on behalf of all others similarly suited v. Paradigm Medical Industries, Inc., Thomas Motter, Mark Miehle and John Hemmer, Case No. 2:03CV00448TC. The complaint also indicates that it is a "Class Action Complaint for Violations of Federal Securities Law and Plaintiffs Demand a Trial by Jury." We have been in the process of reviewing the complaint, which appears to be focused on alleged false and misleading statements pertaining to the Blood Flow Analyzer(TM) and concerning a purchase order from Valdespino Associates Enterprises and Westland Corp. On June 2, 2003, a complaint was filed in the same United States District Court captioned Michael Monroe v. Paradigm Medical Industries, Inc., Thomas Motter and John Hemmer, Case No. 2:03 CV00513 PGC. It too indicates that it is a "class action complaint." It is similar in nature to the Meyer case and is also under review. We intend to vigorously defend and protect our interests in these cases. If the litigants in the class action lawsuits succeed on any of their claims, it could adversely affect our financial condition and operations.

If we are unable to obtain additional capital, we would be required to eliminate certain activities that would adversely effect our operations.

We may require substantial funds for various purposes, including continuing research and development, expanding clinical trials, completing the FDA approval process for our products (including the Photon(TM) laser system), and manufacturing and marketing our existing products. We will need to seek additional capital, possibly through public or private sales of our securities, in order to fund our activities on a long-term basis. Adequate funds may not be available when needed or on terms acceptable to us. Insufficient funds may require us to delay, scale back or eliminate certain or all of our research and development programs or to license third parties to commercialize products or technologies that we would otherwise seek to develop ourself, which may materially adversely affect our continued operations.

The recent loss of members of senior management could adversely affect our operations.

Our success largely depends on a number of key employees. The loss of one or more of these employees could have a material adverse effect on us, including the development and sale of eye surgery systems. On August 30, 2002, Thomas F. Motter resigned as our Chairman of the Board and Chief Executive Officer, and Mark R. Miehle was terminated as our President and Chief Operating Officer. On June 3, 2003, Heber C. Maughan resigned as our Vice President of Finance, Treasurer and Chief Financial Officer. The recent loss of these members of senior management could have a significant adverse effect on us and our operations and prospects. We had no key man insurance on either Mr. Motter, Mr. Miehle or Mr. Maughan.

Our research activities may not result in any commercially profitable products.

The science and technology of medical products, including lasers, is rapidly evolving. Our medical systems may require significant further research, development, testing and regulatory clearances. They are also subject to the risks of failure inherent in the development of products based on innovative technologies. These risks include the possibility that any or all of the proposed products will prove to be ineffective or unsafe; that they fail to receive necessary regulatory clearances; that the proposed products are uneconomical; that others hold proprietary rights which preclude us from marketing such products; or that others market better products. Accordingly, we are unable to predict whether our research and development activities will result in any commercially profitable products. Further, due to the extended testing and regulatory review process required, we may be unable to sell our current and proposed products. There is also no guarantee that we will be able to develop and sell a glaucoma surgery system.

We are uncertain of obtaining FDA approval for our Photon(TM) laser system.

We are subject to substantial regulation by the FDA and other federal and state regulatory agencies. FDA regulations require us to obtain either 510(k) clearance or pre-marketing approval prior to marketing a product in the United States. We are also subject to foreign regulation and must receive various types of approvals from foreign government agencies prior to selling our products in some countries. The clearance and approval processes for both the FDA and foreign regulatory authorities are costly, time consuming and uncertain. In addition, we are required to obtain FDA approval before exporting a device which has not received FDA marketing clearance or approval. We may never be able to obtain these required government approvals. Delays or failure to obtain such approvals would materially and adversely effect us, as would changes in existing

requirements. We have received 510(k) clearance from the FDA for our ultrasonic surgery systems allowing us to sell both devices in the United States. We have also received 510(k) clearance to market our Blood Flow Analyzer(TM).

In May 1995, we were granted an investigational device exemption for our Photon(TM) laser system allowing us to conduct clinical studies in support of our application with the FDA to obtain approval to market the system. During the clinical trials, we discovered that the Photon(TM) laser system may not effectively remove hard (dense or impacted) cataracts. In May, 1998, we received FDA clearance to conduct clinical tests on soft cataracts. We believe the FDA will approve our 510(k) predicate device application for the Photon(TM) laser system since in the United States most cataracts are removed before tissue hardens. We have completed the authorized clinical studies and, in October 2001, made a supplemental submission to the FDA regarding the 510(k) application. We received a preliminary review from the FDA of our supplemental submission in December 2001 and submitted additional clinical information to the FDA on February 6, 2002.

On May 7, 2002, we received a letter from the FDA requesting further clinical information. We are in the process of generating the additional clinical information in response to the letter and expect to make a submission to the FDA with the additional clinical information within the first quarter of 2004. We received an FDA warning letter in August 2000 concerning Phase I clinical trials, but believe all items in the warning letter have been satisfied and the clinical trials and their data are in good standing. We have also received FDA approval to manufacture and export the Photon(TM) laser system internationally. However, we have not yet obtained approval from some foreign countries to market the laser product where approval is necessary. We anticipate that many contemplated applications of our currently existing and planned products will be subject to the lengthy regulatory approval process, including preclinical studies, clinical trials and extensive regulatory review. This process could take many years and require the expenditure of substantial resources.

Our executives lack operating experience.

Our executives rely on their experience and skill from their professional occupations. None of our executives has direct experience in managing a company that utilizes research and product development activities and technology to such a high degree.

Our Photon(TM) laser system may not receive FDA approval.

We are developing a laser cataract surgery system for inclusion in our Workstation(TM). Phase I clinical trials have concluded for FDA approval for the Photon(TM) laser system. During the clinical trials, we discovered that the Photon(TM) laser system may not effectively remove hard (dense or impacted) cataracts. In May, 1998, we received FDA clearance to conduct clinical tests on soft cataracts. We believe the FDA will approve our 510(k) predicate device application for the Photon(TM) laser system since in the United States most cataracts are removed before tissue hardens. While we rely upon several products for revenues, we are dependent on FDA approval of our Photon(TM) laser system to generate future revenues. On October 2001, we made a supplemental submission to the FDA for the existing 510(k) application. We received a preliminary review from the FDA of our supplemental submission in December 2002 and submitted additional clinical information to the FDA on February 6, 2002. On May 7, 2002,

we received a letter from the FDA requesting further clinical information. We are in the process of generating the additional clinical information in response

to the letter and expect to make a submission to the FDA with the additional clinical information within the first quarter of 2004. We received an FDA warning letter in August 2000 concerning Phase I clinical trials, but believe all items in the warning letter have been satisfied and the clinical trials and their data are in good standing.

Purchasers of our common shares could experience dilution from our tendering puts under a private equity line of credit agreement with Triton West.

On June 30, 2000, we entered into a private equity line of credit agreement with Triton West Group, Inc., in which Triton agreed to provide an amount up to $20,000,000 to us in order to purchase put common shares pursuant to the terms and conditions of the agreement. Under the agreement, we may elect for a period of three years from the effective date of December 8, 2000 (the date on which the Securities and Exchange Commission declared effective a registration statement registering shares to be purchased by Triton on put transactions with us) to exercise our right to tender a put notice to Triton. The put notice requires Triton to purchase shares of our common stock at 88% of the market price on the trading day immediately following the valuation period, which is a period of five trading days beginning two days before the trading day on which the put notice is deemed to be delivered and two trading days after such date. Under certain conditions, the purchase price will be reduced to 85% of the market price of our common stock. The agreement provides certain restrictions on the tendering of puts. The maximum amount of each put (which may vary from $750,000 to $2,000,000) is to be determined according to a schedule based on the trading price of our common stock at the time and the average 30 day volume of such shares. There must be a minimum of 15 business days between puts. Moreover, a registration statement must be in effect registering the shares of common stock covered by the put. There may be significant dilution associated with tendering put notices under the agreement. There is currently no registration in effect registering any shares of common stock issuable pursuant to the tendering of a put notice to Triton.

Our products may become obsolete due to rapid technological change.

Our market is subject to rapid technological change. Development by others of new or improved products, processes or technologies may make our products obsolete or less competitive. Accordingly, we must continue investing in research and development on our existing products and to develop new products. Despite such investment, our current or proposed products may be unsuccessful.

Our Photon(TM) laser system could receive competition from other laser systems that are well financed with well recognized trade names.

Our Photon(TM) laser system will potentially receive competition from other laser systems, such as excimer, holmium (Ho:YAG), Erbium (Er:YAG), Nd:YLF (Neodymium:Yttium-Lithium-Fluoride) or lasers of other wave lengths. Competition may also come from other medical devices and other surgical techniques. Further, the cataract surgical device industry is dominated by a small number of large competitors that are well established in the marketplace, have experienced management, are well financed and have a well recognized trade name related to their product lines. We may be unable to penetrate the existing market and acquire a sufficient market share to be profitable. Significant competitive factors which will affect future sales include regulatory approvals, performance, pricing, timely product shipment, safety, customer support, convenience of use and patient and general market acceptance.

