PARADIGM MEDICAL INDUSTRIES INC
Form 10-K
April 15, 2009

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 10-K

[X] ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF

THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2008, or

[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d)

OF THE SECURITIES EXCHANGE ACT OF 1934
For the Transition Period from _____ to _____
Commission File Number 0-28498

Paradigm Medical Industries, Inc.
(Name of small business issuer in its charter)

DELAWARE (State or other jurisdiction of incorporation or organization)	87-0459536 (I.R.S. Employer Identification Number)
2355 South 1070 West, Salt Lake City, Utah (Address of principal executive offices)	84119 (Zip Code)

Registrant's telephone number, including area code: (801) 977-8970
Securities registered pursuant to Section 12(b) of the Act: None
Securities registered pursuant to Section 12(g) of the Act:

Common Stock, par value $.001 per share
(Title of Class)

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

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the

Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes [X] No [ ]

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

Registrant's revenues for the fiscal year ended December 31, 2008 were $1,259,000.

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

Large accelerated filer 9 Accelerated filers 9 Non-accelerated filer : Smaller reporting company 9

(Do not check if a smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Exchange Act Rule 12b-2): Yes [ ] No [X]

The aggregate market value of the voting stock held by non-affiliates of the registrant as of June 30, 2008 was approximately $419,000 based upon the closing sale price of such stock as reported on the OTC Bulletin Board on that date.

As of March 31, 2009, registrant had outstanding 517,901,422 shares of common stock, 5,627 shares of Series A preferred stock, 8,986 shares of Series B preferred stock, no shares of Series C preferred stock, 5,000 shares of Series D preferred stock, 250 shares of Series E preferred stock, 4,598.75 shares of Series F preferred stock, and 588,235 shares of Series G preferred stock.

DOCUMENTS INCORPORATED BY REFERENCE:

Additional documents set forth in Part IV hereof are incorporated by reference.

Transitional Small Business Disclosure Format (check one): Yes [ ] No [X]

PART I

Item 1. Description of Business

General

The Company develops, manufactures, sources, markets and sells ophthalmic surgical and diagnostic instrumentation and related accessories, including disposable products. The Company's surgical equipment is designed for minimally invasive cataract treatment. The Company's cataract removal system, the PhotonTM laser system, is a laser cataract surgery system designed to be marketed as the next generation of cataract removal. Because of the "going concern" status of the Company, management has focused efforts on those products and activities that will, in its opinion, achieve the most resource efficient short-term cash flow to the Company. As reflected in the results for the fiscal year ended December 31, 2008, diagnostic products are currently the Company's major focus and the PhotonTM and other extensive research and development projects have been put on hold pending future evaluation when the financial position of the Company improves. Due to the lack of FDA approval and the lack of current evidence to support recoverability, the Company has recorded an inventory reserve to offset the majority of the inventory associated with the PhotonTM. In addition, most inventory associated with the Precisionist Thirty ThousandTM has been reserved due to the estimated lack of recoverability. The Company's focus is not on any specific diagnostic product or products, but rather on its entire group of diagnostic products. The PhotonTM can be sold in markets outside of the United States. Both the PhotonTM and the Precisionist Thirty ThousandTM, although not currently manufactured, have been manufactured in the past as an Ocular Surgery WorkstationTM.

The Company's diagnostic products include a P2000 pachymetric analyzer, a P37 Ultrasonic A/B Scan, P40, P45 and P60 UBM Ultrasound Biomicroscopes, a P37 A/B Scan, two perimeters, the Blood Flow AnalyzerTM, and the Glaid. The diagnostic ultrasonic products including the P2000 pachymetric analyzer, the P37 Ultrasonic A/B Scan and the P40 UBM Ultrasound Biomicroscope were acquired from Humphrey Systems, a division of Carl Zeiss in 1998. The Company developed and offered for sale in the fall of 2000 the P45, which combines the P37 Ultrasonic A/B Scan and the UBM biomicroscope in one machine. In addition, the Company developed and offered for sale in March 2005 the P60, which represents the fourth generation of UBM devices and has better visual clarity and image flexibility than earlier versions. The perimeter and the corneal topographer were added when the Company acquired the outstanding shares of the stock of Vismed, Inc. d/b/a/ DiconTM in June 2000. The Company purchased Ocular Blood Flow, Ltd. in June 2000 whose principal product is the Blood Flow AnalyzerTM. This product is designed for the measurement of intraocular pressure and pulsatile ocular blood flow volume for detection and monitoring of glaucoma. The Company is currently developing additional applications for all of its diagnostic products.

In June 1997, the Company received FDA clearance to market the Blood Flow AnalyzerTM 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. The Company's Blood Flow AnalyzerTM 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, the Company purchased Occular Blood Flow, Ltd., the manufacturer of the Blood Flow AnalyzerTM. The terms and conditions of the sale were $100,000 in cash and 100,000 shares of common stock. In April 2001, the Company received authorization to use a common procedure terminology or CPT code from the American Medical Association for procedures performed with the Blood Flow AnalyzerTM, for reimbursement purposes for doctors using the device. However, certain payers have elected not to reimburse doctors using the Blood Flow AnalyzerTM.

On July 23, 1998, the Company 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 materialsfor 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 Systems from the sale of the shares issued pursuant to the Agreement was less than $375,000, after payment of commissions, transfer taxes and other expenses relating to the sale of such shares, the Company would be required to issue additional shares of common stock, or pay additional funds to Humphrey Systems as would be necessary to increase the net proceeds from the sale of the assets to $375,000. Since Humphrey Systems realized only $162,818 from the sale of 78,947 shares of its common stock, the Company issued 80,000 additional shares in January 1999 to enable Humphrey Systems to receive its guaranteed amount. The amount of $21,431 was paid to the Company as excess proceeds from the sale of this additional stock.

The rights to the ophthalmic diagnostic instruments, which have been purchased from Humphrey Systems, complement both the Company's cataract surgical equipment and the Company's ocular Blood Flow AnalyzerTM. The Ultrasonic Biometer calculates the prescription for the intraocular lens to be implanted during cataract surgery. The P55 pachymetric measures corneal thickness for the new refractive surgical applications that eliminate the need for eyeglasses and for optometric applications including contact lens fitting. The P37 Ultrasonic A/B Scan combines the Ultrasonic Biometer and ultrasound imaging for advanced diagnostic testing throughout the eye and is a viable tool for retinal specialists. The P40 UBM Ultrasound Biomicroscope utilizes microscopic digital ultrasound resolution for detection of tumors and improved glaucoma management. The Company introduced the P45 in the fall of 2000, which combines the P37 Ultrasonic A/B Scan, and the Ultrasonic Biometer in one machine.

On October 21, 1999, the Company purchased Mentor's surgical product line, consisting of the Phaco SlStemTM, the OdysseyTM and the Surg-E-Tro1TM. This acquisition was an attempt to round out the Company's cataract surgery product line by adding entry-level, moderately priced cataract surgery products. The transaction was paid for with $1.5 million worth of the Company's common stock. Due to the lack of sales volume of these products, they were determined to be obsolete and a reserve was established to offset all inventory associated with these products. During the fourth quarter of 2003, the Company sold all inventory rights associated with the SlStemTM and OdysseyTM for $125,000.

On June 5, 2000, the Company purchased Vismed Inc. d/b/a DiconTM under a pooling of interest accounting treatment. The purchase included the DiconTM perimeter product line consisting of the LD 400, the TKS 5000, the SSTTM, FieldLinkTM, FieldViewTM and Advanced FieldView and the corneal topographer product line, the CT 200TM, the CT 50 and an ongoing service and software business. Perimeters are used to determine retinal sensitivity testing the visual pathway. Corneal topographers are used to determine the shape and integrity of the cornea, the anterior surface of the eye. Corneal topographers are used for the refractive surgical applications that eliminate the need for eyeglasses and for optometric applications including contact lens fitting.

In January 2002, the Company purchased the InnovatomeTM microkeratome of Innovative Optics, Inc. by issuing an aggregate of 1,272,825 shares of its common stock, warrants to purchase 250,000 shares of its common stock at $5.00 per share, exercisable over a period of three years from the dosing date, and $100,000 in cash. The transaction was accounted for as a purchase in accordance with Statement of Financial Accounting Standards No. 141. The Company acquired from Innovative Optics raw materials, work in process and finished goods inventories. Additionally, the Company acquired the furniture and equipment used in the manufacturing process of the microkeratome console and the inspection and packaging of the disposable blades.

The Company was unsuccessful in supplying the disposable blades. The Company discontinued the marketing and sales efforts of this product during the third quarter of 2002. On April 1, 2002, the Company entered into a consulting agreement with John Charles Casebeer, M.D. to develop and promote the microkeratome. For Dr. Casebeer's services during the period from April 1, 2002 to September 30, 2002, the Company issued him a total of 43,684 shares of its common stock, representing payment of $100,000 in stock for his services. All assets acquired from Innovative Optics, including remaining inventory with a book value of $160,000 and equipment and intangible assets with a book value of $2,082,000, were written off during 2002.

On September 19, 2002, the Company completed a transaction with International Bio-Immune Systems, Inc., a Delaware corporation , in which the Company acquired 2,663,254 shares, or 19.9% of the outstanding shares of its common stock, and warrants to purchase 1,200,000 shares of its common stock at $2.50 per share for a period of two years, through the exchange and issuance of 736,945 shares of its common stock, the lending of 300,000 shares of its common stock to the Company and the payment of certain of its expenses through the issuance of an aggregate of 94,000 shares of its common stock to the Company and its counsel. During 2004, the Company sold all 2,663,254

shares of International Bio-Immune Systems stock for net proceeds of $505,000.

On December 3, 2003, the Company executed a purchase agreement with American Optisurgical, Inc. for the sale of the Mentor surgical products line, consisting of the Phaco SIStemTM and the OdysseyTM. The assets sold in the transaction included patents, trademarks, software codes and programs, supplies, work in process, finished goods, and molds related to the equipment. The purchase price paid to the Company by American Optisurgical for the assets was $125,000. The purchase agreement also contained a noncompete provision in which the Company agreed for a period of three years from the closing date not to own, manage, operate or control any business that competes with cataract removal equipment substantially the same as the proprietary technology of the Phaco SlStemTM and the OdysseyTM.

In March 2005, the Company introduced the P60 UBM Ultrasound Biomicroscope. The P60 Biomicroscope represents the fourth generation of UBM devices and has better visual clarity and image flexibility than earlier versions. On March 1, 2005, the Company was awarded the CE Mark for the P60, which enables it to market the device in 19 Western European countries, most of the Middle East and India, and some parts of Asia and the Pacific Rim. On May 26, 2005, the Company received FDA 510(k) premarket approval for the P60, which allows it to be sold in the United States. On February 9, 2006,the Company received a Canadian device license for the P60, which allows it to be sold in Canada.

On June 12, 2006, the Company entered into a Worldwide OEM Agreement with MEDA Co., Ltd., one of China's leading developers and producers of ultrasound devices. Under the terms of the agreement, MEDA agrees to jointly engineer, develop and manufacture the Company's next generation of the Ultrasound BioMicroscope, as well as other proprietary new products and enhancement of the Company's current products. The products to be manufactured by MEDA, at agreed upon costs, and supplied to the Company for resale include the following new products: an ultrasound biomicroscope, two ultrasound A/B Scans, a biometric A-Scan and a pachymeter.

The agreement provides that the Company and MEDA agree to jointly develop and collaborate in the improvement and enhancement of the Company's products and, in the interest of product development, enhancement and differentiation, MEDA agrees to give consideration to potential software development or enhancements made available to the Company for its products. Moreover, in the interest of product improvement, MEDA agrees to collaborate with the Company and its designated engineers, employees and consultants to consider and potentially implement jointly or individually the development of product enhancements to the Company's products to be manufactured by MEDA.

The software and hardware modifications designed jointly by the Company and MEDA will be considered the joint intellectual property of the Company and MEDA and may be used, without restriction, unless otherwise previously agreed to, by either party. MEDA also agrees to provide a twelve month warranty on all products that it manufactures for the Company. If defects cannot be corrected at the Company's facilities, the products may be returned to MEDA for the purposes of carrying out such repairs as required, and MEDA agrees to return the repaired products to the Company or its designated agent or distributor within ten working days from the date of receiving such products, at no cost to the Company, and MEDA will pay return freight costs.

MEDA further agrees to endeavor to answer any technical inquiries concerning the products it has manufactured. MEDA also agrees to train the Company's technical service engineers and designated international distributors as soon as possible after the signing of this agreement, and as future needs arise and as MEDA can reasonably fit such training into the regular schedules of its employees. MEDA agrees to determine the need for future training on new products as necessary and will offer such training in Tiangin, China. For training conducted outside China, the Company or its designated distributors and/or service centers will be responsible for the traveling, living and hotel expenses for MEDA's engineers. Training is at no charge to the Company. The training will also be made available to the Company's designated repair agencies in order to provide service and repair on a worldwide basis. Such agencies will be considered authorized repair facilities for the products manufactured by MEDA.

MEDA provides the Company with several ultrasound devices. These devices include the P37-legal issues A/B Scan, the P2000 A-Scan Biometric AnalyzerTM, P2200 Pachymeter and the P2500, which is a combined A-Scan and pachymeter. MEDA also manufactures the P2700, P3700, and P37-II A/B Scans and the P50 Ultrasound Biomicroscope. The agreement provides exclusive distribution rights to the Company throughout most of the world, including the United States and Canada, once FDA approval is received on these devices.

The agreement shall be effective for three years from date of execution. At the end of the three year term, representatives of the Company and MEDA will confer to determine whether to extend the term of the agreement. This will have a practical effect of extending the term of the agreement for an additional 120 days. If mutual agreement for extending the term of the agreement is not reached within 120 days after the end of the three year term, then the agreement will be deemed terminated. However, if within the 120 day period, the Company and MEDA mutually agree to extend the term of the agreement, then thereafter either party may terminate the agreement by providing at least twelve months' prior written notice to the other party. All outstanding orders at the time of notification will be supplied under the terms of the agreement, and MEDA will continue to fulfill all orders from the Company until the twelve month notice period has expired.

On January 31 and February 1, 2007, MEDA received FDA 510(k) premarket approval for a new generation of ultrasound devices. This approval allows the new devices to be sold in the United States. The new ultrasound devices, which are to be manufactured by MEDA and sold by the Company in the United States, include the P2000 A-Scan (used to measure axial length of the eye), the P2200 Pachymeter (used for measuring corneal thickness), the P2500 A−Scan/Pachymeter (a combination of the two stand alone devices), the P2700 AB/Scan (an ultrasound imaging device for detecting abnormalities within the eye) and the P37-II (a more advanced AB/Scan used to provide portability for ophthalmology veterinary applications) and the P50 Ultrasound Biomicroscope for high frequency imaging of the anterior chamber of the eye.

On September 25, 2006, the Company entered into a Worldwide OEM Agreement with Tinsley, a division of Hartest Precision Instruments Limited, and one of Europe's leading developers and producers of visual fields analysis devices or perimeters. Under the terms of the agreement, Tinsley agrees to engineer, develop and manufacture the Company's newest perimeter, the LD700 Visual Fields Analyzer. The product is to be manufactured by Tinsley at agreed upon costs and supplied to the Company for resale.

On August 14, 2007, the Company entered into an agreement with Equity Source Partners, LLC of Jericho, New York. Under the terms of the agreement, Equity Source Partners will act as the exclusive financial advisor to the Company and will assist the Company in raising private capital, creating a strategy for growing its core business, pursuing a follow on offering, and providing general strategic corporate advice. Among the strategic advisory services Equity Source Partners will provide are to assist in identifying and introducing the Company to third parties in connection with potential strategic relationships, provide advice concerning issues relating to potential strategic relations, capital raises and potential investment banking contacts, and establish contact with prospective providers of capital. Among the financing services Equity Source Partners will perform is to solicit prospective providers of capital on the Company's behalf.