Our new products may incur unexpected production problems, which would impact our sales and profits.

New ventures, particularly those involved in a highly technical

industry such as the medical industry, have substantial inherent risks. These risks are in three general areas: technical, mechanical and human. Notwithstanding any pre-production planning, new products can incur unexpected problems in full scale production, which cannot always be foreseen or accurately predicted. Designs can become unworkable, for unpredicted reasons. Quality control and component sourcing failures can also be expected from time to time. Any business, including ours, is substantially dependent upon the capabilities and performance of both management and sales personnel. Mistakes in judgment or performance can be costly and, in certain instances, disabling. Therefore, management skill, experience, character and reliability are of significant importance.

Mistakes may occur in the design and manufacture of our products, which could prevent or limit the sales of our products.

The high-technology product line requires us to deal with suppliers and subcontractors supplying highly specialized parts, operating highly sophisticated and narrow tolerance equipment and performing highly technical calculations. Components must be custom designed and manufactured, which is not only complicated and expensive, but can also require a number of months to accomplish. Slight mistakes in either the design or manufacture can result in unsatisfactory parts that may not be correctable. Because our business requires the talents of various professions, mistakes from very slight oversights or miscommunications can occur, resulting not only in costly delays and lost orders, but also in disagreements regarding liability and, in any event, extended delays in production. Moreover, we rely on suppliers that are related to each other for parts and equipment. When dealing with related suppliers the terms on which parts and equipment are purchased may not be as favorable as could be obtained from unrelated third-party suppliers.

No independent marketing studies have been made to confirm the commercial demand for the Photon(TM) laser system and the Blood Flow Analyzer(TM).

We believe that there is substantial commercial demand for our Photon(TM) laser system and our Blood Flow Analyzer(TM) for the eyes at a profitable price. However, this belief is solely based on our management's experience and judgment. At this time, there have been no independent marketing studies by independent professional marketing firms to reliably confirm the extent of this demand, the price ranges within which it exists and the amount of promotion necessary to exploit whatever demand does exist.

Our Photon(TM) laser system may not be accepted in the marketplace because it does not remove hard cataracts.

Our products may not be accepted in the marketplace. Such acceptance will depend on a number of factors including receiving regulatory approvals, demonstrating the safety, and advantages of our products over existing systems and techniques. Our Photon(TM) laser system may never gain market acceptance since the system does not effectively remove hard (dense or impacted) cataracts. Further, we may be unable to successfully market our products even if they perform successfully in clinical applications. Our Precisionist ThirtyThousand(TM) Workstation(TM) may not gain acceptance unless we can reduce or eliminate the vacuum surge and develop additional, complementary surgical devices for installation in that host system. Vacuum surge is a phenomenon that occurs when the tip of the ultrasonic needle is obstructed by target tissue, allowing pressure to build up and, if the pressure is not released, a rush of fluid goes from the chamber of the eye into the needle to equalize the pressure. The result can be complications to the eye such as posterior capsule rupture, iris capture and chamber collapse. We believe this phenomenon affects all other

ultrasonic cataract removal systems currently on the market.

Our pending patents may not be perfected and our present or future patents may infringe upon the patents of others, which could restrict or prevent the manufacture and sale of our products.

We depend on our ability to license and obtain patents and on the adherence to confidentiality agreements executed by employees, consultants and third-parties to maintain the proprietary nature of our technology and to operate without infringing on the proprietary rights of others. Our laser probe is protected by a United States patent issued in 1987 to Daniel M. Eichenbaum, M.D. Patents have been granted to the Blood Flow Analyzer(TM) in the United States and the United Kingdom, to the Dicon(TM) Topographer in the United States, and to the Dicon(TM) Perimeter in the United States, the United Kingdom, Germany and Switzerland. The pending patents may not be perfected. Also, our present or future products may be found to infringe upon the patents of others. If our products are found to infringe on the patents, or otherwise impermissibly utilize the intellectual property of others, our development, manufacture and sale of such products could be severely restricted or prohibited. We may be required to obtain licenses to utilize such patents or proprietary rights of others and acceptable terms may be unavailable. If we do not obtain such licenses, the development, manufacture or sale of products requiring such licenses would be materially adversely affected. In addition, we could incur substantial costs in defending ourself against challenges to our patents or infringement claims made by third parties or in enforcing any patents we may obtain.

Because patents only provide limited protection, others could produce and distribute products similar to the Photon(TM) laser system, the Mentor systems and the Blood Flow Analyzer(TM).

We rely on the protections for our products that we hope to realize under the United States and foreign patent laws. However, patents provide limited protections. We have a United States and Japanese patent on the hand-held probe design and applications for various foreign patents are either pending or planned, and the patents for the Blood Flow Analyzer(TM) for the eyes are reported by Occular Blood Flow, Ltd. to have been approved in the United States and the United Kingdom. Similar devices, however, could be designed that do not infringe on our patent rights, but that are similar enough to compete against our patented products. Moreover, it is possible that an unpatented but prior existing device or design may exist that has never been made public and therefore is not known to us or the industry in general. Such a device could be introduced into the market without infringing on our current patent. If any such competing non-infringing devices are produced and distributed, our profit potential would be seriously limited, which would seriously impair our viability.

Some of our products may be denied reimbursement by third-party payors, such as government programs and private insurance plans.

We anticipate that our medical devices will generally be purchased by ophthalmologists and hospitals that will then bill various third-party payors, such as government programs and private insurance plans, for the health care services provided to their patients. Government agencies generally reimburse at a fixed rate based on the procedure performed. Some of the potential procedures for which our medical devices may be used, however, may be denied reimbursement as elective. In addition, third-party payors may deny reimbursement if they determine that the use of our products was unnecessary, inappropriate, not

cost-effective, experimental or used for a non-approved indication. Certain purchasers of our Blood Flow Analyzer,(TM), for example, have had difficulty in obtaining reimbursement from insurance carriers. Even if we receive FDA clearances for our products, third-party payors may nevertheless deny reimbursement. Furthermore, third-party payors increasingly challenge the prices charged for medical products and services. Reimbursement from third-party payors may be unavailable or if available, that reimbursement may be limited when compared with reimbursement for competitive procedures, thereby materially adversely affecting our ability to profitably sell products. The market for our products could also be adversely affected by recent federal legislation that reduces reimbursements under the capital cost pass- through system utilized in connection with the Medicare program. Failure by hospitals and other users of our products to obtain reimbursement from third-party payors or changes in government and private third-party payors' policies toward reimbursement for procedures employing our products would have a material adverse effect on us.

Congress may introduce legislation that could result in price limits and utilization controls on our products.

Members of Congress have introduced legislation to change aspects of the delivery and financing of health care services. Such legislation to control or reduce public (Medicare and Medicaid) and private spending on health care, to reform the methods of payment for health care goods and services by both the public and private sectors, and to provide universal access to health care may be passed. We cannot predict what form this legislation may take or the effect of such legislation on our business. It is possible that the legislation ultimately enacted by Congress will contain provisions resulting in price limits and utilization controls which may reduce the rate of increase in the growth of the ophthalmic laser market or otherwise adversely affect our business. It is also possible that future legislation could result in modifications to the nation's public and private health care insurance systems which will affect reimbursement policies in a manner adverse to us. We also cannot predict what other legislation relating to our business or the health care industry may be enacted, including legislation relating to third-party reimbursement, or what effect legislation may have on the results of our operations.

Our Precisionist Thirty Thousand(TM) Workstation(TM) may experience circuiting problems or component failures which, if not corrected, could impact our sales.

Our Precisionist Thirty Thousand(TM) Workstation(TM) is a new computer-based product that has been marketed since 1997. However, its current installment base is not large enough to be considered proven by day to day use in the marketplace. As is common with other new computer-based products, we have discovered certain circuitry problems and component failures with the first Workstation(TM) that we manufactured. We believe that we have corrected most if not all of these problems. However, there is no assurance that all of these problems have been detected or corrected. If customers were to experience significant problems with the Workstation(TM), if we could not fix or correct the problems, or if our customers were dissatisfied with the functionality or performance of the Workstation(TM), or product support provided by us, we would be materially adversely effected.

Because we have minimal direct sales experience, our sales program may be unsuccessful.

We commenced a direct sales program in July 1993 with three sales representatives to market our products. In July 2000, four additional sales representative were hired. In August 2001, 15 additional sales representatives were hired, bringing the total number of sales representatives to 22. The number of sales representatives has been reduced to five as a result of our downsizing program and absence of the anticipated FDA approval of the Photon(TM) laser system. However, we have minimal direct sales experience and may need to recruit

additional qualified personnel for this purpose. Our sales program may be unsuccessful or we may be unable to attract and retain qualified distributors on favorable terms.

Our product liability insurance could be inadequate to cover liabilities if we face significant product liability claims against us.