The term of the agreement is for twelve months unless extended by mutual consent. As compensation for its services, the Company agrees to provide equity Source Partners with an advisory fee equal to an aggregate of 3% of the outstanding shares of the Company's common stock. In addition, the Company agrees to pay Equity Source Partners a cash fee equal to 7.5% of the gross proceeds from the sale of securities to investors that were introduced to the Company by Equity Source Partners and a cash fee equal to 3% of the gross proceeds received from the sale of securities to investors that were not introduced by Equity Source Partners. The agreement terminated on August 14, 2008, when it was not extended by mutual consent for an additional time period.

On January 16, 2008, the Company entered into a consulting agreement with Corcoran Consulting Group, which specializes in medical reimbursement issues for optometry and ophthalmology. The Company plans to work with Corcoran Consulting Group to create a new common procedure technology, or CPT code number, for reimbursement purposes for physicians and practitioners using the Blood Flow AnalyzerTM. In addition, the Company plans to work with Corcoran Consulting Group to offer educational seminars for physicians and practitioners who purchase the Blood Flow AnalyzerTM.

On January 28, 2008, the Company entered into a Distribution Agreement with LACE Elettronica srl to distribute its Glaid device, a proprietary electrophysiology instrument for the early detection of glaucoma by means of measuring the physical condition of the retina's ganglion cells, including retinal ganglion cell loss. The Glaid device was approved by the FDA in 2005 and has undergone extensive testing and clinical studies in the United States, Canada and Italy, including at Bascom Palmer Eye Institute, University of California at San Diego's Hamilton Glaucoma Center, and New York State College of Optometry.

Under the terms of the agreement, the Company has the exclusive right to distribute the Glaid device in the United States and Canada. The Company also has a first right of refusal for distribution of the product to countries outside the United States and Canada where LACE is not currently selling or marketing the product. These additional distribution rights are subject to reasonable new minimum quotas. The Distribution Agreement requires the Company to purchase the Glaid device from LACE at an agreed upon price and to then sell the product in compliance with minimum order requirements. The five year quotas for the Glaid device are 27 units, 60 units, 100 units, 120 units, and 120 units for years one through five of the agreement. Paradigm sales for quota requirements are to begin as soon as the product is fully completed, with all accessories and consumables, and ready for delivery.

The Distribution Agreement is for the term of five years. At the end of the five year term, representatives of the Company and LACE will determine whether to extend the term of the agreement. If mutual agreement for continuation of the agreement is not reached within 120 days thereafter, the agreement will be deemed terminated. However, if within the 120 day period, the Company and LACE mutually agree to continue the agreement, then either party may terminate the agreement at any time thereafter by providing at least twelve months' prior written notice to the other party. All outstanding orders at the time of notification will be supplied under the terms of the agreement, and LACE will continue to fulfill all orders from the Company until the twelve month notice period has expired.

LACE also agrees to provide a twelve month warranty from the day of delivery on all Glaid devices supplied to the Company. If the defects cannot be corrected at the Company's facilities or at the facilities of trained Company repair centers, the products must then be returned to LACE for purposes of carrying out such repairs as required, and LACE agrees to return the repaired products to the Company or its designated agent or distributor within ten working days from the date of receiving such products, at no cost to the Company, and LACE will pay return freight costs. The Company additionally agrees to arrange for installation of the Glaid device at no cost to LACE. The Company further agrees to provide Company brand specific labeling to be applied to the LACE devices shipped directly to the Company's customers and distributors. On March 12, 2009, the Distribution Agreement was mutually terminated by the Company and LACE due to the difficulties that the companies had in working together.

On December 5, 2008, the Company’s shareholders approved a 1-for-100 reverse stock split, which became effective on December 5, 2008. All references to share and per-share data for all periods presented in this report have been adjusted to give effect to this reverse split.

On April 7, 2009, the Company signed a letter of intent with Fairhills Capital Offshore, LLC in which Fairhills Capital committed to finance up to $1,800,000 through the purchase of promissory notes from the Company. The letter of intent provides that $600,000 in notes will be purchased every three months over a nine month period, with the first purchase of $300,000 to be made at closing and the remainder to be purchased upon the satisfaction of financial objectives to be mutually determined between the Company and Fairhills Capital. The convertible notes will bear interest at 6% per annum. In addition, Fairhills Capital will have a right of first refusal on future financing transactions by the Company for as long as the notes remain outstanding.

Background

Corporate History: The Company's business originated with Paradigm Medical, Inc., a California corporation formed in October 1989. Paradigm Medical, Inc. developed its present ophthalmic business and was operated by its founders Thomas F. Motter and Robert W. Millar. In May 1993, Paradigm Medical, Inc. merged with Paradigm Medical Industries, Inc. At the time of the merger, the Company was a dormant public shell existing under the name French Bar Industries, Inc. French Bar had operated a mining and tourist business in Montana. Prior to its merger with Paradigm Medical, Inc. in 1993, French Bar had disposed of its mineral and mining assets in a settlement of outstanding debt and had returned to the status of a dormant entity. Pursuant to the merger, the Company caused a 1-for-7.96 reverse stock split of its shares of common stock. The Company then acquired all of the issued and outstanding shares of common stock of Paradigm Medical, Inc. using shares of its own common stock as consideration. As part of the merger, the Company changed its name from French Bar Industries, Inc. to Paradigm Medical Industries, Inc. and the management of Paradigm Medical, Inc. assumed control of the Company. In April 1994, the Company caused a 1-for-5 reverse stock split of its shares of common stock. In February 1996, the Company re-domesticated to Delaware pursuant to a reorganization.

Overview

Disorders of the Eye: The human eye is a complex organ which functions much like a camera, with a lens in front and a light-sensitive screen, the retina, in the rear. The intervening space contains a transparent jelly-like substance, the vitreous, which together with the outer layer, the sclera and cornea, helps the eyeball to maintain its shape. Light enters through the cornea, a transparent domed window at the front of the eye. The size of the pupil, an aperture in the center of the iris, controls the amount of light that is then focused by the lens onto the retina as an upside-down image. The lens is the internal optical component of the eye and is responsible for adjusting focus. The lens is enclosed in a capsule. The retina is believed to contain more than 130 million light-receptor cells. These cells convert light into nerve impulses that are transmitted right-side up by the optic nerve to the brain, where they are interpreted. Muscles

attached to the eye control its movements.

Birth defects, trauma from accidents, disease and age related deterioration of the components of the eye could all contribute to eye disorders. The most common eye disorders are either pathological or refractive. Many pathological disorders of the eye can be corrected by surgery. These include cataracts (clouded lenses), glaucoma (elevated or low pressure in the eye), loss of nerve fibers resulting in loss of vision, corneal disorders such as scars, defects and irregular surfaces and vitro-retinal disorders such as the attachment of membrane growths to the retina causing blood leakage within the eye. All of these disorders can impair vision. Many refractive disorders can be corrected through the use of eyeglasses and contact lenses. Myopia (nearsightedness), hyperopia (farsightedness) and presbyopia (inability to focus) are three of the most common refractive disorders.

Ultrasound Technology: Ultrasound devices have been used in ophthalmology since the late 1960's for diagnostic and surgical applications when treating or correcting eye disorders. In diagnostics, ultrasound instruments are used to measure distances and shapes of various parts of the eye for prescription of eyeglasses and contact lenses and for calculation of lens implant prescriptions for cataract surgery treatment. These devices emit sound waves through a hand held probe that is placed onto or near the eye with the sound waves emitted being reflected by the targeted tissue. The reflection "echo" is computed into a distance value that is presented as a visual image, or cross section of the eye, with precise measurements displayed and printed for diagnostic use by the surgeon.

Surgical use of ultrasonics in ophthalmology is limited to treatment of cataract lenses in the eye through a procedure called phacoemulsification or "phaco." A primary objective of cataract surgeries is the removal of the opacified (cataract) lens through an incision that is as small as possible. The opacified lens is then replaced by a new synthetic lens intraocular implant. Phaco technology involves a process by which a cataract is broken into small pieces using ultrasonic shock waves delivered through a hollow, open-ended metal needle attached to a hand held probe. The fragments of cataracts tissue are then removed through aspiration. Phaco systems were first designed in the late 1960's after various attempts by surgeons to use other techniques to remove opacified lenses, including crushing, cutting, freezing, drilling and applying chemicals to the cataract. By the mid-1970's, ultrasound had proven to be the most effective technology to fragment cataracts. Market Scope's (Manchester, Missouri), The 2001 Report on the Worldwide Cataract Market, January 2001 indicates that phaco cataract treatment was the technology for cataract removal used in over 80% of surgeries in the United States and over 20% of all foreign surgeries.

Laser Technology: The term "laser" is an acronym for Light Amplification by Stimulated Emission of Radiation. Lasers have been commonly used for a variety of medical and ophthalmic procedures since the 1960's. Lasers emit photons into a highly intense beam of energy that typically radiates at a single wavelength or color. Laser energy is generated and intensified in a laser tube or solid-state cavity by charging and exciting photons of energy contained within material called the lazing medium. This stored light energy is then delivered to targeted tissue through focusing lenses by means of optical mirrors or fiber optics. Most laser systems use solid state crystals or gases as their lazing medium. Differing wave lengths of laser light are produced by the selection of the lazing medium. The medium selected determines the laser wavelength emitted, which in turn is absorbed by the targeted tissue in the body. Different tissues absorb different wavelengths or colors of laser light. The degree of absorption by the tissue also varies with the choice of wavelength and is an important variable in treating various tissues. In a surgical laser, light is emitted in either a continuous stream or in a series of short duration "pulses", thus interacting with the tissue through heat and shock waves, respectively. Several factors, including the wavelength of the laser and the frequency and duration of the pulse or exposure, determine the amount of energy that interacts with the targeted tissue and thus, the amount of surgical effect on the tissue.

Lasers are widely accepted in the ophthalmic community for treatment of certain eye disorders and are popular for surgical applications because of their relatively noninvasive nature. In general, ophthalmic lasers, such as argon, Nd:YAG and excimer (argon-fluoride) are used to coagulate, cut or ablate targeted tissue. The argon laser is used to treat leaking blood vessels on the retina (retinopathy) and retinal detachment. The excimer laser is used in corneal refractive surgery. The Nd:YAG pulsed laser is used to perforate clouded posterior capsules (posterior capsulotomy) and to relieve glaucoma-induced elevated pressure in the eye (iridotomy, trabeulorplasty, transcleral cyclophotocoagulation). Argon, Nd:YAG and excimer lasers are primarily used for one or two clinical applications each. In contrast to these conventional laser systems, the Company's PhotonTM laser cataract system is designed to be used for multiple ophthalmic applications, including certain new applications that may be made possible with its proprietary technology. Such new applications, however, must be tested in clinical trials and be approved by the FDA.

Products

The Company's principal proprietary surgical products are systems for use by ophthalmologists to perform surgical treatment procedures to remove cataracts. The Company has complete ownership of each product with no technological licensing limitations.

Precisionist Thirty ThousandTM. The Precisionist Thirty ThousandTM is the Company's core phaco surgical technology. The PrecisionistTM was placed into production and offered for sale in 1997. Although manufactured in the past, the PrecisionistTM is not currently being manufactured. As a phaco cataract surgery system, the Company believes the PrecisionistTM with its new fluidics panel is equal or superior to the present competitive systems in the United States. However, due to the lack of recent sales, the majority of the Company's inventory associated with the Precisionist Thirty ThousandTM has been estimated to be obsolete and therefore a reserve for such inventory has been recorded. The system features a graphic color display and unique proprietary on board computer and graphic user interface linked to a soft key membrane panel for flexible programmable operation. The system provides real-time "on-the-fly" adjustment capabilities for each surgical parameter during the surgical procedure for high volume applications. In addition, the PrecisionistTM provides one hundred pre-programmable surgery setups, with a second level of subprogrammed custom modes within each major surgical screen (i.e., ultrasound phaco and irrigation/aspiration modes).

The PrecisionistTM also features the Company's proprietary fluidics panel which is completely noninvasive for improved sterility and to provide a surgical environment in the eye that virtually eliminates fluidic surge and solves chamber maintenance problems normally associated with phaco cataract surgery. This fluidics system provides greater control for the surgeon and allows the safe operation at much higher vacuum settings by sampling changes in aspiration I00 times per second. Greater vacuum in phaco surgery means less use of ultrasound or laser energy to fragment the cataract and less chance for surrounding tissue damage. In addition to the full complement of surgical modalities (e.g., irrigation, aspiration, bipolar coagulation and anterior vitrectomy), system automation includes "dimensional" audio feedback of vacuum levels and voice confirmation for major system functions, providing an intuitive environment in which the advanced phaco surgeon can concentrate on the surgical technique rather than the equipment. Sales of the PrecisionistTM and related accessories were 0% of total revenues in both the fiscal years 2006 and 2005, respectively.

Ocular Surgery WorkstationTM. The Ocular Surgery WorkstationTM comprises the base system of the Precisionist Thirty ThousandTM and is the first system, to the Company's knowledge, which uses the expansive capabilities of today's advanced computer technology to offer seamless open architecture expandability of the system hardware and software modules. The WorkstationTM utilizes an embedded open architecture computer developed for the Company and controlled by a proprietary software system developed by the Company that interfaces with all components of the system. Ultrasound, fluidics (irrigation), aspiration, venting, coagulation and anterior vitrectomy (pneumatic) are all included in the base model. Each component is controlled as a peripheral module within this fully integrated system. This approach allows for seamless expansion and refinement of the WorkstationTM with the ability to add other hardware and software features. Expansion such as the Company's PhotonTM laser system and hardware for additional surgical applications are easily implemented by means of a preexisting expansion rack, which resides in the base of the WorkstationTM. These expanded capabilities could include, but would not be limited to laser systems, video surgical fiber optic imaging, cutting and electrosurgery equipment. However, there is no guarantee that the WorkstationTM will be accepted in the marketplace. If the FDA approves the PhotonTM, the Company will refer to the WorkstationTM as the PhotonTM Ocular Surgery WorkstationTM. To date, the Company has not commercially developed or offered for sale any other added hardware or software features to its WorkstationTM

PhotonTM Laser System: The PhotonTM laser cataract system, which is still subject to FDA approval, is designed to be installed as a seamless plug-in upgrade or add-on to the Company's Precisionist' Ocular Surgery WorkstationTM. The plug-in platform concept is unique in the ophthalmic surgical market for systems of this magnitude and presents a unique market opportunity for the Company. The main elements of the laser system are the Nd:YAG laser module, PhotonTM laser software package and interchangeable disposable hand held fiber optic laser cataract probe. The PhotonTM laser utilizes the on board microprocessor computer of the WorkstationTM to generate short pulse laser energy developed through the patented LCPTM to targeted cataract tissue inside the eye, while simultaneously irrigating the eye and aspirating the diseased cataract tissue from the eye. The probe is smaller in diameter than conventional ultrasound phaco needles and presents no damaging vibration or heat build up in the eye. The Company's Phase I clinical trials demonstrated that this probe could easily reduce the size of the cataract incision from 3.0 mm to under 2.0 mm thereby reducing surgical trauma and complementing current foldable intraocular implant technology.