The nature of our business exposes it to risk from product liability claims and there can be no assurance that we can avoid significant product liability exposure. We maintain product liability insurance providing coverage up to $2,000,000 per claim with an aggregate policy limit of $2,000,000. There is substantial doubt that this amount of insurance would be adequate to cover liabilities should we face significant claims. A successful products liability claim brought against us could have a material adverse effect on our business, operating results and financial condition. Further, product liability insurance is becoming increasingly expensive, and there can be no assurance that we will successfully maintain adequate product liability insurance at acceptable rates, or at all. Should we be unable to maintain adequate product liability insurance, our ability to market our products would be significantly impaired. Any losses that we may suffer from future liability claims or a voluntary or involuntary recall of our products and the damage that any product liability litigation or voluntary or involuntary recall may do to the reputation and marketability of our products would have a material adverse effect on our business, operating results and financial condition.

Our future products sales in foreign countries could be adversely effected by a significant increase in value of the U.S. dollar against local currencies, and economic and political instability.

We anticipate that a significant portion of our future product sales will be in foreign countries. Because we quote prices for our products and accept payment on sales principally in U.S. dollars, any significant increase in the value of the U.S. dollar against local currencies may make our products less competitive with foreign products. The economic and political instability of some foreign countries also may affect the ability of ophthalmologists and others to purchase our products, or the ability of potential customers to pay for the procedures for which our products are used.

The market price of our securities could fluctuate significantly.

Our common stock and Class A warrants were delisted on The Nasdaq SmallCap Market effective June 26, 2003 and currently trade on the OTC Bulletin Board. Factors such as announcements by us of the regulatory status of products, quarterly variations in our financial results, the gain or loss of material contracts, changes in management, regulatory changes, trends in the industry or stock market and announcements by competitors, among other things, could cause the market price of such securities to fluctuate significantly.

We may issue preferred shares with preferences in an equal or prior rank to existing preferred shares.

Our certificate of incorporation authorizes the issuance of shares of "blank check" preferred stock, which will have such designations, rights and preferences as may be determined from time to time by our board of directors. Accordingly, our Board of Directors is empowered, without stockholder approval (but subject to applicable government regulatory restrictions), to issue preferred stock with dividend, liquidation, conversion, voting or other rights which could adversely affect the voting power or other rights of the holders of our common stock. Those terms and conditions may include preferences on an equal

or prior rank to existing preferred stock. Those shares may be issued on such terms and for such consideration as the board then deems reasonable and such stock shall then rank equally in all aspects of the series and on the preferences and conditions so provided, regardless of when issued. In the event of such issuance, the preferred stock could be utilized, under certain circumstances, as a method of discouraging, delaying or preventing a change in control of our company. As of June 30, 2003, the following preferred shares were issued and outstanding: 5,627 shares of Series A preferred stock convertible into 6,753 common shares; 8,986 shares of Series B preferred stock convertible into 10,783 common shares; no shares of Series C preferred stock; 5,000 shares of Series D preferred stock convertible into 8,750 common shares; 1,500 shares of Series E preferred stock convertible into 80,000 common shares; and 5,603.75 shares of Series F preferred stock convertible into 307,933 common shares.

We do not expect to pay any cash dividends in the foreseeable future.

We issued a stock dividend on our Series A preferred stock and Series B preferred stock on January 8, 1996, to stockholders of record as of December 31, 1994. We have not paid any cash dividends on our common shares and do not expect to declare or pay any cash or other dividends in the foreseeable future so that we may reinvest earnings, if any, into the development of the business. The holders of our Series A preferred stock, Series B preferred stock, Series C preferred stock, Series D preferred stock, Series E preferred stock and Series F preferred stock are entitled to non-cumulative cash dividends paid out of surplus earnings.

We have sole discretion in allocating the proceeds from the offering.

All of the net proceeds of the offering, if any, have been allocated to working capital (and not otherwise allocated for a specific purpose) and will be used for such purposes as management may determine in its sole discretion without the need for stockholder approval with respect to any such allocations.

We have indemnification agreements with certain officers and directors that may require us to indemnify them in a civil or criminal action.

Our certificate of incorporation eliminates in certain circumstances the liability of directors for monetary damages for breach of their fiduciary duty as directors. We have entered into indemnification agreements with certain directors and officers. Each such indemnification agreement provides that we will indemnify the indemnitee against expenses, including reasonable attorneys' fees, judgments, penalties, fines and amounts paid in settlement actually and reasonably incurred by him in connection with any civil or criminal action or administrative proceeding arising out of his performance of his duties as a director or officer, other than an action instituted by the director or officer. The indemnification agreements will also require that we indemnify the director or other party thereto in all cases to the fullest extent permitted by applicable law. Each indemnification agreement will permit the director or officer that is party thereto to bring suit to seek recovery of amounts due under the indemnification agreement and to recover the expenses of such a suit if he or she is successful.

Our Board of Directors has the right to issue additional shares of common stock and to create a new series of preferred stock which could dilute holders of common stock.

Our board of directors has the inherent right under applicable Delaware law, for whatever value the board deems adequate, to issue additional common shares up to the limit of shares authorized by the certificate of incorporation,

and, upon such issuance, all holders of shares of common stock, regardless of when they are issued, thereafter generally rank equally in all aspects of that class of stock, regardless of when issued. Our board of directors likewise has the inherent right, limited only by applicable Delaware law and provisions of the Certificate of Incorporation to increase the number of preferred shares in a series, to create a new series of preferred shares and to establish preferences and all other terms and conditions in regard to such newly-created series. Any of those actions will dilute the holders of common shares and also affect the relative position of the holders of any series of any class. Current stockholders have no rights to prohibit such issuances nor inherent "preemptive" rights to purchase any such stock when offered.

USE OF PROCEEDS

Our net proceeds from the sale of the 8,000,000 shares of common stock being offered hereby at an estimated offering price of $.50 per share are estimated to be $3,954,000, after deducting estimated offering expenses, which are estimated to be approximately $46,000. The net proceeds are intended to be used over the next 12 months as follows:

Application of Proceeds	Amount	Percentage
Sales and Marketing(1).....	$ 500,000	12.6%
Research and Development(2).....	600,000	15.2
Acquisition of Capital Equipment(3).....	50,000	1.3
Repayment of Debt(4).....	400,000	10.1
Working Capital(5).....	2,404,000	60.8
Total.....	$3,954,000	100.0%

(1) Represents funds required for the implementation of our direct sales force, attendance at trade shows and production and dissemination of promotional materials.

(2) A majority of these funds will be used for the enhancement and upgrading of our current products approved for sale. These funds will also pay expenses associated with conducting and evaluating the clinical trials and seeking government approvals for our products and developing new products and patents. Included in this estimate are costs associated with the development of the Photon(TM) laser system, including completion of the clinical trials.

(3) Represents funds required to expand in-house manufacturing capabilities to reduce product costs.

(4) These funds will be used to pay our obligations to suppliers and vendors as well as royalty obligations.

(5) Working capital will be available for use as a reserve for contingencies. In the event cash generated from operations is insufficient to fund corporate overhead, working capital may be used to cover such deficiency.

The allocation of the net proceeds set forth above represents our estimates based upon our current operating plans and upon certain assumptions

regarding the progress of the development of our products, technological advances and changing competitive conditions, and assumptions regarding industry and general economic conditions and other conditions. Future events, including problems, delays, expenses and complications frequently encountered by companies developing new products, as well as changes in competitive conditions and the success or lack thereof of our research and development or marketing efforts, may make it necessary or advisable for us to reallocate the net proceeds among the above users or use portions of the net proceeds for other purposes. Any reallocation of the net proceeds other than as provided above, will be at the discretion of our board of directors. We estimate that the net proceeds will be sufficient to fund our proposed business and operations for a period of 12 months from the closing of the offering. If our estimates prove incorrect, we will have to seek alternative sources of financing during such period, including debt and equity financing and the reduction of operating cost and projected growth plans. No assurance can be given that such financing could be obtained by us on favorable terms, if at all, and if we are unable to obtain needed financing, our business would be materially adversely affected. The timing and amount of expenditures of the net proceeds of this offering may vary depending upon the pace of our growth.

Pending application, the net proceeds of the offering will be invested in short-term, high-grade interest-bearing savings accounts, certificates of deposit, United States government obligations, money market accounts or short-term interest bearing obligations.

DIVIDEND POLICY

We have never paid any cash dividends on our common stock and do not anticipate paying any cash dividends on our common stock in the foreseeable future. Dividends paid in cash pursuant to outstanding shares of our Series A, Series C, Series D, Series E and Series F preferred stock are only payable from our surplus earnings and are non-cumulative and therefore, no deficiencies in dividend payments from one year will be carried forward to the next. We currently intend to retain future earnings, if any, to fund the development and growth of our proposed business and operations. Any payment of cash dividends in the future on the common stock will be dependent upon our financial condition, results of operations, current and anticipated cash requirements, plans for expansion, restrictions, if any, under any debt obligations, as well as other factors that our board of directors deems relevant.

CAPITALIZATION

The following table sets forth our the capitalization (i) at March 31, 2003, and (ii) as adjusted to give effect to the sale of 8,000,000 shares of common stock offered hereby at a minimum price of $.50 per share and the initial application of the proceeds therefrom as set forth in the Use of Proceeds.

	Actual	Ma
Long-term obligations(2).....	$ 80,000	
Stockholders' Equity:		

Series A Preferred Stock, $.001 par value per share; 500,000 shares authorized, 5,627 issued and outstanding.....	-
Series B Preferred Stock, $.001 par value per share; 500,000 shares authorized, 8,986 issued and outstanding.....	-
Series C Preferred Stock, $.001 par value per share; 30,000 shares authorized, 0 issued and outstanding.....	-
Series D Preferred Stock, $.001 par value per share; 1,140,000 shares authorized, 5,000 issued and outstanding.....	-
Series E Preferred Stock, $.001 par value per share; 50,000 shares authorized, 1,500 issued and outstanding.....	-
Series F Preferred Stock, $.001 par value per share; 50,000 shares authorized, 5,774 issued and outstanding.....	-
Common Stock, $.001 par value per share; 40,000,000 shares authorized, 21,986,874 issued and outstanding (29,986,874 issued and outstanding, as adjusted).....	22,000
Additional paid-in-capital, common stock.....	56,776,000
Stock subscription receivable.....	(294,000)
Accumulated deficit.....	(54,359,000)
Total stockholders' equity	2,145,000
Total Capitalization.....	2,225,000

(1) Adjusted to give effect to the net proceeds received from the sale of 8,000,000 shares of common stock offered hereby at a minimum price of $.50 per share and the application of proceeds therefrom as set forth in the Use of Proceeds.

MARKET FOR COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

Our authorized capital stock consists of 80,000,000 shares of common stock, $.001 par value per share, and 5,000,000 shares of preferred stock, $.001 par value per share. We have created six classes of preferred stock, designated as Series A preferred stock, Series B preferred stock, Series C preferred stock , Series D preferred stock, Series E preferred stock and Series F preferred stock.

Our common stock and Class A warrants trade on the OTC Bulletin Board under the respective symbols of "PMED.OB" and "PMEDW.OB." Prior to July 22, 1996, there was no public market for the common stock. From July 22, 1996 to June 25, 2003, our common stock and Class A warrants were listed on the Nasdaq SmallCap Market. As of July 2, 2003, the closing sale prices of the common stock and Class A warrants were $.245 per share and $.10 per warrant, respectively. The following are the high and low sale prices for the common stock and Class A warrants by quarter as reported by Nasdaq since January 1, 2000.

Period (Calendar Year)	Common Stock Price Range High	Common Stock Price Range Low	Class A Warrants Price Range High	Class A Warrants Price Range Low
2000				
First Quarter	14.50	6.88	6.50	2.63
Second Quarter	10.50	4.19	3.63	1.19
Third Quarter	6.19	3.38	2.00	.50
Fourth Quarter	4.94	1.31	1.25	.50
2001				
First Quarter	4.13	1.50	1.00	.19
Second Quarter	3.50	1.61	.74	.19
Third Quarter	2.75	1.86	.45	.16
Fourth Quarter	3.08	1.94	.39	.17
2002				
First Quarter	3.31	2.21	.38	.19
Second Quarter	1.91	.60	.32	.05
Third Quarter	1.50	.16	.20	.08
Fourth Quarter	.30	.13	.10	.01
2003				
First Quarter	.42	.14	.12	.01
Second Quarter	.74	.14	.44	.01

Our Series A preferred stock, Series B preferred stock, Series C preferred stock, Series D preferred stock, Series E preferred stock and Series F preferred stock are not publicly traded. As of December 31, 2002, there were 717 record holders of common stock, six record holders of Series A preferred stock, four record holders of Series B preferred stock, no record holders of Series C preferred stock, one record holder of Series D preferred stock, 14 record holders of Series E preferred stock and 52 record holders of Series F preferred stock.

We have never paid any cash dividends on our common stock and does not anticipate paying any cash dividends on our common stock in the foreseeable future. We must pay cash dividends to holders of our Series A preferred, Series B preferred, Series C preferred, Series D preferred stock, Series E preferred and Series F preferred stock before it can pay any cash dividend to holders of our common stock. Dividends paid in cash pursuant to outstanding shares of our Series A, Series B, Series C, Series D, Series E and Series F preferred stock are only payable from our surplus earnings, and are non-cumulative and therefore, no deficiencies in dividend payments from one year will be carried forward to the next.

We currently intend to retain future earnings, if any, to fund the development and growth of our proposed business and operations. Any payment of cash dividends in the future on the common stock will be dependent upon our financial condition, results of operations, current and anticipated cash requirements, plans for expansion, restrictions, if any, under any debt obligations, as well as other factors that our board of directors deems relevant. We issued 6,764 shares of our Series A preferred and 6,017 shares of our Series B preferred on January 8, 1996 as a stock dividend to Series A and Series B preferred shareholders of record as of December 31, 1994.

SELECTED FINANCIAL DATA

The following table sets forth our selected financial data for the years ended December 31, 2001 and 2002, and the three months ended March 31, 2002 and 2003. The selected financial data as of and for the years ended December 31, 2000 and 2001 are derived from our financial statements which have been audited by Tanner & Co. The selected financial data as of and for the three months ended March 31, 2002 and 2003 are derived from our unaudited quarterly financial statements. The following financial information should be read in conjunction with the Financial Statements, and related notes thereto, included at Exhibit "A" attached hereto.

	For the year ended December 31,		For three mont March 3	
	2001	2002	2002	-
Statement of Operations Data:			(Unaudited)	
Net Sales	$ 7,919,000	$ 5,368,000	$ 1,537,000	$
Net cost of sales	4,370,000	4,210,000	841,000	
Operating expenses	12,834,000	12,277,000	2,763,000	
Operating loss	(9,285,000)	(11,119,000)	(2,067,000)	
Other income (expense)	(858,000)	(36,000)	(6,000)	
Net loss	(10,143,000)	(11,155,000)	(2,073,000)	
Net loss per common share	(.98)	(.63)	(.13)	
Shares used in computing net loss per share	13,245,000	17,736,000	15,775,000	

Balance Sheet Data:	As of December 31, 2002	As of March 31, 2003
Current assets	$ 3,868,000	$ 3,444,000
Current liabilities	2,362,000	2,519,000
Working capital	1,506,000	925,000
Total assets	5,289,000	4,744,000
Accumulated deficit	(53,656,000)	(54,359,000)
Stockholder's equity	2,847,000	2,145,000

MANAGEMENT'S DISCUSSION AND ANALYSIS OR PLAN OF OPERATION

This report contains forward-looking statements and information relating to us that is based on beliefs of management as well as assumptions made by, and information currently available to management. These statements reflect our current view respecting future events and are subject to risks, uncertainties and assumptions, including the risks and uncertainties noted throughout the document. Although we have attempted to identify important factors that could cause the actual results to differ materially, there may be other factors that cause the forward-looking statements not to come true as anticipated, believed, projected, expected or intended. Should one or more of these risks or uncertainties materialize, or should underlying assumptions prove incorrect, actual results may differ materially from those described herein as anticipated, believed, projected, estimated, expected or intended.

General

The following Management's Discussion and Analysis of Financial Condition and Results of Operations, contains forward-looking statements which involve risks and uncertainty. Our actual results could differ materially from those anticipated in these forward-looking statements as a result of certain factors discussed in this section. Our fiscal year is from January 1 through December 31.

Our ultrasound diagnostic products include a pachymeter, an A-Scan, an A/B Scan and a biomicroscope, the technology for which was acquired from Humphrey Systems in 1998. We introduced the P45 in the fall of 2000, which combines the A/B Scan, and the biomicroscope in one machine. In addition, we market our Blood Flow Analyzer(TM) acquired in the purchase of Ocular Blood Flow Ltd. in June 2000. Other diagnostic products are the Dicon(TM) Perimeter and the Dicon (TM) Corneal Topographer which were acquired in the acquisition of Vismed d/b/a Dicon in June 2000. We purchased the inventory, design and production rights of the SIStem(TM) from Mentor Corporation in October 1999 which was designed to perform minimally invasive cataract surgery. In November 1999, we entered into a Mutual Release and Settlement Agreement with the manufacturer of the Precisionist ThirtyThousand(TM) in which we purchased the raw material and finished goods inventory to bring the manufacturing of this product in-house. FDA approval for our Photon(TM) laser system for cataract removal is in process.

Activities for the twelve months ended December 31, 2002 included sales of our products and related accessories and disposable products. On May 7, 2002, we received a letter from the FDA requesting further clinical information. We are in the process of generating the additional clinical information in response to the letter. We cannot market or sell the Photon(TM) in the United States until FDA approval is granted. On November 4, 2002, we received FDA approval for expanded indications of use of the Blood Flow Analyzer(TM) for pulsatile ocular blood flow, volume and pulsatility equivalence index. Also, we are continuing our aggressive campaign to educate the payers of Medicare claims throughout the country about the Blood Flow Analyzer(TM), its purposes and the significance of our performance in patient care in order to achieve reimbursements to the providers. These efforts should lead to a more positive effect on sales.