The laser probe may also eliminate any possibility for burns around the incision or at the cornea and may therefore be used with cataract surgery techniques that utilize a more delicate clear cornea incision which can eliminate sutures and be conducted with topical anesthesia. However, this system may not effectively remove harder grade cataracts. Harder grade cataracts can be removed using the already existing ultrasound capability of the Precisionist'M. Because of the "going concern" status of the Company, management has focused efforts on those products and activities that will, in its opinion, achieve the most resource efficient short-term cash flow to the Company. As reflected in the results for the fiscal year ended December 31, 2008, diagnostic products are currently the Company's major focus and the PhotonTM and other extensive research and development projects have been put on hold pending future evaluation when the

Company's financial position improves. Due to the uncertainty surrounding the timetable for obtaining FDA approval and the lack of significant revenue from the other surgical products, the Company has recorded an inventory reserve against the majority of the inventory associated with the PhotonTM and Precisionist Thirty ThousandTM. The Company's focus is not on any specific diagnostic product or products, but rather on its entire group of diagnostic products.

At some point in the future, the Company may intend, subject to economic feasibility and the availability of adequate funds, to refine the laser delivery system and laser cataract surgical technique used on soft cataracts through expanded research and clinical studies. Subject to the aforementioned constraints, the Company intends to refine the fluidics management system by improving chamber maintenance during surgical procedures and to develop techniques to optimize time and improve invasive techniques through expanded research and clinical studies. As far as the Company can determine, no integrated single laser photofragmenting probe is presently available on the market that uses laser energy directly, contained in an enclosed probe, to denature cataract tissue at a precise location inside the eye while simultaneously irrigating and aspirating the site.

The Company's laser system is based upon the concept that pulsed laser energy produced with the microprocessor controlled Nd:YAG laser system provides ophthalmic surgeons with a more precise and less traumatic alternative in cataract surgery. Although conventional ultrasonic surgical systems have proven effective and reliable in clinical use for many years, their use of high frequency shock waves and vibration to fragment the cataract can make the procedure difficult and can present risk of complication both during and after surgery. In contrast, the Company's laser system, which utilizes short centralized energy bursts, should permit the delivery of the laser beam with less trauma to adjacent tissue. Therefore, unlike ultrasonic systems, whose vibrations and shock waves affect (and can damage) non-cataract tissues within the eye, the Company's PhotonTM laser cataract system should only affect tissues with which it comes into direct contact.

In October of 2000, the Company received FDA approval for the PhotonTM WorkstationTM to be used with a 532mm green laser which is effective for medical procedures other than cataract removal, such as photocoagulation of retinal and venous anomalies within or outside the eye, pigmented lesions around the orbital socket, posterior or anterior procedures associated with glaucoma or diabetes and general photocoagulation for various dermatological venous anomalies including telangiectasia (surface veins), or commonly referred to as "spider veins". The goal is to be able to integrate multiple laser wavelengths into one system or workstation that can be used for multiple medical specialties. This approval represents only one of the potential applications that could represent substantial growth opportunities including additional sales of equipment, instruments, accessories and disposables.

The PhotonTM Ocular Surgery WorkstationTM has not been commercially developed with any other added hardware or software features. There is no guarantee that the ophthalmic surgery market will accept the laser in this capacity or that the FDA will grant approval. Regulatory approval would require completion of pending PhotonTM clinical trials and resubmission of a 510(k) predicate device application to the FDA. Because of the "going concern" status of the Company, management has focused efforts on those products and activities that will, in its opinion, achieve the most resource efficient short-term cash flow to the Company. As reflected in the results for the fiscal year ended December 31, 2008, diagnostic products consisting mainly of P40, P45 and P60 UBM Ultrasound Biomicroscopes; P2700, P3700 and P37 A/B Scans; perimeters, CT 50 Corneal Topographer, and Blood Flow AnalyzerTM are currently the Company's major focus and the PhotonTM and other extensive research and development projects have been put on hold pending future evaluation when the financial position of the Company improves. The Company's focus is not on any specific diagnostic product or products, but rather on the entire group of diagnostic products.

On March 31, 2005, Joseph W. Spadafora filed a complaint against the Company in the United States District Court, District of Utah, in which he alleges that he was a clinical investigator in the study for the FDA involving the Company's PhotonTM laser system where he performed numerous surgeries using the PhotonTM. Dr. Spadafora contends that in meetings with the Company's personnel he suggested ways in which the handpiece on the PhotonTM could be improved. Dr. Spadafora further contends that on August 5, 1999, when the Company filed a patent application for an improved handpiece with the United States Patent and Trademark Office, he was not named as one of the inventors or a coinventor on the patent application. On September 24, 2004, the Company was issued a patent entitled, "Laser Surgical Handpiece with Photon Trap." Because the Company did not list Dr. Spadafora as one of the

inventors or a coinventor on the patent, Dr. Spadafora requests in his complaint that a court order be entered declaring that he is the inventor or coinventor of the patent and, as a result, is entitled to all or part of the royalties and profits that the Company earned or will earn from the sale of any product incorporating or using the improved handpiece.

On June 2, 2006, the Company entered into a settlement agreement with Dr. Spadafora for the dismissal of the lawsuit. Under the terms of the settlement agreement, the Company agrees to provide Dr. Spadafora with the exclusive right over a three-year period to market and sell the PhotonTM laser system and its components, including the inventory and intellectual property rights. If Dr. Spadafora were successful in finding a prospective purchaser to acquire the PhotonTM laser system upon terms acceptable to the Company, it agrees to pay him a commission equal to 10% of the total purchase price. If the purchase price for the PhotonTM laser system includes a royalty or other payments payable to the Company on later sales of the PhotonTM laser system other than its handpiece component, the Company agrees to pay Dr. Spadafora 8% of such royalties or other payments on such later sales through the full term of the purchase agreement. The Company further agrees that if a purchase price includes a royalty or other payments payable to the Company on later sales of the handpiece component of the PhotonTM laser system, the Company agrees to pay Dr. Spadafora 15% of such royalties or other payments through the full term of the purchase agreement.

Additionally, the settlement agreement provides that if the Company is successful through its sole efforts, without any assistance from Dr. Spadafora, in finding a purchaser to acquire the PhotonTM laser system or its components during the second or third year of Dr. Spadafora's exclusive rights, the Company agrees to pay Dr. Spadafora a commission equal to 1.7% of the total purchase price and of the Company's royalties or other payments on subsequent sales of the PhotonTM laser system or its components through the full term of the purchase agreement. Finally, the settlement agreement provides for mutual releases by Dr. Spadafora and the Company for the benefit of each other, and that the Company and Dr. Spadafora each agree to pay their own costs, expenses and attorney's fees incurred in connection with the lawsuit and the preparation of the settlement agreement.

Surgical Instruments and Disposables: In addition to the cataract surgery equipment, the Company's surgical systems are designed to utilize accessory instruments and disposables, some of which are proprietary to the Company. These include replacement ultrasound tips, sleeves, tubing sets and fluidics packs, instrument drapes and laser cataract probes. The Company intends to expand its disposable accessories as it penetrates the cataract surgery market and expands the treatment applications for its WorkstationTM. These products contributed 0% of total revenues for both 2008 and 2007.

Diagnostic Eye Care Products: Glaucoma is a second leading cause of adult blindness in the world. Glaucoma is described as a partial or total loss of visual field resulting from certain progressive disease or degeneration of the retina, macula or nerve fiber bundle. The cause and mechanism of the glaucoma pathology is not completely understood. Present detection methods focus on the measurement of intraocular pressure in the eye, visual field and observation of the optic nerve head to determine the possibility of pressure being exerted upon the retina and optic nerve fiber bundle, which can diminish the visual field. Recently, retinal blood circulation has been indicated as a key component in the presence of glaucoma. Some companies produce color Doppler equipment in the $80,000 price range intended to provide measurement of ocular blood flow activity in order to diagnose and treat glaucoma at an earlier stage.

Blood Flow AnalyzerTM: In June 1997, the Company received FDA clearance to market the Blood Flow AnalyzerTM for early detection and treatment management of glaucoma and other retinal related diseases. The device measures not only intraocular pressure but also pulsatile ocular blood flow, the reduction of which may cause nerve fiber bundle death through oxygen deprivation thus resulting in visual field loss associated with glaucoma. The Company's Blood Flow AnalyzerTM is a portable automated in-office system that presents an affordable method for ocular blood flow testing for the ophthalmic and optometric practitioner. This was the first diagnostic eye care device. The device is a portable desktop system that utilizes a proprietary and patented pneumatic Air Membrane Applanation ProbeTM or AMAPTM, which can be attached to any model of standard examination slit lamp, which is then placed on the cornea of the patient's eye to measure the intraocular pressure within the eye. The device is unique in that it reads a series of intraocular pressure pulses over a short period of time (approximately five to ten seconds) and generates a waveform profile, which can be correlated to blood flow volume within the eye. A proprietary software algorithm developed by David M. Silver, Ph.D., at Johns Hopkins University, calculates the blood flow volume. The device presents a numerical intraocular pressure reading and blood flow analysis rating in a concise printout, which is affixed to the patient history file. In addition, the data generated by the device can be downloaded to a personal computer system for advanced database development and management.

The Company markets the Blood Flow AnalyzerTM as a stand-alone model packaged with a custom built computer system. The Blood Flow AnalyzerTM utilizes a single use disposable cover for the Air Membrane Applanation Probe"M, a corneal probe which is shipped in sterile packages. The probe tip cover provides accurate readings and acts as a prophylactic barrier for the patient. The device has been issued a patent in the European Economic Community and the United States and has a patent pending in Japan. The FDA cleared the Blood Flow AnalyzerTM for marketing in June 1997 and the Company commenced selling the system in September 1997. In addition to the

Humphrey products, this diagnostic product allowed the Company to expand its market to approximately 35,000 optometry practitioners in the United States in addition to the approximately 18,000 ophthalmic practitioners who currently perform eye surgeries and are candidates for the Company's surgical systems.

In April 2001, the Company received written authorization from the CPT Editorial Research and Development Department of the American Medical Association to use common procedure terminology or CPT code number 92120 for its Blood Flow AnalyzerTM, for reimbursement purposes for doctors using the device. However, certain payors have elected not to reimburse doctors using the Blood Flow AnalyzerTM. The Company is continuing its aggressive campaign to educate the payors about the Blood Flow AnalyzerTM, its purposes and the significance of its performance in patient care in order to achieve reimbursements to the doctors. Currently, there is reimbursement by insurance payors to doctors using the Blood Flow AnalyzerTM in 22 states and partial reimbursement in four other states. The amount of reimbursement to doctors using the Blood Flow AnalyzerTM generally ranges from $56.00 to $76.00 per patient, depending upon the insurance payor. Insurance payors providing reimbursement for the Blood Flow AnalyzerTM have the discretion to increase or reduce the amount of reimbursement. The Company is endeavoring to obtain reimbursement by insurance payors in other states where there is currently no reimbursement being made.

The manufacturing activities for the Blood Flow AnalyzerTM have been moved to the Salt Lake City facility from the outsourced plant located in England. On October 21, 2002, the Company received FDA approval on its 510(k) application for additional indications of use for the Blood Flow AnalyzerTM. The additional indications include pulsatile ocular blood flow and pulsatile ocular blood volume. These are diagnostic measurements that assess the hemodynamic and vascular health of the eye. Also, the Company is continuing its aggressive campaign to educate the insurance payors about the Blood Flow AnalyzerTM, its purposes and the significance of its performance in patient care in order to achieve reimbursements to the doctors using its Blood Flow AnalyzerTM. Sales of the Blood Flow AnalyzerTM and related accessories accounted for 5% and 13% of total sales for the fiscal years ended December 31, 2008 and 2007, respectively.

On January 16, 2008, the Company entered into a consulting agreement with Corcoran Consulting Group, which specializes in medical reimbursement issues for optometry and ophthalmology. The Company plans to work with Corcoran Consulting Group to create a new common procedure technology, or CPT code number, for reimbursement purposes for physicians and practitioners using the Blood Flow Analyzer ™. In addition, the Company plans to work with Corcoran Consulting Group to offer educational seminars for physicians and practitioners who purchase the Blood Flow Analyzer ™.

DiconTM Perimeters: DiconTM perimeters consist of the LD 400, the TKS 5000, and software consisting of Field Link™ FieldViewTM and Advanced Field View. Perimeters are used to determine retinal sensitivity testing the visual pathway. Perimeters have become a standard of care in the detection and monitoring of glaucoma worldwide. Perimetry is reimbursable worldwide. The DiconTM perimeters feature patented kinetic fixation and voice synthesis now in 27 different languages. Software programs are sold to assist in the analysis of the test results. Sales of the perimeters and related accessories generated 24% and 19% of the total revenues for 2008 and 2007, respectively.

The LD 400FT, or Fast Threshold Autoperimeter, is the successor to the LD 400. The device is an autoperimeter used to measure patient visual fields. The LD 400FT is identical in hardware to the LD 400 but it uses new software to enable a fast threshold test. This test reduces the time required by ophthalmologists and optometrists conducting autoperimetry tests by more than 40% by running an abbreviated test at light levels determined to be sufficient to be seen in normal patients. The procedure currently takes more than 15 minutes. The fast threshold test by the LD 400FT is similar to tests by other devices on the market. Healthy patients will pass the test. Patients with reduced visual fields will be flagged by the test enabling the device to automatically run a more comprehensive examination to determine the extent of the visual field loss. All existing LD 400s can be upgraded to support the new fast threshold test through the purchase of a software package.

The LD700 Perimeter is the next generation of perimeters, providing a small footprint and compact design. The test given with the LD700 tests for visual field loss that is often an indicator of the presence of glaucoma. The LD700 is designed to identify glaucoma suspects and also monitor the onset of glaucoma in patients afflicted with this eye disease. It is also used in the management of medication used to treat glaucoma to assure the prescribed medication is effective in slowing the progression of glaucoma and other ailments that result in visual field loss.

DiconTM Corneal Topographers: DiconTM corneal topographers include the CT 200TMand the CT 50. Corneal topographers are used to determine the shape and integrity of the cornea, the anterior surface of the eye. Clinical applications for corneal topographers include refractive surgery that eliminates the need for eyeglasses and optometric applications including contact lens fitting. Revenues from the topographer and related accessories were 0% and 1% of the total revenues for 2008 and 2007, respectively. An enhanced version of the CT 200TH was introduced during the fourth quarter of 2003. The Company has completed the upgrades to the CT 200THand the CT 50 Corneal Topographers, which are now operating with Windows XP software rather than the former Windows 95 operating systems.

P2000 Pachymetric Analyzer: The ultrasonic pachymeter is used for measurement of corneal thickness. The Model P2000 is positioned as a standard office pachymeter. This device is targeted to the refractive surgery market and contributed 2% and 3% of the total revenues for both 2008 and 2007, respectively.

P37 A/B Scan Ocular Ultrasound Diagnostic: The A/B Scan is used by retinal subspecialists to identify foreign bodies in the posterior chamber of the eye and to evaluate the structural integrity of the retina. The A/B Scan is attractive to the general ophthalmic community at large because of its lower price point and its image resolution qualities. Sales from this product were 11% and 10% of the total revenues for 2008 and 2007, respectively.

P40, P45 and P60 UBM Ultrasound Biomicroscopes: Humphrey Systems developed the P40 UBM Ultrasound Biomicroscope in conjunction with the New York Eye and Ear Infirmary in Manhattan and the University of Toronto. The P40 biomicroscope and its intellectual property were included in the purchase from Humphrey Systems and gives the Company the proprietary rights to this device. The P40 biomicroscope creates a high resolution computer image of the unseen parts of the eye that is a "map" for the glaucoma surgeon. The P40 biomicroscope is an "enabling technology" for the ophthalmologist, one that the Company has repositioned for broader market sales penetration. Formerly sold only to glaucoma subspecialty practitioners, the Company reintroduced the P40 biomicroscope at a price point targeted for the average practitioners seeking to add glaucoma filtering surgical procedures and income to their cataract surgical practice.