In April 2002, We announced the closure of our San Diego facility in anticipation of the termination of the lease for that location. The operations were transferred to the Salt Lake City facility. We incurred a reduction of force of 28 San Diego personnel. The consolidation was intended to save costs and to eliminate duplicities in functions and facilities that occurred with the acquisition of Dicon. The cost of the consolidation was approximately $80,000.

In January 2002, we purchased certain assets and lease obligations of Innovative Optics, Inc. ("Innovative Optics") by issuing an aggregate of 1,272,825 shares of our common stock (636,412 shares are held in escrow pending the result of a project to reduce the cost of the disposable razor blades utilized by the microkeratome, which was acquired in the transaction), warrants to purchase 250,000 shares of our common stock at $5.00 per share, exercisable over a period of three years from the closing date, and $100,000 in cash. The transaction was accounted for as a purchase in accordance with Statement of Financial Accounting Standards No. 141 ("SFAS No. 141").

We acquired from Innovative Optics, the raw materials, work in process and finished goods inventories. Additionally, it acquired the patents and trade name associated with the product, the furniture and equipment of Innovative Optics used in the manufacturing process of the microkeratome console and the inspection and packaging of the disposable blades. We subsequently issued 477,039 shares of common stock that were held in escrow at a value of $630,000,

based in the market price of such shares on the date of issuance. This amount was charged to in-process research and development because the issuance of such shares related to the continuing research and development of the microkeratome blades. We were unsuccessful in reducing the costs of the blade production process and were unable to supply blades to the user base. We terminated our marketing and sales efforts for the microkeratome, but we continue to search for an alternative source of blades or a purchaser of the product line. Because we determined that we could not manufacture the blades to support our customer base at an economical cost, in accordance with SFAS No. 142, due to the lack of projected future cash flows, during 2002 we recorded an impairment expense of $2,082,000 for the remaining book value of property and equipment and intangible assets purchased from Innovative Optics. In addition, we recorded an inventory reserve for the remaining inventory purchased from Innovative Optics of approximately $160,000.

On September 19, 2002, we completed a transaction with International Bio-Immune Systems, Inc., a Delaware corporation ("IBS"), in which we acquired 2,663,254, or 19.9% of the outstanding shares of IBS and warrants to purchase 1,200,000 shares of common stock of IBS at $2.50 per share for a period of two years, through the exchange and issuance of 736,945 shares of our common stock the lending of 300,000 shares of our common stock to IBS, and the payment of certain expenses of IBS through the issuance of an aggregate of 94,000 shares of our common stock to IBS and its counsel. The issuance of 736,945 shares were valued based on the market price of our common stock on the date of the transaction and resulted in an investment in IBS, when combined with a cash investment of $65,000 made in 2000, of $879,000. The 300,000 shares were also valued at the market price on the date of issuance and were recorded as a stock subscription receivable of $294,000 because such shares will either be paid for or returned in the future. IBS is a privately held biotechnology based, cancer diagnostic and immunotherapy company with potential clinically effective products for the diagnosis, treatment and imaging of patients with major tumor types (e.g. colon, lung, cervix, pancreas and breast). IBS is located in Great Neck, New York. IBS does not produce significant revenues as its products have not received FDA approval. Due to the uncertainty of future cash flows and the fact that the products have not been approved by the FDA, we were unable to support the value of the investment by substantiated methods and determined that the likelihood of recovery of our investment was remote. Therefore, in accordance with generally accepted accounting principles, the investment of $879,000 was charged to impairment expense.

The tragic events of September 11, 2001 combined with a recessionary trend in the economy have had a negative effect on our sales. International attendance at the largest trade show of the year in November 2001 was down markedly. The absence of these professionals eliminates many opportunities for us to demonstrate and sell our products to this sector. It is difficult to quantify how much an effect that these events have had on us, but we believe that we have suffered some negative impact due to September 11, 2001 and the downturn in the economy in general, which may continue for an indefinite period of time.

Results of Operations

Three Months Ended March 31, 2003, Compared to Three Months Ended March 31, 2002

Net sales for the three months ended March 31, 2003 were $727,000 as compared to $1,537,000 for the same period of 2002 due principally to the decrease in sales of the Blood Flow Analyzer(TM) and the UBM biomicroscope. Sales of the Blood Flow Analyzer(TM) decreased by $107,000 to $163,000, or 22% of total revenues for the three months ended March 31, 2003, compared to

$270,000, or 18% of total revenues for the same period in 2002. We believe that the decline in sales of the Blood Flow Analyzer(TM) is due to difficulties some users of the Blood Flow Analyzer(TM) have had in obtaining reimbursement from insurance carriers. Certain payers have elected not to reimburse the doctors per the common procedure terminology ("CPT") code assigned to us by the American Medical Association. We are continuing our aggressive campaign to educate the payers about the Blood Flow Analyzer(TM), its purposes and the significance of its performance in patient care in order to achieve reimbursements to the providers. Sales of the ultrasonicbiomicroscope were $43,000 during the first quarter 2003, or 6% of total quarterly revenues, compared to $194,000, or 13% of total revenues for the same period last year. The decline in sales of the UBM biomicroscope was a result of our reduced sales and marketing force. Due to the limited number of sales and marketing personnel, we have recently been unable to continue the marketing efforts that have been sustained in the past. Sales from the other ultrasonic products were $94,000, or 13% of total revenues for the quarter ended March 31, 2003, compared to $200,000, or 13% of total quarterly revenues for the same period last year. Sales of the Dicon products, the perimeter and corneal topographer, were $258,000, or 36% of the total revenues for the current quarter, compared to $284,000, or 18% of the total revenues for the same quarter of 2002. Sales from the surgical line totaled $31,000, or 4% of total revenues for the three months ended March 31, 2003, compared to $75,000, or 5% of total revenues for the corresponding period of 2002.

Gross profit for the three months ended March 31, 2003 was 52% of total revenues, and 45% of total revenues for the comparable period of 2002. Cost of goods sold for the three months ended March 31, 2003 and 2002, respectively, did not include significant write downs of inventory. The increase in gross margin percentage was mainly due to efficiencies gained through the reduction of employees.

Marketing and selling expenses decreased by approximately $693,000 to $322,000, for the three months ended March 31, 2003, from $1,015,000 for the comparable period in 2002 due mainly to less personnel related expenses and travel reimbursements. We had fewer salespersons during the first quarter of 2003, compared to the number of sales persons employed during the first quarter of 2002. Payroll related expenses and travel reimbursements were $220,000 in 2003, compared to $592,000 for the same period in 2002. The first quarter of 2002 also included additional marketing and advertising expenses including tradeshow expenses of $327,000, compared to $12,000 for the three months ended March 31, 2003.

General and administrative expenses decreased by $521,000 to $477,000 for the three months ended March 31, 2003, from $998,000 for the comparable period in 2002 due principally to the cost reductions implemented by us during 2002, which included the closure of our San Diego facility. For the period ending March 31, 2003, personnel costs decreased by $190,000, travel related costs decreased by $50,000 and consulting and legal costs decreased by $234,000.

Research, development and service expenses were $281,000 for the three months ended March 31, 2003, compared to $750,000 recorded in the same period of 2002, a decrease of $469,000. Service department expenses decreased in the first quarter of 2003 from the same period of 2002 by $32,000 due principally to the reduction of personnel in this department. Production development and support expenses, which includes indirect manufacturing costs of purchasing, shipping and supervisory personnel, decreased by $354,000 in the first quarter of 2003, compared to the same period a year ago due mainly to decreased personnel resulting from the San Diego facility closure in 2002.

Other expense decreased by $2,000 for the three months ended March 31, 2003 to $4,000, from $6,000 for the same period in 2002 as a result of a decrease in interest expense from capital leases.

Fiscal Year Ended December 31, 2002 Compared to Fiscal Year Ended December 31, 2001:

Consolidated sales for the twelve months ended December 31, 2002 were $5,368,000 compared to $7,919,000 for the same period for 2001, approximately a 32% decrease due principally to a decline in sales of the Blood Flow Analyzer(TM). We have experienced a general decline in sales during 2002. The reduction of our domestic sales force, competition and the downturn in the economy are all factors contributing to the decline in sales. Additionally, certain payers have elected not to reimburse the doctors per the common procedure terminology ("CPT") code assigned to us by the American Medical Association, which has caused decreased sales of the Blood Flow Analyzer(TM) in 2002. The revenues generated from sales of the Blood Flow Analyzer(TM) were $459,000 and slightly less than $2,000,000, or 9% and 25% of total revenues for 2002 and 2001, respectively. On November 4, 2002, we received FDA approval for expanded indications of use of the Blood Flow Analyzer(TM) for pulsatile ocular blood flow, volume and pulsatility equivalence index. Also, we are continuing our aggressive campaign to educate the payers about the Blood Flow Analyzer(TM), its purposes and the significance of its performance in patient care in order to achieve reimbursements to the providers. This effort should have a positive effect on sales.

Sales of the Ultrasonic Biomicroscope were approximately $1,361,000 during 2002, or 25% of total annual revenues, compared to sales of $1,584,000, or 20% of total revenues for the same period of 2001. Revenues from the ultrasonic product line, not including the Ultrasonic Biomicroscope, totaled approximately $606,000 during 2002, or 11% of total annual revenues, compared to $646,000, or 8% of total revenues for the same period last year. We have seen a recent interest in certain of our ultrasound products and are endeavoring to take advantage of this interest to the best of our capabilities.

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Sales of the perimeter and corneal topographer decreased by $649,000, from $2,128,000 in 2001, or 27% of total revenues to $1,479,000, or 27% of total revenues. The perimeter and corneal topographer, both mature products, declined in sales in 2001 from those in 2000 by approximately 37%. One of the strategies of the Dicon/Paradigm merger in June of 2000 was to piggyback these products with the phaco surgical line to achieve penetration into the ophthalmic market, in addition to the optometric market, resulting in a growth in the sales of the Dicon products. This anticipated growth has not occurred and may continue to decrease in the future or remain at a lower level than originally expected.

The phaco surgical line and related disposable products accounted for approximately $596,000, 11% of total revenues for the twelve months ended December 31, 2002 compared to $641,000, or 8% of total revenues for the same period in 2001. We concentrated much of our marketing focus on our diagnostic products (Blood Flow Analyzer(TM) and the Ultrasonic Biomicroscope Workstation or P45) during 2002 and 2001. We also continued aggressively in our efforts to obtain FDA approval for our Photon(TM) laser system. We sold one Photon(TM) laser system in 2002 and none in 2001. The Photon(TM) cannot be sold within the United States until FDA approval is received. International sales of the Photon(TM) have not occurred due in part to the lack of FDA approval. Although not required in the international market, we believe many potential customers rely on the FDA approval of products before purchasing.

The gross profit on sales for the fiscal year 2002 was approximately 22 % compared to 45% for the same period in 2001. The profit margin decline can be attributed principally to an increase of $1,755,000 in the reserved for obsolete inventory. Due to the lack of significant sales volume of certain products, many

inventory items were reduced in cost to reflect obsolescence, technological advances and product enhancements. Of this amount, approximately $160,000 related to inventory purchased from Innovative Optics in 2002, and the remainder was mainly related to the Mentor surgical line of products, namely the SIStem, Odyssey and the Surg-E- trol, which have not experienced significant sales in 2002 and 2001. In addition, we reduced sales prices during the year in an attempt to increase sales, which has reduced our margins. International sales contributed a greater portion in 2002, compared to 2001, which sales also produce lower gross margins.

Marketing and selling expenses decreased $1,967,000, or 41%, to $2,795,000 for the twelve months ended December 31, 2002 from $4,762,000 for the comparable period in 2001. Our sales force decreased to five domestic sales people during 2002 resulting in a reduction of personnel and travel costs of $1,356,000 from the prior year. Marketing efforts were reduced, including the number of trade shows attended, which resulted in a cost reduction of $611,000 during the fiscal year ended December 31, 2002, compared to the same period in 2001.

General and administrative expenses decreased by $1,423,000, or 28%, to $3,702,000 for the 2002 fiscal year from $5,125,000 for the comparable period in 2001, due principally to the cost reduction program implemented during 2002. During the twelve months ended December 31, 2002 compared to the same period in 2001, payroll related costs decreased by $197,000, travel related costs declined $139,000 and outside consulting costs decreased lower by $932,000. General operating costs were reduced by $169,000 due principally to the closure of the San Diego facility.

Research, development and service expenses (which includes production and manufacturing support and the service department expenses) decreased by $128,000, or 4%, to $2,819,000 for the twelve months ended December 31, 2002 from $2,947,000 for the same period in 2001. The cost reduction program and the closure of the San Diego office resulted in lower payroll related expenses of $927,000 in 2002 compared to the same period last year. Pursuant to the asset purchase agreement with Innovative Optics, Inc., we issued 477,000 shares of common stock, which was valued at $630,000 based upon the current market value of the stock at the time of issue. This amount was recorded as in-process research and development costs related to the blade cost reduction project. No such expense was recorded in 2001. Consulting fees related to software development and enhancements increased by $71,000 during 2002 compared to the year ended December 31, 2001.

We recognized impairment expenses of $2,961,000 during the year ended December 31, 2002 principally due to the requirements of SFAS No. 142, which requires impairment of intangible assets if the valuation cannot support the asset value recorded. We acquired the assets of Innovative Optics, Inc. in January 2002. The principal product was a microkeratome with the corresponding disposable blades. This acquisition resulted in goodwill of $1,949,000. We were unsuccessful in producing the blades for the user base at a cost that was economically feasible. The original process proved unworkable and unprofitable. We decided not to continue supporting the product, thus creating an event that resulted in impairing the intangible asset as recorded at the time of purchase of $2,082,000. In addition, we impaired the fixed assets acquired from Innovative Optics, Inc. in the amount of $30,000.

On September 19, 2002, we completed a transaction with International Bio-Immune Systems, Inc., a Delaware corporation ("IBS"), in which we acquired 2,663,254, or 19.9% of the outstanding shares of IBS and warrants to purchase 1,200,000 shares of common stock of IBS at $2.50 per share for a period of two years, through the exchange and issuance of 736,945 shares of our common stock, the lending of 300,000 shares of our common stock to IBS, and the payment of certain expenses of IBS through the issuance of an aggregate of 94,000 shares of

our common stock to IBS and its counsel. The issuance of 736,945 shares were valued based on the market price of our common stock on the date of the transaction and resulted in an investment in IBS, when combined with a cash investment of $65,000 made in 2000, of $879,000. The 300,000 shares were also valued at the market price on the date of issuance and were recorded as a stock subscription receivable of $294,000 because such shares will either be paid for or returned in the future. IBS is a privately held biotechnology based, cancer diagnostic and immunotherapy company with potential clinically effective products for the diagnosis, treatment and imaging of patients with major tumor types (e.g. colon, lung, cervix, pancreas and breast). IBS is located in Great Neck, New York. IBS does not produce significant revenues as its products have not received FDA approval. Due to the uncertainty of future cash flows and the fact that the products have not been approved by the FDA, we were unable to support the value of the investment by substantiated methods and determined that the likelihood of recovery of its investment was remote. Therefore, in accordance with generally accepted accounting principles the investment of $879,000 was charged to impairment expense

Net interest expense was $36,000 during 2002 compared to net interest income of $7,000 for the twelve months ended December 31, 2001 due to interest expense incurred from capital leases for the purchase of certain fixed assets and due to smaller amounts of cash on deposit during 2002. Other expense included a charge to expense in 2001of $812,000 representing the value of the 350,000 shares of common stock issued to Mentor Corporation in settlement of a legal action brought against us during 2001.

We incurred a net loss of $11,155,000, or ($.63) per share based upon 17,736,0000 weighted average shares outstanding for the year ended December 31, 2002. This compares to a net loss applicable to common shareholders of $13,044,000, or ($.98) per share, based on 13,245,000 weighted average shares outstanding for the year ended December 31, 2001. For the year ended December 31, 2001, the net loss attributable to common shareholders included a reduction of $2,901,000 in connection with two private placements offered by us in 2001 ($2,587,000 was attributable to the beneficial conversion feature included in the Series E and Series F Preferred Stock offerings and $314,000 represented the computed value of the warrants associated with the Series E Preferred Stock offering). No such calculation was included in the net loss for the fiscal year 2002. The net loss for 2002 included $2,961,000 of impairment expense due principally to the write down of intangible assets in excess of current valuation.

Fiscal Year Ended December 31, 2001 Compared to Fiscal Year Ended December 31, 2000:

Consolidated sales for the twelve months ended December 31, 2001 were $7,919,000 compared to $7,989,000 for the same period for 2000, approximately a 1% decrease. We restructured our outside sales force during 2001 to provide nationwide coverage. This resulted in a slowdown of sales activity due to the time it took to hire and train the new personnel. We believe that sales activity was hampered for about a ninety day period. We also launched in earnest the sales of the Blood Flow Analyzer(TM) during the second quarter of 2001 after receiving authorization to use a CPT code which provides for a reimbursement to doctors. We believe that the investment in time, training and resources in developing the sales force will provide positive results in the future despite a loss of sales activity in 2001.

Sales of the Blood Flow Analyzer(TM) was the single largest contributor to total 2001 revenues generating slightly less than $2,000,000 (25%) of

revenues. Sales in 2000 were not significant as the major marketing efforts did not take place until 2001. Sales of the P45 ultrasonic Biomicroscope workstation accounted for approximately 9% of total 2001 revenues, or $686,000, compared to approximately a 3% contribution to total 2000 revenues, or $219,000. We introduced the P45 in the fall of 2000 resulting in a full year's of selling activity during 2001 as compared to a few months during 2000. The remainder of the ultrasonic product line (UBM, A-Scan, A/B scan and Pachymeter) contributed $1,543,000 in revenues in 2001 (19%) compared to $2,027,000 in 2000 (25%).