The P40 biomicroscope related surgical filtering procedures are fully reimbursable by Medicare and insurance providers. This untapped new market positions the Company with its proprietary P40 biomicroscope and, to its knowledge, the only commercially viable product of this type on the market, as a leader in the rapidly expanding glaucoma imaging and treatment segment. In the fall of 2000, the Company introduced the P45 UBM Ultrasonic Biomicroscope, which combines the P40 biomicroscope and the P37 A/B Scan Ocular Ultrasound Diagnostic into one instrument. The Company believes that by combining functions, the P45 will appeal to a broader market. The P40 biomicroscope and related accessories sales were 1% and 6% of the total revenues for 2008 and 2007, respectively. The P45 biomicroscope and related accessories sales contributed 0% and 2% of the total revenues for 2008 and 2007, respectively.

On October 25, 2004, the Company entered into a Manufacturing and Distribution Agreement with E-Technologies, Inc., a Iowa based developer of software and related technology for technical applications. Under the terms of the agreement, E-Technologies granted to the Company the exclusive right to manufacture, market, sell and distribute an ultrasound biomicroscope. Upon execution of the agreement, the Company paid $30,000 to E-Technologies for engineering costs associated with the development of the biomicroscope. When the biomicroscope received FDA approval on May 26, 2005, the Company paid E-Technologies an additional fee of $45,000.

In consideration for the exclusive right to manufacture and distribute the biomicroscope, the Company agreed to pay E-Technologies a royalty in the amount of $5,000 for each of the first 25 biomicroscopes sold by the Company. Thereafter, the Company agreed to pay E-Technologies the sum of $4,000 for each biomicroscope sold. As an additional condition, the Company agreed to sell 25 biomicroscopes during the first 12 months after the biomicroscope receives FDA approval. The agreement is effective for a term of two years. After the expiration of the two year period, the agreement is to automatically renew for additional one year periods, unless either party elects to terminate the agreement upon at least 30 days prior written notice to the other party before the end of any term of the agreement. The agreement was terminated on July 18, 2006.

In March 2005, the Company introduced the P60 UBM Ultrasound Biomicroscope. The P60 biomicroscope represents the fourth generation of UBM devices and has better visual clarity and image flexibility than earlier versions. On March 1, 2005, the Company was awarded the CE Mark for the P60, which enables it to market the device in 19

Western European countries, the Middle East and India, and some parts of Asia and the Pacific Rim. On May 26, 2005, the Company received FDA 510(k) premarket approval for the P60, which allows it to be sold in the United States. On February 9, 2006, the Company received a Canadian device license for the P60, which allows it to be sold in Canada. The P60 biomicroscope and related accessories sales were 21% and 16% of total revenues for 2007 and 2006, respectively.

On June 5, 2007, the Company introduced a new software package for the P60 biomicroscope. This V2.1 software incorporates greater image resolution, a user-friendly and robust database management system, and networking capabilities that allow the patient image data to be transferred within a user's network for efficient patient record management. The Company developed the new V2.1 software in partnership with the optic and engineering group at Reliacon Global, Inc.

In July 2000, the Company received ISO 9001 and EN 46001 certification using TUV Essen as the notified body. Under ISO 9001 certification, its products are now CE marked. The CE mark allows the Company to ship product for revenue into the European Community. The Company successfully retained its certification in 2005 and retained ISO 13485 in December2005 from TUV Essen.

On June 12, 2006, the Company entered into a Worldwide OEM Agreement with MEDA Co., Ltd., one of China's leading developers and producers of ultrasound devices. Under the terms of the agreement, MEDA agrees to jointly engineer, develop and manufacture the Company's next generation of the Ultrasound BioMicroscope, as well as other proprietary new products and enhancement of the Company's current products. The products to be manufactured by MEDA, at agreed upon costs, and supplied to the Company for resale include the following new products: an ultrasound biomicroscope, two ultrasound A/B Scans, a biometric A-Scan and a pachymeter.

The agreement provides that the Company and MEDA agree to jointly develop and collaborate in the improvement and enhancement of the Company's products and, in the interest of product development, enhancement and differentiation. MEDA agrees to give consideration to potential software development or enhancements made available to the Company for its products. Moreover, in the interest of product improvement, MEDA agrees to collaborate with the Company and its designated engineers, employees and consultants to consider and potentially implement jointly or individually the development of product enhancements for the Company's products to be manufactured by MEDA.

On January 31 and February 1, 2007, MEDA received FDA 510(k) pre-market approval for a new generation of ultrasound devices. This approval allows the new devices to be sold in the United States. The new ultrasound devices, which are to be manufactured by MEDA and sold by the Company in the United States, include the P2000 A-Scan (used to measure axial length of the eye), the P2200 Pachymeter (used for measuring corneal thickness), the P2500 A−Scan/Pachymeter (a combination of the two stand-alone devices), the P2700 and P3700 AB/Scans (an ultrasound imaging device for detecting abnormalities within the eye), the P37-II (a more advanced AB/Scan used to provide portability for ophthalmology veterinary applications) and the P50 Ultrasound Biomicroscope for high frequency imaging of the anterior chamber of the eye.

Parts and Services: The parts and service revenue from the repair and service of equipment sold accounted for 30% and 9% of total revenues in 2008 and 2007, respectively.

The following table identifies each product class, status of commercial development, the percentage of sales contributed by that class, reimbursement status, and status of applicable United States and foreign regulatory approvals:

Product (1)	Product Class	Commercial Development	Reimbursement Status	2007%	2008%	Regulatory Approvals
P2200 and P2500 Pachymetric Analyzer	System, Imaging, Pulsed Echo Diagnostic	Complete	Yes	4%	1%	FDA 510(K) K844299* ISO 9001: 1994, EN 9001**
P2000 A-Scan Biometric Ultrasound Analyzer	System Imaging, Pulsed Echo Diagnostic	Complete	Yes	3%	2%	FDA 510(K) I844299* ISO 9001: 1994, EN ISO 9001**
P37, P37-II, P2700 and P3700 A/B Scan Ocular Ultrasound Diagnostic	Transducer, Ultrasound Diagnostic	Complete	Yes	22%	17%	FDA 510(K) K844299* ISO 9001: 1994, EN ISO 9001**
P40 UBM Ultrasound BioMicroscope	System, Imaging, Pulsed Echo Ultrasound Diagnostic	Complete	Yes	6%	1%	FDA 510(K) K844299* ISO 9001: 1994, EN ISO 9001**
P45 UBM Ultrasound Biomicroscope, Workstation Plus	System, Imaging, Pulsed Echo Ultrasound Diagnostic	Complete	Yes	2%	0%	FDA 510(K) K844299* ISO 9001: 1994, EN ISO 9001**
P60 UBM Ultrasound Biomicroscope, Workstation Plus	System, Imaging, Pulsed Echo Ultrasound Diagnostic	Complete	Yes	21%	20%	FDA 510(K) K844299* ISO 9001: 1994, EN ISO 9001.**
BFA Ocular Blood Flow Analyzer'TM and Disposables	Tonometer, Manual Diagnostic	Complete	Yes****	13%	5%	FDA 510(K) K844299* ISO 9001: 1994, EN ISO 9001**
CT 200 Corneal Topography System	Topographer Corneal AC-Powered Diagnostic	Complete	Yes	1%	0%	FDA 510(K) K844299* ISO 9001: 1994, EN ISO 9001**
LD 400 Autoperimetry System	Perimeter, Automatic AC-Powered Diagnostic	Complete	Yes	15%	17%	FDA 510(K) K844299* ISO 9001: 1994, EN ISO 9001**
TKS 5000 Autoperimetry System	Perimeter, Automatic AC-Powered, Diagnostic	Complete	Yes	4%	7%	FDA 510(K) K844299* ISO 9001: 1994, EN ISO 9001**

Glaid Ocular Electrophysiology Device	System, Imagine Electrophysiologic Diagnostic	Complete	Yes	0%	16%	FDA 510(K) K043367* ISO 9001: 1994, EN ISO 9001**
Precisionist Thirty ThousandTM, Ocular Surgery Workstation with Surgical Equipment and Disposables(2)	Phacofragmentation	Complete	Yes	0%	0%	FDA 510(K) K844299* ISO 9001: 1994, EN ISO 9001**
PhotonTM Laser, Ocular Surgery Workstation with Surgical Equipment and Disposables(3)	Phacoemulsification	In-Process (4)	No	0%	0%	IDB G940151 ISO 9001: 1994, EN ISO 9001**
Parts and Services	Perimeter, BFA, Tonometer, Topographer, Ultrasound Workstations, Systems, Imaging	Complete	Yes	9%	14%	FDA 510(K) K844299* ISO 9001: 1994, EN ISO 9001**

(1) Except for the PhotonTM Ocular Surgery Workstation, which can only be sold in countries outside the United States, these products can be sold in the United States and in foreign countries including but not limited to Argentina, Australia, Bangladesh, Borneo, Brazil, Canada, China, Czechoslovakia, Egypt, France, Germany, Greece, Hong Kong, India, Israel, Italy, Japan, Jordan, Korea, Malaysia, Mexico, New Zealand, Pakistan, Peru, Poland, Puerto Rico, Russia, Saudi Arabia, Spain, Sri Lanka, Taiwan, Thailand, Turkey, United Kingdom, and United Arab Emirates.

(2) Due to the lack of recent sales volume, the inventory associated with the Precisionist Thirty Thousand TM, the SIStemTM and the OdysseyTM has been deemed obsolete and a reserve has been recorded to offset such inventory.

(3) Due to the lack of recent evidence to support the recoverability of inventory associated with the PhotonTM, the Company has recorded a reserve to offset the majority of such inventory on hand.

(4) The PhotonTM is in-process and not complete because the Company has not completed the clinical trials in order to obtain FDA regulatory approval.

* FDA 510(K) K844299 and FDA 510(K) K043367 represent domestic approval by U.S. Food and Drug Administration.

** ISO 9001: 1994, EN ISO 9001 represents international approval.

*** IDE G940151 represents approval for international distribution only.

**** Represents full reimbursement in 20 states and partial reimbursement in six other states.

As detailed in the table above, except for the PhotonTM Laser Ocular Surgery Workstation, which requires additional development and regulatory approvals, the Company's current products are developed and available for sale in footnote (1) of the table. The Company's possible future efforts to finalize development of the PhotonTM laser system and obtain the necessary regulatory approvals would depend on adequate funding. If these efforts were undertaken but proved to be unsuccessful, the impact would include the costs associated with these efforts and the anticipated future revenues which the Company would not receive as expected. The Company estimates that the funds needed to complete the clinical trials on the PhotonTM in order to obtain the necessary FDA regulatory approval to be approximately $2,500,000. This does not include the necessary funds for product development and to bring the PhotonTM to market.

The Company currently purchases components and parts used in its products from a limited number of key suppliers. The Company's reliance on its principal suppliers could result in delays associated with redesigning a product due to an inability to obtain an adequate supply of required components and parts, and reduced control over pricing, quality and timely delivery. The loss of any of these principal suppliers or the inability of a supplier to meet performance and quality specifications, requested quantities or delivery schedules could cause the Company's revenues to decline. In addition, any interruption or discontinuance in the supply of components or parts could have an adverse effect on the Company's business, results of operation and financial condition. The Company's principal suppliers include Capistrano Labs, US Ultrasound and Anthrop.

Marketing and Sales

Ophthalmologists are mainly office based and perform their surgeries in local hospitals or surgical centers that provide the necessary surgical equipment and supplies. Ophthalmologists are generally involved in decisions relating to the purchase of equipment and accessories for their independent ambulatory surgical centers and for the hospitals with which they are affiliated. This provides the opportunity for direct, targeted, personal selling, responsive high quality customer service and short buying cycles to achieve a product sale in the office or hospital. Hospitals also comprise a significant market, as recent demand for ultrasonic surgery technology has put pressure on the ophthalmologist, who in turn persuades the hospital to install the latest technology system so that he can offer this procedure to his patients and the community. Ophthalmologist and hospital administrators are understanding the necessity of Ultrasound diagnostic equipment such as the UBM and providing the opportunity for increased product demonstrations. The

capability to detect and manage glaucoma is greatly enhanced with the UBM.

Industry analysts report that the United States ophthalmic device market has been characterized by slower growth in recent years. This has apparently been caused by the potential reforms associated with the health care industry. Further, hospitals have been inclined to keep their older phaco machines longer than expected as they have been forced to mind budgets more carefully and have become less willing to invest in capital equipment until more information on healthcare reform becomes available. However, analysts predict that the ophthalmic and diagnostic equipment device market will see renewed growth in the coming years as the health care environment stabilizes and as the growing elderly population produces an increased number of cataract surgeries. As a consequence of these factors, the market should see a greater rate of replacement of older machines that hospitals and surgeons have been postponing for longer than usual. The acceptance of the UBM as a necessary diagnostic and disease management tool is enhancing the opportunities for increased sales of these to hospitals as well as larger private clinics.

Current Market Acceptance and Potential: The principal purchasers of the Company's products have been ophthalmologists, optometrists, universities and clinics in many countries throughout the world. The Company believes that the market for its products is being driven by: (i) the aging of the population, which is evidenced by the domestic and international cataract surgery volume growth trend over the past ten years, (The National Eye Institute reported in March 2002 that the number of blind or visually impaired Americans is likely to double over the next 30 years.) (ii) the entry by emerging countries (including China, Russia, and other countries in Asia, Eastern Europe and Africa) into advanced technology medical care for their populations, (iii) increased awareness worldwide of the benefits of the minimally invasive phaco cataract procedure, (iv) the introduction of technology improvements such as the Company's laser system, and (v)the growing awareness of the need for early detection and treatment of glaucoma.

Marketing Organization: The Company markets its products internationally through a network of distributors and domestically through direct sales representatives, independent sales organizations, and ophthalmic product distributors. As of December 31, 2008, the Company had two direct domestic sales employees and five independent sales representatives in the United States and 30 ophthalmic and medical product distributors outside the United States. These sales representatives are assigned exclusive territories and have entered into contracts with the Company that contain performance quotas. Domestic sales channels have been expanded to include independent sales representatives and distributors. The Company also plans to continue to market its products by identifying customers through internal market research, trade shows and direct marketing programs.

Product advertising is intended to be focused in the major industry trade journals. Most of the ophthalmologists or optometrists in the United States receive one or more of these magazines through professional subscription programs. The media has shown strong interest in the Company's technology and products, as evidenced by several recent articles in these publications.

Manufacturing and Raw Materials: Currently, the Company maintains a 16,926 square foot facility in Salt Lake City. The Company transferred the manufacturing activities for the Blood Flow AnalyzerTM to San Diego from Ocular Blood Flow, Ltd. in England during 2001. During the second quarter of 2002, the Company consolidated and closed the San Diego operations into the Salt Lake City facility. The facility accommodates its manufacturing, marketing and engineering capabilities. The Company manufactures under systems of quality control and testing, which complies with the Quality System Requirements established by the FDA, as well as similar guidelines established by foreign governments, including the CE Mark and ISO-9001.

The Company subcontracts the manufacturing of some of its ancillary instruments, accessories and disposables through specified vendors in the United States. These products are contracted in quantities and at costs consistent with its financial purchasing capabilities and pricing needs. The Company manufactures certain accessories at its facility in Salt Lake City.

Product Service and Support: Service for the Company's products is overseen from its Salt Lake City location and is augmented by its international dealer network, which provides technical service and repair. Installation, on-site training and a limited product warranty are included as the standard terms of sale. The Company provides distributors with replacement parts at no charge during the warranty period. International distributors are responsible for installation, repair and other customer service to installed systems in their territory. All systems parts are modular sub-components that are easily removed and replaced. The Company maintains adequate parts inventory and provides overnight replacement parts shipments to its dealers.

Research and Development

The Company believes its research and development capabilities provide it with the ability to respond to regulatory developments, including new products, new product features devised from its users and new applications for its products on a timely and proprietary basis. The Company intends to continue investing in research and development and to strengthen its ability to enhance existing products and develop new products. In addition to its in-house research and development capabilities, the Company has enlisted several recognized and respected consultants and other technical personnel to act in technical and medical advisory capacities.

Research, development and service expenses (which includes production and manufacturing support and the service department expenses) decreased by $89,000, or 26%, to $255,000 for the twelve months ended December 31, 2008, from $355,000 for the same period in 2007. None of the costs of research and development activities during 2008 and 2007 was borne directly by customers.

During the period in which Thomas F. Motter served as the Company's Chairman and Chief Executive Officer, he formed a clinical advisory board and met from time to time with the board. Jeffrey F. Poore, who served as the Company's President and Chief Executive Officer from March 2003 to March 2004, decided not to utilize the clinical advisory board. Instead, he consulted with former members of the advisory board on an informal basis. The Company currently has no agreements with any former members of the clinical advisory board and none of these former members hold or own any rights to its products or technologies. The Company's current management meets regularly with recognized and respected ophthalmic experts for advice concerning the Company's diagnostic devices.

Competition

General. The Company is subject to competition in the glaucoma diagnostic markets from developers of technologies for ophthalmic diagnostic instruments used for treatment. A few large companies that are well established in the marketplace have experienced management, are well financed and have well recognized trade names and product lines that dominate the diagnostic equipment industry. The Company believes that the combined sales of the three largest entities account for over 50% of the glaucoma diagnostic market. The remaining market is fragmented among emerging smaller companies, some of which are foreign.

Most major competitors either entered or expanded into the glaucoma market through the acquisition of smaller, entrepreneurial high technology manufacturing companies. Therefore, because existing competitors or other entities desiring to enter the market could conceivably acquire current entrepreneurial enterprises with small market activity, any and all competitors must be considered to be formidable.

Ultrasound Equipment Manufacturers. The Company currently recognizes Sonomed, Tomey, Nidek, OTI and Quantel as its primary competitors in the ultrasound equipment market. In respect to ultrasound diagnostic equipment such as the UBM, A-Scan, Pachymeter and A/B Scan, the Company is well positioned to compete against companies that currently hold a significant share of the market.

The Retinal Diagnostic Market. The Glaucoma Research Foundation suggests that with the aging of the so-called baby boom generation, there will be an increase of refractive surgeries, macular degeneration and glaucoma in the United States, the leading causes of adult blindness worldwide. The National Eye Institute stated in 2002 that the number of visually impaired Americans is likely to double over the next three decades. Their report estimated that 2.4 million people suffer some visual impairment in this country. The damage caused by these diseases is irreversible. The preconditions for the onset of macular degeneration or glaucoma are low ocular blood flow and/or high intraocular pressure. Diagnostic screening is important for individuals susceptible to these diseases. People in high risk categories include: African Americans over 40 years of age, all persons over 60 years of age, persons with a family history of glaucoma or diabetes, and the very nearsighted. The Glaucoma Research Foundation recommends that these high risk individuals be tested regularly for glaucoma. According to the U.S. Census Bureau, in 2004 there were over 36 million adults 65 years of age and older and over ten million African Americans 45 years of age and older. The Glaucoma Research Foundation reports that glaucoma currently accounts for more than seven million visits to physicians annually.

The Company is subject to intense competition in the ophthalmic diagnostic market from well financed, established companies with recognizable trade names and product lines and new and developing technologies. The industry is dominated by several large entities which the Company believes accounts for the majority of diagnostic equipment sales. The Company continues to derive revenues from the sale of its ultrasound diagnostic equipment and Blood Flow AnalyzerTM. The Blood Flow AnalyzerTM is designed to detect glaucoma in an earlier stage than is presently possible. In addition, the device performs tonometry and blood flow analysis. Other ophthalmic diagnostic devices that do not detect glaucoma in the early stages of the disease as does the Company's Blood Flow AnalyzerTM retail at

comparable prices. Thus, the Company believes that it can compete in the diagnostic market place based upon the lower price and improved diagnostic functions of the analyzer. The Company also believes that its ability to compete successfully will depend on its capability to create and maintain advanced technology, develop proprietary products, attract and retain scientific personnel, obtain patent or other proprietary protection for its products and technologies, obtain required regulatory approvals and manufacture, assemble and successfully market products either alone or through third parties.

Intellectual Property Protection

The Company's cataract surgical products are proprietary in design, engineering and performance. Its surgical ultrasonic products have not been patented to date because the primary technology for ultrasonic tissue fragmentation, as available to all competitors in the market, is mainly in the public domain.

The Company acquired proprietary intellectual property in the transaction with Humphrey Systems when the Company purchased the diagnostic ultrasonic product line in 1999. This technology uses ultrasound to create a high resolution computer image of the unseen parts of the eye that is a "map" for the practitioner. The P40 UBM Ultrasound Biomicroscope, one of the ultrasonic products the Company purchased, is subject to a license agreement dated September 27, 1990, with Sunnybrook Health Science Center. Under the terms of the license agreement, the Company has the exclusive worldwide rights to manufacture and sell the UBM biomicroscope, for which the Company is required to pay a royalty of $150 for each licensed product sold. The license agreement was automatically terminated by its terms on September 27, 2002, at which time the Company had a royalty free worldwide license to use and sell the P40 UBM Ultrasound Biomicroscope. However, the Company has a continuing obligation after such termination to continue to use and sell the biomicroscope only in the field of ophthalmology. As a result of its agreement with MEDA Co., Ltd., the Company is also able to provide the P50 UBM biomicroscope, which is manufactured by MEDA, to other industry segments such as the research and the veterinary markets.

The PhotonTM laser cataract probe is protected under a United States patent issued to Daniel M. Eichenbaum, M.D. in 1987 and subsequently assigned to PhotoMed International, Inc. and a Japanese patent issued to the Company in 1997 for the utility and methods of laser ablation, aspiration and irrigation of tissue through a hand held probe of a unique design. The United States patent expired in September 2004.

The Company secured the exclusive worldwide rights to this patent shortly after its issue, and to the international patents pending, from PhotoMed by means of a license agreement dated July 7, 1993. The license agreement provided the Company with the rights to manufacture, distribute and sell a laser system using the PhotonTM laser cataract probe and related components to customers on a worldwide basis, for which PhotoMed is to receive a 1% royalty on all net sales of such systems and related components sold worldwide.

Under the license agreement PhotoMed is entitled to all royalty payments from net sales at the time of billing to the purchaser or within 30 days of the date of shipment, whichever occurs first. The Company is required each quarter to prepare a summary of sales and the royalties to which PhotoMed is entitled to be paid. The sales summary must list the number of surgical systems and disposable units sold in each country, the dollar value of gross and net sales, the amount of the royalty to which PhotoMed is entitled, and any other information requested by PhotoMed from time to time. Under the terms of the agreement, the Company has agreed to be actively engaged in either research and development of a salable product utilizing the patent or in marketing and selling such a product.

The license agreement was amended on December 5, 1997 to allow PhotoMed the right to conduct research, development and marketing utilizing the patent in certain medical subspecialties other than ophthalmology for which the Company would receive royalty payments equal to 1% of the proceeds from the net sales of products utilizing the patent. The license agreement expired when the United States patent rights expired in September 2004, but the license agreement could be automatically extended or renewed for any term of extension or renewal awarded for the patent rights. In addition, the Company has the right to terminate the license agreement at any time after July 7, 2003 upon 90 days prior written notice to PhotoMed.

The PhotonTM laser cataract probe is also protected under a United States patent issued to the Company in 2002 for a laser surgical device for the removal of intraocular tissue including a handpiece and a trap. The patent is due to expire

in August 2019. There are also two pending United States patents relating to the PhotonTM laser cataract probe.

The Blood Flow AnalyzerTM was granted a patent in the United Kingdom in 1998 and in the United States in 1999, and has a patent pending in Japan. These patents relate to pneumatic pressure probes for use in measuring change in intraocular pressure and in measuring pulsatile ocular blood flow. The United States patent rights expire in January 2019 and the United Kingdom patent rights expire in November 2015.

The DiconTM Perimeters and the DiconTM Corneal Topographer each have a U.S. patent with a wide scope of claims. The United States patent for the DiconTM Perimeter was issued in 1991 and the patent rights expire in March 2010. The United States patent for the DiconTM Corneal Topographer was issued in 2002 and the patent rights expire in January 2018.

The Company's trademarks are important to its business. It is its policy to pursue trademark registrations for its trademarks associated with its products as appropriate. Also, the Company relies on common law trademark rights to protect its unregistered trademarks, although common law trademark rights do not provide the Company with the same level of protection as would U.S. federal registered trademarks. Common law trademark rights only extend to the geographical area in which the trademark is actually used while U.S. federal registration prohibits the use of the trademark by any party anywhere in the United States.

The Company also relies on trade secret law to protect some aspects of its intellectual property. All of its key employees, consultants and advisors are required to enter into a confidentiality agreement with the Company. Most of its third-party manufacturers and formulators are also bound by confidentiality agreements with the Company.

Regulation

The FDA under the Food, Drug and Cosmetics Act regulates the Company's surgical and diagnostic systems as medical devices. As such, these devices require premarket clearance or approval by the FDA prior to their marketing and sale. Such clearance or approval is premised on the production of evidence sufficient for the Company to show reasonable assurance of safety and effectiveness regarding its products. Pursuant to the Food, Drug and Cosmetics Act, the FDA regulates the manufacture, distribution and production of medical devices in the United States and the export of medical devices from the United States. Noncompliance with applicable requirements can result in fines, injunctions, civil penalties, recall or seizure of products, total or partial suspension of production, denial of premarket clearance or approval for devices. Recommendations by the FDA that the Company not be allowed to enter into government contracts in order to avoid criminal prosecution may also be made.

Following the enactment of the Medical Device Amendments to the Food, Drug and Cosmetics Act in May 1976, the FDA began classifying medical devices in commercial distribution into one of three classes: Class I, II or III. This classification is based on the controls that are perceived to be necessary to reasonably ensure the safety and effectiveness of medical devices. Class I devices are those devices, the safety and effectiveness of which can reasonably be ensured through general controls, such as adequate labeling, advertising, premarketing notification and adherence to the FDA's Quality System Requirements regulations. Some Class I devices are exempt from some of the general controls. Class II devices are those devices the safety and effectiveness of which can reasonably be assured through the use of special controls, such as performance standards, postmarket surveillance, patient registries and FDA guidelines. Class III devices are devices that must receive premarketing approval by the FDA to ensure their safety and effectiveness. Generally, Class III devices are limited to life sustaining, life supporting or implantable devices, or to new devices that have been found not to be substantially equivalent to legally marketed devices.

There are two principal methods by which FDA approval may be obtained. One method is to seek FDA approval through a premarketing notification filing under Section 510(k) of the Food, Drug and Cosmetics Act. If a manufacturer or distributor of a medical device can establish that a proposed device is "substantially equivalent" to a legally marketed Class I or Class II medical device or to a pre-1976 Class III medical device for which the FDA has not called for a pre-marketing approval, the manufacturer or distributor may seek FDA Section 510(k) premarketing clearance for the device by filing a Section 510(k) premarketing notification. The Section 510(k) notification and the claim of substantial equivalence will likely have to be supported by various types of data and materials, possibly including clinical testing results, obtained under an Investigational Device Exemption granted by the FDA. The manufacturer or distributor may not place the device into interstate commerce until an order is issued by the FDA granting premarketing clearance for the device. There can be no assurance that the Company will obtain Section 510(k) premarketing clearance for any of the future devices for which the Company seeks such clearance including the PhotonTM laser system.

The FDA may determine that the device is "substantially equivalent" to another legally marketed Class I, Class II or pre-1976 Class III device for which the FDA has not called for a premarketing approval, and allow the proposed device to be marketed in the United States. The FDA may determine, however, that the proposed device is not substantially equivalent, or may require further information, such as additional test data, before the FDA is able to make a determination regarding substantial equivalence. A "not substantially equivalent" determination or a request for additional information could delay the Company's market introduction of its products and could have a material adverse effect on its business, operating results and financial condition.

The alternate method to seek approval is to obtain premarketing approval from the FDA. If a manufacturer or distributor of a medical device cannot establish that a proposed device is substantially equivalent to another legally marketed device, whether or not the FDA has made a determination in response to a Section 510(k) notification, the manufacturer or distributor will have to seek premarketing approval for the proposed device. A premarketing approval application would have to be submitted and be supported by extensive data, including preclinical and clinical trial data to prove the safety and efficacy of the device. If human clinical trials of a proposed device are required and the device presents a significant risk, the manufacturer or the distributor of the device will have to file an Investigational Device Exemption application with the FDA prior to commencing human clinical trials. The Investigational Device Exemption application must be supported by data, typically including the results of animal and mechanical testing. If the Investigational Device Exemption application is approved, human clinical trials may begin at a specific number of investigational sites, and the approval letter could include the number of patients approved by the FDA.

An Investigational Device Exemption clinical trial can be divided into several parts or phases. Sometimes a company will conduct a feasibility study (Phase I) to confirm that a device functions according to its design and operating parameters. This is a usual clinical trial site. If the Phase I results are promising, the applicant may, with the FDA's permission, expand the number of clinical trial sites and the number of patients to be treated to assure reasonable stability of clinical results. Phase II studies are performed to confirm predictability of results and the absence of adverse reactions. The applicant may, upon receipt of the FDA's authorization, subsequently expand the study to a third phase with a larger number of clinical trial sites and a greater number of patients. This involves longer patient follow-up times and the collection of more patient data. Product claims, labeling and core data for the premarketing approval are derived primarily from this portion of the clinical trial. The applicant may also, upon receipt of the FDA's permission, consolidate one or more of such portions of the study. Sponsors of clinical trials are permitted to sell those devices distributed in the course of the study, provided such compensation does not exceed recovery of the costs of manufacture, research, development and handling. Although both approval methods may require clinical testing of the device in question under an approved Investigational Device Exemption, the premarketing approval procedure is more complex and time consuming.

Upon receipt of the premarketing approval application, the FDA makes a threshold determination whether the application is sufficiently complete to permit a substantive review. If the FDA determines that the premarketing approval is sufficiently complete to permit a substantive review, the FDA will "file" the application. Once the submission is filed, the FDA has by regulation 90 days to review it; however, the review time is often extended significantly by the FDA asking for more information or clarification of information already provided in the submission. During the review period, an advisory committee may also evaluate the application and provide recommendations to the FDA as to whether the device should beapproved. In addition, the FDA will inspect the manufacturing facility to ensure compliance with the FDA's Quality System Requirements prior to approval of a premarketing application. While the FDA has responded to premarketing approval applications within the allotted time period, premarketing approval reviews generally take approximately 12 to 18 months or more from the date of filing to approval. The premarketing approval process is lengthy and expensive, and there can be no assurance that such approval will be obtained for any of the Company's products determined to be subject to such requirements. A number of devices for which other companies have sought premarketing approval have never been approved for marketing.