Sales of the perimeter and corneal topographer decreased by $1,283,000, from $3,411,000 in 2000 (43%) to $2,128,000 (27%). The perimeter and corneal topographer, both mature products, declined in sales in 2000 from those in 1999 by approximately 20%. One of the strategies of the Dicon/Paradigm merger in June of 2000 was to piggyback these products with the phaco surgical line to achieve penetration into the ophthalmic market, in addition to the optometric market, resulting in a growth in the sales of the Dicon products. This anticipated growth has not occurred and may continue to decrease in the future or remain at a lower level than originally expected.

The phaco surgical line and related disposable products accounted for approximately $641,000 (8%) of total revenues for the twelve months ended December 31, 2001 compared to $1,144,000 (14%) in revenues for the same period in 2000. We concentrated much of our marketing focus on our diagnostic products (Blood Flow Analyzer(TM) and the Ultrasonic Biomicroscope Workstation or P45) during 2001. We also continued aggressively in our efforts to obtain FDA approval for its Photon(TM) laser system. We did not recognize any sales of its Photon(TM) laser system in 2001. The Photon(TM) cannot be sold within the United States until FDA approval is received. International sales of the Photon(TM) did not occur due in part to the lack of FDA approval. Although not required in the international market, we believe many potential customers rely on the FDA approval of products before purchasing.

The gross profit on sales for the fiscal year 2001 was approximately 38% compared to 17% for the same period in 2000. The sharp difference was due principally to an inventory write-down of $1,596,000 during 2000 to net realizable value. Gross profit on sales for the fiscal year ended December 31, 1999 was 38%, which indicates a more consistent trend, with the exception of the inventory adjustment that was recognized in 2000.

Marketing and selling expenses increased $812,000, or 21%, to $4,762,000 for the twelve months ended December 31, 2001 from $3,950,000 for the comparable period in 2000. We increased costs for enhanced tradeshow participation of $355,000 due mainly to expenses incurred in relation to the annual meeting of the American Academy of Ophthalmology in November 2001. This is the largest event in the country in which we participate. This increase was also partly due to the addition of fifteen direct sales people to cover the United States rather than working through distributors adding approximately $382,000 of additional expenses. The hiring of the sales force took place during the second and third quarters of 2001 and will result in a higher level of expenses in the form of salaries and travel reimbursements in future operating periods.

General and administrative expenses decreased by $307,000, or 6%, to $5,125,000 for the 2001 fiscal year from $5,432,000 for the comparable period in 2000. We had recognized $1,883,000 in noncash transactions during 2000 by granting warrants to nonemployees as payment for services, stock bonuses granted to our officers and stock granted to nonemployees as payment for services. During 2001, we recorded $558,000 of noncash transactions from granting warrants and stock to nonemployees for consulting services. Consulting expenses paid in

cash for financial and investor relations services increased by approximately $165,000 over the comparable period in 2000. We initiated procedures to cancel or not to renew outside consulting agreements during the fourth quarter of 2001.

Research, development and service expenses increased by $980,000, or 69%, to $2,405,000 for the twelve months ended December 31, 2002 from $1,425,000 for the same period in 2001. This increase was due principally to added personnel in engineering, in service and in manufacturing support. As a result, payroll and benefits expense increased by a total of $692,000 in anticipation of sales demands, which did not occur as expected. Personnel in this area, therefore, were affected by the layoffs at the end of December 2001 in a strategic decision to retain and focus resources in the sales and marketing area. Consulting expense and purchases of sample parts and tooling related to new product development increased by $182,000, and $145,000, respectively. The main development project in 2001 was postponed to concentrate sales efforts on our existing product line and to aggressively pursue FDA approval for our Photon(TM) laser.

Net interest income was approximately $6,000 during 2001 compared to $130,000 for the twelve months ended December 31, 2000 due to increased interest expense incurred by entering into capital leases for the purchase of certain fixed assets and due to smaller amounts of cash on deposit during 2001. Other expense included a charge to expense of $812,000 representing the value of the 350,000 shares of common stock issued to Mentor Corporation in settlement of a legal action brought against us.

We incurred a net loss of $13,044,000, or $.98 per share based upon 13,245,0000 weighted average shares outstanding for the year ended December 31, 2001. This compares to a net loss of $9,305,000, or $.81 per share, based on 11,547,000 weighted average shares outstanding for the year ended December 31, 2000. The increase in the net loss attributable to common shareholders was due principally to losses recognized in accordance with Financial Accounting Standards Board Statement Number 123 ("SFAS 123") in connection with two private placements offered by us in 2001 of $2,901,000 ($2,587,000 was attributable to the beneficial conversion feature included in the Series E and Series F Preferred Stock offerings and $314,000 represented the computed value of the warrants associated with the Series E Preferred Stock offering). No such expense calculation was included in the net loss for the fiscal year 2002. The Mentor settlement charge of $812,000 included in the net loss for 2001 was an increase over the comparable period a year ago.

Liquidity and Capital Resources

We used cash in operating activities of $87,000 for the three months ended March 31, 2003, compared to $1,334,000 for the three months ended March 31, 2002. The decrease in cash used by operating activities for the first three months of 2003 was primarily attributable to reduced operating costs, including the closure of the San Diego facility. We did not use any cash in investing activities for the three months ended March 31, 2003, compared to $210,000 in the same period in 2002. Cash used in investing activities in the first three months of 2002 was primarily due to the cash paid in the acquisition of certain assets of Innovative Optics and capital equipment. Net cash used in financing activities was $15,000 for the three months ended March 31, 2003 and 2002, resulting from principal payments on lease obligations.

We used cash in operating activities of $2,872,000 for twelve months ended December 31, 2002, compared to $8,799,000 for the twelve months ended December 31, 2001. We decreased our inventory balance by $952,000 during the year by decreasing purchases as compared to 2001 and utilizing the inventory on hand in our production. In anticipation of building product to meet sales demand, more specifically, for the Blood Flow Analyzer and the P45 ultrasonic Biomicroscope workstation plus, we purchased significant amounts of inventory in

2001. Trade receivables decreased by $1,473,000 mainly due to the increased collection of outstanding accounts and to lower sales during 2002. We used cash in investing activities of $299,000 for the twelve months ended December 31, 2002, compared to $246,000 for the year 2001 due mainly to less fixed asset additions during 2002 compared to the same period in 2001. Net cash provided by

financing activities for the twelve months ended December 31, 2002 was $503,000, compared to $9,553,000 for the year ended December 31, 2001. We received $8,965,000 in net proceeds from two private placements, the Series E and Series F Preferred Stock offerings during 2001, compared to net proceeds from one private placement of common stock in 2002 of $631,000. We also sold 392,000 shares of our common stock under the $20,000,000 equity line for $673,000 in 2001 reducing the amount available under the equity line to approximately $18,500,000. No sales of common stock under the equity line occurred during 2002. Debt reduction for the year was $59,000.

As of March 31, 2003, we had raised approximately $1,500,000 through a $20,000,000 equity line of credit under an investment banking arrangement. As of March 31, 2003, approximately $18,500,000 was available under the equity line of credit. In the past, we have relied heavily upon sales of our common and preferred stock to fund operations. There can be no assurance that such equity funding will be available on terms acceptable to us in the future. We will continue to seek funding to meet our working capital requirements through collaborative arrangements and strategic alliances, additional public offerings and/or private placements of its securities or bank borrowings. We are uncertain whether or not the combination of existing working capital, benefits from sales of our products and the private equity line of credit will be sufficient to assure our operations through December 31, 2003.

We have taken measures to reduce the amount of uncollectible accounts receivable such as more thorough and stringent credit approval, improved training and instruction by sales personnel, and frequent direct communication with the customer subsequent to delivery of the system. The allowance for doubtful accounts was 13% of total outstanding receivables as of December 31, 2001, compared to 27% as of December 31, 2002, and 23% as of March 31, 2003. Much of the increase in the allowance relates to our outstanding receivable balance pertaining to our international dealers. The downturn in the economy worldwide has resulted in increased difficulty in collecting certain accounts. Certain international dealers have some aged unpaid invoices that have not been resolved. We have addressed our credit procedures and collection efforts during 2002 and have instituted changes that require more payments at the time of sale via letters of credit and not on a credit term basis. Such changes have resulted in a decrease in the allowance as a percentage of total accounts receivable at March 31, 2003, however, we intend to continue our efforts to reduce the allowance as a percentage of accounts receivable.

We carried an allowance for obsolete inventory of $2,251,000 at March 31, 2003, and $2,126,000 as of December 31, 2002, or approximately 48% and 45% of total inventory, respectively. This inventory reserve was increased by $125,000 in the first quarter of 2003 and $1,755,000 during 2002 mainly due to sales declines and the discontinuance of the microkeratome purchased from Innovative Optics in 2002. Our means of expansion and development of product has been largely from acquisition of businesses, product lines, existing inventory, and the rights to specific products. Through such acquisitions, we have acquired substantial inventory, some of which the eventual use and recoverability was uncertain. In addition, we have a significant amount of inventory relating to our Photon(TM) laser system, which does not yet have FDA approval in order to sell the product domestically. Therefore, the allowance for inventory was established to reserve for these potential eventualities.