Any products manufactured or distributed by the Company pursuant to a premarket clearance notification or pre−marketing approval are or will be subject to pervasive and continuing regulation by the FDA. The Food, Drug and Cosmetics Act also requires that the Company's products be manufactured in registered establishments and in accordance with Quality System Requirements regulations. Labeling, advertising and promotional activities are subject to scrutiny by the FDA and, in certain instances, by the Federal Trade Commission. The export of medical devices is also subject to regulation in certain instances. In addition, the use of the Company's products may be regulated by various state agencies. All lasers manufactured for the Company are subject to the Radiation Control for Health and Safety Act administered by the Center for Devices and Radiological Health of the FDA. The law requires laser manufacturers to file new product and annual reports and to maintain quality control, product testing and sales records, to incorporate certain design and operating features in lasers sold to end users pursuant to specific performance standards, and to comply with labeling and certification requirements. Various warning labels must be affixed to the laser, depending on the class of the product, as established by the performance standards.

Although the Company believes that it currently complies and will continue to comply with all applicable regulations regarding the manufacture and sale of medical devices, such regulations are always subject to change and depend heavily on administrative interpretations. There can be no assurance that future changes in review guidelines, regulations or administrative interpretations by the FDA or other regulatory bodies, with possible retroactive effect, will not materially adversely affect the Company. In addition to the foregoing, the Company is subject to numerous

federal, state and local laws relating to such matters as safe working conditions, manufacturing practices, environmental protection, fire hazard control and disposal of potentially hazardous substances. There can be no assurance that the Company will not be required to incur significant costs to comply with such laws and regulations and that such compliance will not have a material adverse effect upon the Company's ability to conduct business.

The Company and the manufacturers of its products may be inspected on a routine basis by both the FDA and individual states for compliance with current Quality System Requirements regulations and other requirements.

Congress has considered several comprehensive federal health care programs designed to broaden coverage and reduce the costs of existing government and private insurance programs. These programs have been the subject of criticism within Congress and the health care industry, and many alternative programs and features of programs have been proposed and discussed. Therefore, the Company cannot predict the content of any federal health care program, if any is passed by Congress, or its effect on the Company and its business. Some measures that have been suggested as possible elements of a new program, such as government price ceilings on non-reimbursable procedures and spending limitations on hospitals and other healthcare providers for new equipment, could have an adverse effect on its business, operating results or financial condition. Uncertainty concerning the features of any health care program considered by the Congress, its adoption by the Congress and the effect of the program on the Company's business could result in volatility of the market price of its common stock.

Furthermore, the introduction of the Company's products in foreign countries may require it to obtain foreign regulatory clearances. The Company believes that only a limited number of foreign countries have extensive regulatory requirements, including France, Germany, Korea, China and Japan. The time involved for regulatory approval in foreign countries varies and can take a number of years. A number of European and other economically advanced countries, including Italy, Norway, Spain and Sweden, have not developed regulatory agencies for intensive supervision of such devices. Instead, they generally have been willing to accept the approval of the FDA. Therefore, a premarketing approval, Section 510(k) or approved Investigational Device Exemption from the FDA is tantamount to approval in those countries. These countries and most developing countries have simply deferred direct discretion to licensed practicing surgeons to determine the nature of devices that they will use in medical procedures. The Company's two ultrasound surgical and diagnostic systems, the PhotonTM laser cataract system it is developing and the ocular blood flow analyzer and the UBM biomicroscope are all devices which require FDA approval. Therefore, a significant aspect of the acceptance of the devices in the market is the Company's effectiveness in obtaining the necessary approvals. Having an approved Investigational Device Exemption allows the Company to export a product to qualified investigational sites.

Regulatory Status of Products

All of the Company's products, with the exception of the PhotonTM, are approved for sale in the U.S. by the FDA under a 510(k). All of the Company's products have been accepted for import into CE countries and various non-CE countries.

The Company acquired permission from the FDA to export the PhotonTM laser cataract system outside the United States under an open Investigational Device Exemption granted by the FDA in September 1994. Although the PhotonTM laser cataract system is uniquely configured in an original and proprietary manner, the laser system, a Nd:YAG laser, is not proprietary to the device or the Company and is widely used in the medical industry and other industries as well. Of particular significance is the fact that this particular component has received previous market clearance from the FDA for other ophthalmic and medical applications. Also of significance is the Company's belief that the surgical treatment method used with the PhotonTM laser is similar to the current ultrasound cataract treatment employed by ophthalmologists.

The Company submitted a Premarket Notification 510(k) application to the FDA for the PhotonTM laser cataract system in September 1993. The FDA requested clinical support data for claims made in the 510(k), and in October 1994 the Company submitted an Investigational Device Exemption application to provide for a "modest clinical study" in order to collect the data required by the FDA for clearance of the PhotonTM laser cataract system. The FDA granted this Investigational Device Exemption in May 1995 for a Phase I Feasibility Study. The Company began human clinical trials in April 1996 and completed the Phase I study in November 1997. The Company started Phase II trials in September 1998 and completed numerous cases of treatment group and control group patients, which were included in its submission to the FDA.

The Company received a warning letter dated August 30, 2000 from the Office of Compliance, Center for Devices and Radiological Health of the Food and Drug Administration relating to certain deficiencies in the human clinical trials for its PhotonTM Laser Cataract System. The warning letter concerned the conditions found by the FDA during several audits at its clinical sites. The FDA's comments were isolated to the administrative procedures of compiling data from the clinical sites. The Company responded to the warning letter in a submission dated September 27, 2000. In the submission the Company took corrective action that included submitting a revised clinical protocol and case report forms and procedures for the collection and control of data. In a subsequent letter dated November 2, 2000 to the Company, the FDA granted conditional approval provided that the Company correct certain deficiencies. After providing several additional submissions to the FDA, the Company received a letter dated February 13, 2001 from the

FDA stating that the deficiencies had been corrected and the clinical trials could continue.

Subsequent to the warning letter, the Company received approval to continue its clinical trials, the results of which were included in its supplemental submission to the FDA in October 2001 for the existing (510)(k) predicate device application for the PhotonTM laser system. In December 2001, the Company received a preliminary review from the FDA regarding the supplemental submission. As a result of that preliminary review, the Company submitted additional clinical information to the FDA on February 6, 2002. The application is receiving ongoing review by the FDA. On May 7, 2002, the Company received a letter from the FDA requesting further clinical information. The Company has generated additional clinical information in response to the letter and is uncertain if the Company will make a submission to the FDA with the additional clinical information. Because of the "going concern" status of the Company, management has focused efforts on those products and activities that will, in its opinion, achieve the most resource efficient short-term cash flow to the Company. Its diagnostic products are currently its major focus and the PhotonTM and other extensive research and development prospects have been put on hold pending future evaluation until the Company's financial position improves. Its focus is not on any specific diagnostic product or products, but rather on its entire group of diagnostic products.

Employees

As of March 31, 2009, the Company had 16 full-time employees and one part-time employee. This number does not include its manufacturer's representatives who are independent contractors rather than its employees. The Company also utilizes several consultants and advisors. There can be no assurance that the Company will be successful in recruiting or retaining key personnel. None of its employees are a member of a labor union and the Company has never experienced any business interruption as a result of any labor disputes.

In December 2001 the Company initiated the first phase of a corporate downsizing program to reduce its operating expenses. The Company implemented the second phase of its downsizing program in the second quarter of 2002, by closing and transferring its manufacturing from its site in San Diego, California to Salt Lake City, resulting in further reductions in operating expenses. As a result of the downsizing program and some resignations, the number of its employees has been reduced by 72% from 112 to 22 employees. The estimated cost savings from the downsizing program will be in excess of $2,000,000 annually. The costs of downsizing have included onetime expenses of approximately $43,000 for moving and travel. In addition, the Company incurred additional onetime expenses of approximately $18,000 for housing accommodations for key employees working in Salt Lake City. The Company realized a net cost savings from down sizing of approximately $2,394,000 during the twelve months ended December 31, 2002.

Item 2. Description of Property

The Company's corporate offices are currently located at 2355 South 1070 West, Salt Lake City, Utah. This facility consists of 16,926 square feet of leased office and warehouse space. These facilities were leased from Eden Roc, a California partnership, at a base monthly rate of $7,109, plus a $1,690 monthly common area maintenance fee. In January 2003, the Company renegotiated a three-year lease with Eden Roc at a monthly rate of $9,295, plus a $1,859 common area maintenance fee for the year 2003, with the rate increased to $11,433 (including a $1,859 common area maintenance fee) for 2004 and to $11,720 (including a $1,859 common area maintenance fee) for 2005. Pursuant to the lease, the Company pays all real estate and personal property taxes and the insurance costs on the premises. The lease expired on December 31, 2005. Since January 1, 2006, the Company has leased 16,926 square feet of space in the facility on a month to month basis at a monthly rate of $7,109 plus a $1,690 common area maintenance fee.

The Company believes that these facilities are adequate and satisfy its needs for the foreseeable future.

Item 3. Legal Proceedings

On June 20, 2003, an action was brought against the Company by CitiCorp Vendor Finance, Inc., formerly known as Copelco Capital, Inc. in the Third Judicial District Court, Salt Lake County, State of Utah (Civil No. 030914195). The complaint claims that $49,626 plus interest is due for the leasing of three copy machines that were delivered to the Company's Salt Lake City facilities in or about April of 2000. The action also seeks an award of attorney’s fees and costs incurred in the collection. The Company filed an answer to the complaint disputing the amounts allegedly owed due to machine problems and a claimed understanding with the vendor. The Company returned two of the machines. The Company was engaged in settlement discussions with CitiCorp until counsel for CitiCorp withdrew from the case. New counsel for CitiCorp was appointed. Thereafter, there was a substitution of plaintiff, with CIT Technology Financing Services I, LLC as the new plaintiff. In June 2008, the Company filed an amended answer and a third party complaint. Pursuant to a notice from the court dated January 13, 2009 to show cause why the case should not be dismissed for failure to prosecute and a hearing held on March 3, 2009, the Company and CIT Technology Financing Services agreed to dismiss the case without prejudice. Settlement discussion may continue.

On December 27, 2007, the Company entered into a settlement agreement with Larry Hicks to settle the lawsuit that he brought against the Company for payments due under a consulting agreement with the Company in the Third Judicial District Court, Salt Lake County, State of Utah (Civil No. 030922220). Under the terms of the settlement agreement, the Company agreed to pay Mr. Hicks a total of $20,000, of which $7,500 was paid within seven days of the date of execution of the settlement agreement. The remaining amount owing of $12,500 was to be paid in five consecutive quarterly installments of $2,500 each, beginning in the first quarter of 2008 and ending in the first quarter of 2009. Payments of $2,500 each were made for the quarters ended March 31, 2008, June 30, 2008, September 30, 2008, and December 31, 2008.

On March 19, 2009, an action was brought against the Company by Pilot Freight Services in the Third Judicial District Court, Salt Lake County, State of Utah (Civil No. 090405609), for payments due for shipping charges. The complaint claims the sum of $11,336 is due for unpaid shipping charges, together with accrued interest from the date the shipping charges became due, with the last shipping charge becoming due on October 22, 2008. The Company is in the process of investigating the claims made in the complaint and intends to file an answer in defense of the action.

The Company is not a party to any other material legal proceedings outside the ordinary course of its business or to any other legal proceedings, which, if adversely determined, would have a material adverse effect on its financial condition or results of operations.

Item 4. Submission of Matters to a Vote of Security Holders

On December 5, 2008, the shareholders approved a 1-for-100 reverse stock split of the Company's common stock at a Special Meeting of the Shareholders. There were 736,703,232 votes cast in favor of the reverse split, 242,024,479 votes against the reverse split, and 3,281,414 abstentions. The reverse stock split became effective upon shareholder approval at the Special Meeting of Shareholders.

PART II

Item 5. Market for Common Equity and Related Stockholder Matters

The Company's authorized capital stock consists of 1,400,000,000 shares of common stock, $.001 par value per share, and 5,000,000 shares of preferred stock, $.001 par value per share. The Company has created seven 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, Series F preferred stock and Series G preferred stock.

On December 5, 2008, the Company’s shareholders approved a 1-for-100 reverse stock split, which became effective on December 5, 2008. All references to share and per-share data for all periods presented in this report have been adjusted to give effect to this reverse split.

The Company's common stock trades on the OTC Bulletin Board under the symbol of "PDMI.OB." Prior to July 22, 1996, there was no public market for the common stock. From July 22, 1996 to June 25, 2003, the Company's common stock was listed on the Nasdaq SmallCap Market. Since June 25, 2003, the common stock has traded on the OTC Bulletin Board. As of March 30, 2008, the closing sale prices of the common stock was $.002 per share. The following are the high and low sale prices for the common stock by quarter as reported by the OTC Bulletin Board since January 1, 2007.

Period (Calendar Year)	Common Stock Price Range High	Low
2007		
First Quarter	$ 3.20	$ .30
Second Quarter	1.40	.60
Third Quarter	.70	.40
Fourth Quarter	.50	.30
2008		
First Quarter	$ .01	$ .06
Second Quarter	.01	.02
Third Quarter	.02	.01
Fourth Quarter	.05	.012
2009		
First Quarter	$ .0027	$ .0015

The Company's Series A preferred stock, Series B preferred stock, Series C preferred stock, Series D preferred stock, Series E preferred stock, Series F preferred stock and Series G preferred stock are not publicly traded. As of March 31, 2009, there were 4,489 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, one record holder of Series E preferred stock, 18 record holders of Series F preferred stock, and one record holder of Series G preferred stock.

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

The Company currently intends to retain future earnings, if any, to fund the development and growth of its proposed business and operations. Any payment of cash dividends in the future on the common stock will be dependent upon its 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 its board of directors deems relevant. The Company issued 6,764 shares of its Series A preferred and 6,017 shares of its 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.

Item 6. Management's Discussion and Analysis or Plan of Operation

This report contains forward-looking statements and information relating to the Company that is based on beliefs of management as well as assumptions made by, and information currently available to management. These statements reflect its current view respecting future events and are subject to risks, uncertainties and assumptions, including the risks and uncertainties noted throughout the document. Although the Company has 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.

24

Critical Accounting Policies

Revenue Recognition. The Company recognizes revenue in compliance with Staff Accounting Bulletin 101, Revenue Recognition in Financial Statements (SAB 101), as revised by Staff Accounting Bulletin No. 104, Revenue Recognition (SAB 104). SAB 101 and SAB 104 detail four criteria that must exist before revenue is recognized:

1. Persuasive evidence of an arrangement exists. Prior to shipment of product, the Company required a signed purchase order and, depending upon the customer, a down payment toward the final invoiced price or full payment in advance with certain international product distributors.

2. Delivery and performance have occurred. Unless the purchase order requires specific installation or customer acceptance, the Company recognizes revenue when the product ships. If the purchase order requires specific installation or customer acceptance, the Company recognizes revenue when such installation or acceptance has occurred. Title to the product passes to its customer upon shipment. This revenue recognition policy does not differ among its various different product lines. The Company guarantees the functionality of its product. If its product does not function as marketed when received by the customer, the Company either makes the necessary repairs on site or has the product shipped to the Company for the repair work. Once the product has been repaired and retested for functionality, it is reshipped to the customer. The Company provides warranties that generally extend for one year from the date of sale. Such warranties cover the necessary parts and labor to repair the product as well as any shipping costs that may be required. The Company maintains a reserve for estimated warranty costs based on its historical experience and management's current expectations.

3. The sales price is fixed or determinable. The purchase order received from the customer includes the agreed upon sales price. The Company does not accept customer orders, and therefore does not recognize revenue, until the sales price is fixed.

4. Collectibility is reasonably assured. With limited exceptions, the Company requires down payments on product prior to shipment. In some cases the Company requires payment in full prior to shipment. The Company also performs credit checks on new customers and ongoing credit checks on existing customers. The Company maintains an allowance for doubtful accounts receivable based on historical experience and management's current expectations.