At March 31, 2003, we had net operating loss carryforwards (NOLs) of approximately $41,000,000 and research and development tax credit carryforwards of approximately $34,000. These carryforwards are available to offset future taxable income, if any, and began to expire in the year 2001 and extend for twenty years. Our ability to use our net operating loss carryforwards (NOLs) to offset future income is dependent upon certain limitations as a result of the pooling transaction with Vismed, Inc. d/b/a Dicon and the tax laws in effect at the time the NOLs can be utilized. The Tax Reform Act of 1986 significantly limits the annual amount that can be utilized for certain of these carryforwards as a result of changes of ownership.

Effect of Inflation and Foreign Currency Exchange

We have not realized a reduction in the selling price of our products as a result of domestic inflation. Nor have we experienced unfavorable profit reductions due to currency exchange fluctuations or inflation with its foreign customers. All sales transactions to date have been denominated in US Dollars.

Impact of New Accounting Pronouncements

In April 2002, the FASB issued Statement of Financial Accounting Standards (SFAS) No. 145, "Rescission of FASB Statements No. 4, 44, and 64, Amendment of FASB Statement No. 13, and Technical Corrections." This statement requires the classification of gains or losses from the extinguishments of debt to meet the criteria of Accounting Principles Board Opinion No. 30 before they can be classified as extraordinary in the income statement. As a result, companies that use debt extinguishment as part of their risk management cannot classify the gain or loss from that extinguishment as extraordinary. The statement also requires sale-leaseback accounting for certain lease modifications that have economic effects similar to sale-leaseback transactions. We do not expect Adoption of SFAS No. 145 did have a material impact on financial position or future operations.

In June 2002, the FASB issued SFAS No. 146, "Accounting for Costs Associated with Exit or Disposal Activities." This standard, which is effective for exit or disposal activities initiated after December 31, 2002, provides new guidance on the recognition, measurement and reporting of costs associated with these activities. The standard requires companies to recognize costs associated with exit or disposal activities when they are incurred rather than at the date the company commits to an exit or disposal plan. The adoption of SFAS No. 146 by us is not expected to have a material impact on our financial position or future operations.

In December 2002, the FASB issued SFAS No. 148 "Accounting for Stock-Based Compensation--Transition and Disclosure--an amendment of FASB Statement No. 123," which is effective for all fiscal years ending after December 15, 2002. SFAS No. 148 provides alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation under SFAS No. 123 from the intrinsic value based method of accounting prescribed by Accounting Principles Board Opinion No. 25. SFAS 128 also changes the disclosure requirements of SFAS 123, requiring a more prominent disclosure of the pro-forma effect of the fair value based method of accounting for stock-based compensation. The adoption of SFAS No. 148 by us did not have a material impact on our financial position or future operations.

In January 2003, the Financial Accounting Standards Board (FASB) issued Interpretation No. 46, Consolidation of Variable Interest Ethics (FIN No. 46), which addresses consolidation by business enterprises of variable interest

entities. FIN No. 46 clarifies the application of Accounting Research Bulletin No. 51, Consolidated Financial Statements, to certain entities in which equity investors do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support from other parties. FIN No. 46 applies immediately to variable interest entities created after January 31, 2003, and to variable interest entities in which an enterprise obtains an interest after that date. It applies in the first fiscal year or interim period beginning after June 15, 2003, to variable interest entities in which an enterprise holds a variable interest that it acquired before February 1, 2003. We do not expect to identify any variable interest entities that must be consolidated. In the event a variable interest entity is identified, we do not expect the requirements of FIN No. 46 to have a material impact on our financial condition or results of operations.

In November 2002, the FASB issued Interpretation No. 45, Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others (FIN No. 45). FIN No. 45 requires certain guarantees to be recorded at fair value, which is different from current practice to record a liability only when a loss is probable and reasonably estimable, as those terms are defined in FASB Statement No. 5, Accounting for Contingencies. FIN No. 45 also requires us to make significant new disclosures about guarantees. The disclosure requirements of FIN No. 45 are effective for us in the first quarter of fiscal year 2003. FIN No. 45's initial recognition and initial measurement provisions are applicable on a prospective basis to guarantees issued or modified after December 31, 2002. Our previous accounting for guarantees issued prior to the date of the initial application of FIN No. 45 will not be revised or restated to reflect the provisions of FIN No 45. We do not expect the adoption of FIN No. 45 to have a material impact on our consolidated financial position, results of operations or cash flows.

BUSINESS

General

We develop, manufacture, source, market and sell ophthalmic surgical and diagnostic instrumentation and related accessories, including disposable products. Our surgical equipment is designed for minimally invasive cataract treatment. We market three cataract surgery systems with related accessories and disposable products. Our flagship cataract removal system, the Photon(TM) laser system, is a laser cataract surgery system marketed as the next generation of cataract removal. The Photon(TM) product is currently under review by the Food Drug and Administration ("FDA"). The Photon(TM) is available for sale in many markets outside of the United States. Both the Photon(TM) and the Precisionist ThirtyThousand(TM) are manufactured as an Ocular Surgery Workstation(TM). We plan to market the Ocular Surgery Workstation(TM) as a plug-in module for the Photon(TM) and other lasers for use in eye care and other medical specialties. We also offer the SIStem(TM), a mid-range priced ultrasonic phaco, and competes in the market segment that only desires an ultrasonic phaco.

Our diagnostic products include a pachymeter, an A-Scan, an A/B Scan, an UBM biomicroscope, a perimeter, a corneal topographer and the Blood flow Analyzer(TM). The diagnostic ultrasonic products including the pachymeter, the A-Scan, the A/B Scan and the UBM biomicroscope were acquired from Humphrey Systems, a division of Carl Zeiss in 1998. We developed and offered for sale in the fall of 2000 the P45, which combines the A/B Scan and the UBM in one machine. The perimeter and the corneal topographer were added when we acquired the outstanding shares of the stock of Vismed, Inc. d/b/a/ Dicon(TM) in June 2000. We purchased Ocular Blood Flow, Ltd. ("OBF") in June 2000 whose principal product is the Blood Flow Analyzer(TM). This product is designed for the measurement of intraocular pressure and pulsatile ocular blood flow volume for

detection and treatment of glaucoma. We are currently developing additional applications for all of its diagnostic products.

A cataract is a condition, which largely affects the elderly population, in which the natural lens of the eye hardens and becomes cloudy, thereby reducing visual acuity. Treatment consists of removal of the cloudy lens and replacement with a synthetic lens implant, which restores visual acuity. Cataract surgery is the single largest volume and revenue producing outpatient surgical procedure for ophthalmologists worldwide. The Health Care Finance Administration reports that in the United States approximately two million cataract removal procedures are performed annually, making this the largest outpatient procedure reimbursed by Medicare. Most cataract procedures are performed using a method called phacoemulsification or "phaco", which employs a high frequency (40 kHz to 60 kHz) ultrasonic probe needle device to fragment the cataract while still in the eye and remove it in pieces by suction through a small incision.

In June 1997, we received FDA clearance to market the Blood Flow Analyzer(TM) for measurement of intraocular pressure and pulsatile ocular blood flow for the detection of glaucoma and other retina related diseases. Ocular blood flow is critical, the reduction of which may cause nerve fiber bundle death through oxygen deprivation, thus resulting in visual field loss associated with glaucoma. Our Blood Flow Analyzer(TM) is a portable automated in-office system that presents an affordable method for ocular blood flow testing for the ophthalmic and optometric practitioner. In June 2000 we purchased OBF, the manufacturer of the Blood Flow Analyzer(TM). The terms and conditions of the sale were $100,000 in cash and 100,000 shares of common stock. In April 2001, we received authorization to use a CPT code from the American Medical Association for procedures performed with the Blood Flow Analyzer(TM) which provides for a reimbursement to doctors using the device. However, certain payers have elected not to reimburse doctors using the Blood Flow Analyzer(TM).

On July 23, 1998, we entered into an Agreement for Purchase and Sale of Assets with the Humphrey Systems Division of Carl Zeiss, Inc. to acquire the ownership and manufacturing rights to certain assets of Humphrey Systems that are used in the manufacturing and marketing of an ultrasonic microprocessor-based line of ophthalmic diagnostic instruments, including the Ultrasonic Biometer Model 820, the A/B Scan System Model 837, the Ultrasound Pachymeter Model 855, and the Ultrasound Biomicroscope Model 840, and all accessories, packaging and end-user collateral materials for each of the product lines for the sum of $500,000, payable in the form of 78,947 shares of common stock which were issued to Humphrey Systems and 26,316 shares of common stock which were issued to business broker Douglas Adams. If the net proceeds received by Humphrey Sys