5. Revenues for sales of products that require specific installation and acceptance by the customer are recognized upon such installation and acceptance by the customer. Revenues for sales of other surgical systems, ultrasound diagnostic devices, and disposable products are recognized when the product is shipped. A signed purchase agreement and a deposit or payment in full from customers is required before a product leaves the premises. Title passes at time of shipment (F.O.B. shipping point). The Company's products contain both hardware and software components. The Company does not recognize revenue for the software components of the products separate from the product as a whole because the software is incidental to the product, as defined in paragraph 2 of SOP 97-2.

Recoverability of Inventory. Since its inception, the Company has purchased several complete lines of inventory. In some circumstances the Company has been able to utilize certain items acquired and others remain unused. On a quarterly basis, the Company attempts to identify inventory items that have shown relatively no movement or very slow movement. Generally, if an item has shown little or no movement for over a year, it is determined not to be recoverable and a reserve is established for that item. In addition, if the Company identifies products that have become obsolete due to product upgrades or enhancements, a reserve is established for such products. The Company intends to make efforts to sell these items at significantly discounted prices. If items are sold, the cash received would be recorded as revenue, but there would be no cost of sales on such items due to the reserve that has been recorded. At the time of sale, the inventory would be reduced for the item sold and the corresponding inventory reserve would also

be reduced.

Recoverability of Goodwill and Other Intangible Assets. The Company's intangible assets consist of goodwill, product and technology rights, engineering and design costs, and patent costs. Intangibles with a determined life are amortized on a straight-line basis over their determined useful life and are also evaluated for potential impairment if events or circumstances indicate that the carrying amount may not be recoverable. Intangibles with an indefinite life, such as goodwill, are not amortized but are tested for impairment on an annual basis or when events and circumstances indicate that the asset may be impaired. Impairment tests include comparing the fair value of a reporting unit with its carrying net book value, including goodwill. To date, the Company's determination of the fair value of the reporting unit has been based on the estimated future cash flows of that reporting unit.

Allowance for Doubtful Accounts. The Company records an allowance for doubtful accounts to offset estimated uncollectible accounts receivable. Bad debt expense associated with the increases in the allowance for doubtful accounts is recorded as part of general and administrative expense. The Company's accounting policy generally is to record an allowance for receivables over 90 days past due unless there is significant evidence to support that the receivable is collectible.

General

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

The Company is engaged in the design, development, manufacture and sale of high technology diagnostic eye care products. Given the "going concern" status of the Company, management has focused efforts on those products and activities that will, in its opinion, achieve the most resource efficient short-term cash flow. As seen in the results for the twelve months ended December 31, 2008, diagnostic products have been the major focus and the PhotonTM and other extensive research and development projects have been put on hold pending future evaluation when the Company's financial position improves. The Company does not focus on a specific diagnostic product or products but, instead, on this entire diagnostic product group.

During the year ended December 31, 2008, the Company recorded a decrease in the warranty accrual of $163,000. This decrease was a result of a comprehensive analysis by management regarding historic warranty costs. Historically, the Company has recorded a monthly warranty expense and related increase to the warranty accrual. However, in recent periods the usage of the warranty accrual has continued to increase. After reviewing the recent historical data, management determined that the warranty accrual should be decreased by $163,000 to $64,000. Management will continue to closely monitor the warranty accrual usage to ensure that the proper amount has been accrued.

During the twelve months ended December 31, 2008, management made certain adjustments to the financial statements, including a decrease in the reserve for obsolete or estimated non-recoverable inventory of $13,000. The Company also recorded a net increase in the allowance for doubtful accounts receivable of $34,000 and no change in accruals to settle outstanding disputes.

The Company's ultrasound diagnostic products include a P2200 pachymetric analyzer, a P2000 Ultrasound A-Scan biometric analyzer, a P2500 combination A/Scan and Pachymeter, a P37 Ultrasound A/B Scan, a P37-II Ultrasound A/B Scan, a P2700 Ultrasound A/B Scan, a P3700 Ultrasound A/B Scan, a P40 Ultrasound Biomicroscope, a P45 Plus Ultrasound Biomicroscope, and a P60 Ultrasound Biomicroscope, the technology for which was acquired from Humphrey Systems in 1998. The Company introduced the P45 Plus in the fall of 2000, which combines the A/B Scan, and the biomicroscope into one instrument. The Company introduced the P60 in March 2005, which represents the fourth generation of UBM devices and has better visual clarity and image flexibility than earlier versions. In addition, the Company markets its Blood Flow AnalyzerTM acquired in the purchase of Ocular Blood Flow Ltd. in June 2000. Other diagnostic products are the DiconTMLD400 Auto Perimeter and the DiconTM CT 200e Corneal Topographer, which were acquired in the acquisition of Vismed d/b/a Dicon in June 2000.

Because of the "going concern" status of the Company, management has focused efforts on those products and activities that will, in its opinion, achieve the most resource efficient short-term cash flow to the Company. As reflected in the results for the fiscal year ended December 31, 2008, diagnostic products are currently the Company's major focus and the PhotonTM and other extensive research and development projects have been put on hold pending future evaluation when the financial position of the Company improves. Due to the lack of current evidence to support recoverability, the Company has recorded an inventory reserve to offset the inventory associated with the Precisionist Thirty ThousandTM and the PhotonTM as well as certain other inventory items that are estimated to be non-recoverable due to the lack of significant turnover of such items in recent periods.

Activities for the twelve months ended December 31, 2008 and 2007 included sales of the Company's products and related accessories and disposable products. Stephen L. Davis was named President on November 18, 2008. Mr. Davis replaced Raymond L. Cannefax who was terminated by the Board of Directors. Mr. Davis previously served as the Company's Vice President of Sales and Marketing from May 2007 to February 2008. On March 20, 2006, the Company named Luis A. Mostacero as Vice President of Finance. Mr. Mostacero previously served as the Company's Controller from April 2004 to September 2005. On January 8, 2008, Mr. Mostacero was also appointed as Chief Financial Officer. Mr. Mostacero resigned on January 16, 2009, to pursue other opportunities. Mr. Davis has been appointed the Company's Treasurer until a new Treasurer is appointed. On October 11, 2006, Christina O'Connor was appointed as Vice President of International Sales and Julio C. Maximo as Vice President of Operations. Ms. O'Connor resigned on July 7, 2008, to pursue other opportunities. On January 4, 2007, Alfred B. Franklin was appointed as Vice President of Domestic Sales. Mr. Franklin resigned on May 10, 2007, to pursue other opportunities.

On May 7, 2002, the Company received a letter from the FDA requesting further clinical information regarding the PhotonTM. The Company is in the process of generating the additional clinical information in response to the letter. The Company cannot market or sell the PhotonTM in the United States until FDA approval is granted. On November 4, 2002, the Company received FDA approval for expanded indications of use of the Blood Flow AnalyzerTM for pulsatile ocular blood flow, volume and pulsatility equivalence index. Also, the Company is continuing its efforts to educate the payors of Medicare claims throughout the country about the Blood Flow AnalyzerTM, its purposes and the significance of its 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 2001, the Company received written authorization from the CPT Editorial Research and Development Department of the American Medical Association to use a common procedure terminology or CPT code number 92120 for its Blood Flow AnalyzerTM, for reimbursement purposes for doctors using the device. However, certain insurance payors have elected not to reimburse doctors using the Blood Flow AnalyzerTM. The Company believes the reasons why insurance payors initially elected not to reimburse doctors using the CPT code were the relatively high volume of claims that began to be submitted under CPT code number 92120 compared to the limited volume of claims previously submitted under this code, and the time consumed by the Blood Flow AnalyzerTM test, which some payors may have believed was less than what is allowed under CPT code number 92120. This trend began shortly after insurance payors were presented with reimbursement requests under this code, and the Company believes these reasons were the basis for the initiation of nonpayment.

The impact of this nonpayment by certain payors on the Company's future operations is a lower volume of sales, particularly in those states where reimbursement is not yet approved or is delayed. Currently, there is reimbursement by insurance payors in 20 states and partial reimbursement in six other states. As insurance payors have the prerogative whether to provide reimbursement to doctors using the Blood Flow AnalyzerTM, the Company is continuing to work with insurance payors in states where there is no reimbursement to doctors using the CPT code to demonstrate the value of the instrument. However, some insurance payors are currently not providing reimbursement to doctors where a regional or state administrator of Medicare has elected not to provide Medicare coverage for the Blood Flow AnalyzerTM. The Company is continuing to work with the regional and state administrators of Medicare who have denied Medicare coverage for the Blood Flow AnalyzerTM to demonstrate the value of the instrument.

There were a number of factors that contributed to the decrease in sales of the Company's diagnostic products. The U.S. recessionary economic trend has impacted the Company's domestic sales. Additionally, the Company restructured its sales organization and sales channels by decreasing its direct sales force who are full-time employees to two direct sales employees and five independent sales representatives as of December 31, 2008. The dependent sales force has been reduced because the Company does not have sufficient revenues to justify a larger direct sales force. One of the challenges for fiscal 2009 will be the judicious reestablishment of the sales force in anticipation of increased sales.

The Company intends to increase its efforts to sell its diagnostic products through independent sales representatives and ophthalmic equipment distributors, which are paid commissions only for their sales. As of December 31, 2008, the Company had 30 ophthalmic and medical product distributors outside the United States. The Company hopes to benefit from these recently hired sales representatives and distributors in the United States as they gain familiarity, through training, of the Company's diagnostic products.

Outstanding Commitments to Issue Shares

The following table identifies the Company's outstanding commitments to issue shares, including the shares underlying the convertible notes and warrants issuable upon conversion of the notes and exercise of

the warrants. All references to share and pre-share data for all periods presented in this report have been adjusted to give effect to the 1-for-100 reverse stock split, effective December 5, 2008.

Security	Underlying Shares of Common Stock
Notes (1)	966,705,263
Warrants (2)	637,594
Preferred Stock (3)	8,624
Stock Options (4)	114,550
Total	967,466,031

(1) Assumes full conversion of $4,132,665 of notes issued to AJW Partners, LLC, AJW Offshore, Ltd., AJW Qualified Partners, LLC, and New Millennium Capital Partners 11, LLC at a conversion price of $.0009 per share (based upon a market price of $.0095 as of December 31, 2008 with a 55% discount).

(2) Consisting of warrants exercisable at prices ranging from $.10 per share to $675.00 per share, including warrants issued to AJW Partners, LLC, AJW Offshore, Ltd., AJW Qualified Partners, LLC, and New Millennium Capital Partners II, LLC to purchase 165,344 shares of common stock at an exercise price of $20.00 per share, exercisable through the period from April 27, 2010 to June 30, 2010, and warrants to purchase 120,000 shares of common stock at an exercisable price of $10.00 per share, exercisable through the period from February 28, 2011 to April 20, 2012, warrants to purchase 100,000 shares of common stock at an exercise price of $.50 per share, exercisable through June 11, 2012, warrants to purchase 150,000 shares of common stock at an exercise price of $.10 per share, exerciseable through December 24, 2012, and warrants to purchase 150,000 shares of common stock at an exercise price of $.10 per share, exercisable through June 16, 2015.

(3) Consisting of 68 shares of common stock issuable upon conversion of 5,627 shares of Series A preferred stock, 108 shares of common stock issuable upon conversion of 8,986 shares of Series B preferred stock, 88 shares of common stock issuable upon conversion of 5,000 shares of Series D preferred stock, 133 shares of common stock issuable upon conversion of 250 shares of Series E preferred stock, 2,346 shares of common stock issuable upon conversion of 4,398.75 shares of Series F preferred stock, and 5,882 shares of common stock issuable upon conversion of 588,235 shares of Series G preferred stock.

(4) Consisting of stock options granted to executive officers and employees to purchase 92,050 shares of common stock at exercise prices ranging from $1.00 per share to $10.00 per share, and stock options granted to directors to purchase 22,500 shares of common stock at exercise prices ranging from $9.00 per share to $275.00 per share.

There are a total of 967,466,031 shares underlying our convertible notes, warrants, preferred stock and stock options, assuming full conversion of the outstanding notes and preferred stock and the exercise of all the outstanding warrants and stock options. The number of the Company's authorized shares of common stock is 1,400,000,000 shares. The large number of the Company's shares of common stock underlying its notes, warrants, preferred stock and stock options will require the Company to increase the number of authorized shares. Failure to obtain stockholder approval to increase the number of authorized shares could result in the noteholders commencing legal action against the Company and foreclosing on all of its assets to recover damages. Any such action would require the Company to curtail or cease its operations.

Convertible Notes

April 27, 2005 Sale of $2,500,000 in Convertible Notes. To obtain funding for the Company's ongoing operations, the Company entered into a securities purchase agreement with four accredited investors on April 27, 2005 for the sale of (i) $2,500,000 in convertible notes and (ii) warrants to purchase 165,344 shares of its common stock. The sale of the convertible notes and warrants is to occur in three traunches and the investors provided the Company with an aggregate of $2,500,000 as follows:

- $850,000 was disbursed on April 27, 2005;
- $800,000 was disbursed on June 23, 2005 after the Company filed a registration statement on June 22, 2005 to register the shares of common stock issuable upon conversion of the convertible notes and exercise of warrants; and
- $850,000 was disbursed on June 30, 2005, the effective date of the registration statement.

Under the terms of the securities purchase agreement, the Company agreed it would not, without the prior written consent of a majority-in-interest of the investors, negotiate or contract with any party to obtain additional equity financing (including debt financing with an equity component) that involves (i) the issuance of common stock at a discount to the market price of the common stock on the date of issuance (taking into account the value of any warrants or options to acquire common stock in connection therewith), (ii) the issuance of convertible securities that are convertible into an indeterminate number of shares of common stock, or (iii) the issuance of warrants during the lock-up period beginning April 27, 2005 and ending on the later of (a) 270 days from April 27, 2005, or (b) 180 days from the date the registration statement is declared effective.

In addition, the Company agreed not to conduct any equity financing (including debt financing with an equity component) during the period beginning April 27, 2005 and ending two years after the end of the above lock-up period unless it first provided each investor an option to purchase its pro rata share (based on the ratio of each investor's purchase under the securities purchase agreement) of the securities being offered in any proposed equity financing. Each investor must be provided written notice describing any proposed equity financing at least 20 business days prior to the closing of such proposed equity financing and the option must be extended to each investor during the 15-day period following delivery of such notice.

The $2,500,000 in convertible notes bear interest at 8% per annum from the date of issuance. Interest is computed on the basis of a 365-day year and is payable quarterly in cash, with six months of interest payable up front. The interest rate resets to zero percent for any month in which the stock price is greater than 125% of the initial market price, or $9.45, for each trading day during that month. Any amount of principal or interest on the convertible notes that is not paid when due will bear interest at the rate of 15% per annum from the date due thereof until such amount is paid. The notes mature in three years from the date of issuance, and are convertible into the Company's common stock at the noteholders' option, at the lower of (i) $9.00 or (ii) 60% of the average of the three lowest intraday trading prices for the common stock on the OTC Bulletin Board for the 20 trading days before but not including the conversion date. Accordingly, there is no limit on the number of shares into which the notes may be converted.

The convertible notes are secured by the Company's assets, including the Company's inventory, accounts receivable and intellectual property. Moreover, the Company has a call option under the terms of the notes. The call option provides the Company with the right to prepay all of the outstanding convertible notes at any time, provided there is no event of default by the Company and the Company's stock is trading at or below $9.00 per share. An event of default includes the failure by the Company to pay the principal or interest on the notes when due or to timely file a registration statement as required by the Company or obtain effectiveness with the Securities and Exchange Commission of the registration statement. Prepayment of the notes is to be made in cash equal to either (a) 125% of the outstanding principal and accrued interest for prepayments occurring within 30 days following the issue date of the notes; (b) 130% of the outstanding principal and accrued interest for prepayments occurring between 31 and 60 days following the issue date of the notes; or (c) 145% of the outstanding principal and accrued interest for prepayments occurring after the 60th day following the issue date of the notes.

The warrants are exercisable until five years from the date of issuance at a purchase price of $2.00 per share. The investors may exercise the warrants on a cashless basis if the shares of common stock underlying the warrants are not registered pursuant to an effective registration statement. In the event the investors exercise the warrants on a cashless basis, the Company will not receive any proceeds therefrom. In addition, the exercise price of the warrants will be adjusted in the event the Company issues common stock at a price below market, with the exception of any securities issued as of the date of the warrants or issued in connection with the callable secured convertible notes issued pursuant to the securities purchase agreement.

The noteholders have agreed to restrict their ability to convert their convertible notes or exercise their warrants and receive shares of the Company's common stock such that the number of shares of common stock held by them in the aggregate and their affiliates after such conversion or exercise does not exceed 4.99% of the then issued and outstanding shares of common stock. However, the noteholders may repeatedly sell shares of common stock in order to reduce their ownership percentage, and subsequently convert additional convertible notes.

The due date of the convertible note is June 30, 2008, and the note is currently in default. The amount of the note is classified as a current liability on the balance sheet in the Company's financial statements.

As of December 31, 2008, there was an outstanding balance of $1,258,000 in principle and accrued interest on the convertible notes. During the years ended December 31, 2008 and 2007, the Company issued 9,709,938 and 2,830,172 shares of common stock for the conversion of $200,910 and $212,346 of the convertible notes, respectively.

February 28, 2006 Sale of $1,500,000 in Convertible Notes. To obtain additional funding for the Company's ongoing operations, the Company entered into a second securities purchase agreement on February 28, 2006 with the same four accredited investors for the sale of (i) $1,500,000 in convertible notes and (ii) warrants to purchase 120,000 shares of its common stock. The sale of the convertible notes and warrants is to occur in three traunches and the investors are obligated to provide the Company with an aggregate of $1,500,000 as follows:

- $500,000 was disbursed on February 28, 2006;
- $500,000 was disbursed on June 28, 2006 after the Company filed a registration statement on June 15, 2006 to register the shares of common stock underlying the convertible notes. The registration statement was subsequently withdrawn on July 25, 2006 and a new registration statement was filed on September 15, 2006 to register 600,000 shares of common stock issuable upon conversion of the notes.
- $500,000 was disbursed on April 30, 2007, the day prior to the effective date of the registration statement on May 1,2007.

Under the terms of the securities purchase agreement, the Company also agreed it would not, without the prior written consent of a majority-in-interest of the investors, negotiate or contract with any party to obtain additional equity financing (including debt financing with an equity component) that involves (i) the issuance of common stock at a discount to the market price of the common stock on the date of issuance (taking into account the value of any warrants or options to acquire common stock in connection therewith), (ii) the issuance of convertible securities that are convertible into an indeterminate number of shares of common stock, or (iii) the issuance of warrants during the lock-up period beginning February 28, 2006 and ending on the later of (a) 270 days from February 28, 2006, or (b) 180 days from the date the registration statement is declared effective.

In addition, the Company agreed not to conduct any equity financing (including debt financing with an equity component) during the period beginning February 28, 2006 and ending two years after the end of the above lock-up period unless it first provided each investor an option to purchase its pro rata share (based on the ratio of each investor's purchase under the securities purchase agreement) of the securities being offered in any proposed equity financing. Each investor must be provided written notice describing any proposed equity financing at least 20 business days prior to the closing of such proposed equity financing and the option must be extended to each investor during the 15-day period following delivery of such notice.

The $1,500,000 in convertible notes bear interest at 8% per annum from the date of issuance. Interest is computed on the basis of a 365-day year and is payable quarterly in cash, with six months of interest payable up front. The interest rate resets to zero percent for any month in which the stock price is greater than 125% of the initial market price, or $2.75, for each trading day during that month. Any amount of principal or interest on the convertible notes that is not paid when due will bear interest at the rate of 15% per annum from the date due thereof until such amount is paid. The notes mature in three years from the date of issuance, and are convertible into the Company's common stock at the noteholders' option, at the lower of (i) $2.00 or (ii) 60% of the average of the three lowest intraday trading prices for the common stock on the OTC Bulletin Board for the 20 trading days before but not including the conversion date. Accordingly, there is no limit on the number of shares into which the notes may be converted.

The convertible notes are secured by the Company's assets, including the Company's inventory, accounts receivable and intellectual property. Moreover, the Company has a call option under the terms of the notes. The call option provides the Company with the right to prepay all of the outstanding convertible notes at any time, provided there is no event of default by the Company and the Company's stock is trading at or below $2.00 per share. An event of default includes the failure by the Company to pay the principal or interest on the notes when due or to timely file a registration statement as required by the Company or obtain effectiveness with the Securities and Exchange Commission of the registration statement. Prepayment of the notes is to be made in cash equal to either (a) 125% of the outstanding principal and accrued interest for prepayments occurring within 30 days following the issue date of the notes; (b) 130% of the outstanding principal and accrued interest for prepayments occurring between 31 and 60 days following the issue date of the notes; or (c) 145% of the outstanding principal and accrued interest for prepayments occurring after the 60th day following the issue date of the notes.

The warrants are exercisable until five years from the date of issuance at a purchase price of $1.00 per share. The investors may exercise the warrants on a cashless basis if the shares of common stock underlying the warrants are not

registered pursuant to an effective registration statement. In the event the investors exercise the warrants on a cashless basis, then the Company will not receive any proceeds therefrom. In addition, the exercise price of the warrants will be adjusted in the event the Company issues common stock at a price below market, with the exception of any securities issued as of the date of the warrants or issued in connection with the notes issued pursuant to the securities purchase agreement.

The noteholders have agreed to restrict their ability to convert their callable secured convertible notes or exercise their warrants and receive shares of the Company's common stock such that the number of shares of common stock held by them in the aggregate and their affiliates after such conversion or exercise does not exceed 4.99% of the then issued and outstanding shares of common stock. However, the noteholders may repeatedly sell shares of common stock in order to reduce their ownership percentage, and subsequently convert additional convertible notes.

Two of the three traunches relative to the note totaling $834,275 are due in 2009 and have been classified as a current liability on the balance sheet in the Company's financial statements.

As of December 31, 2008, there was an outstanding balance of $1,334,275 in principle and accrued interest on the convertible notes. During the year ended December 31, 2008 and 2007, the Company issued zero and 600,000 shares of common stock for the conversion of $0.00 and $167,000 of the convertible notes, respectively.

The Company received notice from the accredited investors holding the convertible notes dated February 28, 2006 and the convertible notes dated June 11, 2007, that on January 22, 2009, E-Lionheart, LLC and other third parties purchased $500,000 of the convertible notes dated February 28, 2006 and the $500,000 of convertible notes dated June 11, 2007. The total purchase price of these convertible notes was $1,514,444. Between February 18, 2009 and March 27, 2009, the third parties converted a total $454,147 of the February 28, 2006 convertible notes at conversion prices ranging from $.0009 to .00105 per share and received a total of 502,169,656 shares of the Company's common stock pursuant to said conversions. As of March 31, 2009, the Company had outstanding 517,901,422 shares of common stock.

June 11, 2007 Sale of $500,000 in Convertible Notes: To obtain further funding for the Company's ongoing operations, the Company entered into a third securities purchase agreement on June 11, 2007 with the same four accredited investors for the sale of (i) $500,000 in convertible notes and (ii) warrants to purchase 100,000 shares of its common stock. The investors disbursed $500,000 to the Company on June 11, 2007.

Under the terms of the June 11, 2007 securities purchase agreement, the Company agreed that it would not, without the prior written consent of a majority-in-interest of the investors, negotiate or contract with any party to obtain additional equity financing (including debt financing with an equity component) that involves (i) the issuance of common stock at a discount to the market price of the common stock on the date of issuance (taking into account the value of any warrants or options to acquire common stock in connection therewith), (ii) the issuance of convertible securities that are convertible into an indeterminate number of shares of common stock, or (iii) the issuance of warrants during the lock-up period beginning June 11, 2007 and ending on the later of (a) 270 days from June 11, 2007, or (b) 180 days from the date the registration statement is declared effective.

In addition, the Company agreed not to conduct any equity financing (including debt financing with an equity component) during the period beginning June 11, 2007 and ending two years after the end of the above lock-up period unless it first provided each investor an option to purchase its pro-rata share (based on the ratio of each investor's purchase under the securities purchase agreement) of the securities being offered in any proposed equity financing. Each investor must be provided written notice describing any proposed equity financing at least 20 business days prior to the closing of such proposed equity financing and the option must be extended to each investor during the 15-day period following delivery of such notice.

The $500,000 in convertible notes bear interest at 8% per annum from the date of issuance. Interest is computed on the basis of a 365-day year and is payable quarterly in cash, with six months of interest payable up front. The interest rate resets to zero percent for any month in which the stock price is greater than 125% of the initial market price, or $2.75, for each trading day during that month. Any amount of principal or interest on the callable secured convertible notes that is not paid when due will bear interest at the rate of 15% per annum from the date due thereof until such amount is paid. The convertible notes mature in three years from the date of issuance, and are convertible into the Company's common stock at the noteholders' option, at the lower of (i) $.02 or (ii) 50% of the average of the three lowest intraday trading prices for the common stock on the OTC Bulletin Board for the 20 trading days before but not including the conversion date. Accordingly, there is no limit on the number of shares into which the notes may be converted.

The convertible notes are secured by the Company's assets, including the Company's inventory, accounts receivable and intellectual property. Moreover, the Company has a call option under the terms of the notes. The call option provides the Company with the right to prepay all of the outstanding convertible notes at any time, provided there is no event of default by the Company and its stock is trading at or below $.10 per share. An event of default includes the failure by the Company to pay the principal or interest on the convertible notes when due or to timely file a registration statement as required by the Company or obtain effectiveness with the Securities and Exchange Commission of the registration statement. Prepayment of the convertible notes is to be made in cash equal to either (a) 125% of the outstanding principal and accrued interest for prepayments occurring within 30 days following the issue date of the notes; (b) 130% of the outstanding principal and accrued interest for prepayments occurring between 31 and60 days following the issue date of the notes; or (c) 145% of the outstanding principal and accrued interest for prepayments occurring after the 60th day following the issue date of the notes.

The warrants are exercisable until seven years from the date of issuance at a purchase price of $.50 per share. The investors may exercise the warrants on a cashless basis if the shares of common stock underlying the warrants are not then registered pursuant to an effective registration statement. In the event the investors exercise the warrants on a cashless basis, the Company will not receive any proceeds therefrom. In addition, the exercise price of the warrants will be adjusted in the event the Company issues common stock at a price below market, with the exception of any securities issued as of the date of the warrants or issued in connection with the convertible notes issued pursuant to the securities purchase agreement.

The noteholders have agreed to restrict their ability to convert their convertible notes or exercise their warrants and receive shares of the Company's common stock such that the number of shares of common stock held by them in the aggregate and their affiliates after such conversion or exercise does not exceed 4.99% of the then issued and outstanding shares of common stock. However, the noteholders may repeatedly sell shares of common stock in order to reduce their ownership percentage, and subsequently convert additional convertible notes, provided, however, that such conversions do not exceed $75,000 per calendar month, or the average daily dollar volume calculated during the ten business days prior to conversion multiplied by the number of trading days of that calendar month, per calendar month.

The Company is required to register the shares of its common stock issuable upon the conversion of the convertible notes and the exercise of the warrants that were issued to the noteholders pursuant to the securities purchase agreement the Company entered in to on June 11, 2007. The registration statement must be filed with the Securities and Exchange Commission within 60 days of the June 11, 2007 closing date and the effectiveness of the registration is to be within 135days of such closing date. Penalties of 2% of the outstanding principal balance of the convertible notes plus accrued interest are to be applied for each month the registration is not effective within the required time. The penalty may be paid in cash or stock at the Company's option.

As of December 31, 2008, there have been no conversions of these convertible notes. Upon conversion of the convertible notes, the Company extinguishes the convertible debt and related embedded derivatives and no gain or loss is recorded on the Company's statements of operations as a result of said conversion.

The Company received notice from the accredited investors holding the convertible notes dated February 28, 2006 and the convertible notes dated June 11, 2007, that on January 22, 2009, E-Lionheart, LLC and other third parties purchased $500,000 of the convertible notes dated February 28, 2006 and the $500,000 of convertible notes dated June 11, 2007. The total purchase price of these convertible notes was $1,514,444.

December 19, 2007 Issuance of $389,010 in Convertible Notes: On December 19, 2007, the Company was notified by the holders of the convertible notes that there was a past due interest owing on the outstanding convertible notes. The total amount of interest owed was.$389,010. To pay this interest, the noteholders were willing to accept $389,010 in additional convertible notes due on December 31, 2010. Accordingly, on December 19, 2007, the Company issued $389,010 in convertible notes to the noteholders as full payment of the past due interest.

The $389,010 in convertible notes bear interest at 2% per annum from December 31, 2007. Interest is computed on the basis of a 365-day year and is payable quarterly in cash, with six months of interest payable up front. The interest rate resets to zero percent for any month in which the stock price is greater than 125% of the initial market price, or $2.75, for each trading day during that month. Any amount of principal or interest on the callable secured convertible notes that is not paid when due will bear interest at the rate of 15% per annum from the date due thereof until such amount is paid. The convertible notes mature on December 31, 2010, and are convertible into the Company's common stock at the noteholders' option, at the lower of (i) $2.00 or (ii) 50% of the average of the three lowest intraday trading

prices for the common stock on the OTC Bulletin Board for the 20 trading days before but not including the conversion date. Accordingly, there is no limit on the number of shares into which the notes may be converted.

The convertible notes have a call option under the terms of the notes. The call option provides the Company with the right to prepay all of the outstanding convertible notes at any time, provided there is no event of default by the Company and its stock is trading at or below $4.00 per share. An event of default includes the failure by the Company to pay the principal or interest on the convertible notes when due. Prepayment of the convertible notes is to be made in cash equal to either (a) 135% of the outstanding principal and accrued interest for prepayments occurring within 30 days following the issue date of the notes; (b) 145% of the outstanding principal and accrued interest for prepayments occurring between 31 and 60 days following the issue date of the notes; or (c) 150% of the outstanding principal and accrued interest for prepayments occurring after the 60th day following the issue date of the notes.

The noteholders have agreed to restrict their ability to convert their convertible notes and receive shares of the Company's common stock such that the number of shares of common stock held by them in the aggregate and their affiliates after such conversion does not exceed 4.9% of the then issued and outstanding shares of common stock. However, the noteholders may repeatedly sell shares of common stock in order to reduce their ownership percentage, and subsequently convert additional convertible notes, provided, however, that such conversions do not exceed the average daily dollar volume calculated during the ten business days prior to conversion multiplied by the number of trading days of that calendar month, per calendar month.

As of December 31, 2008, there have been no conversions of these convertible notes. Upon conversion of the convertible notes, the Company extinguishes the convertible debt and related embedded derivatives and no gain or loss is recorded on the Company's statements of operations as a result of said conversion.

December 24, 2007 Sale of $250,000 in Convertible Notes: To obtain further funding for the Company's ongoing operations, the Company entered into a fourth securities purchase agreement on December 24, 2007 with the same four accredited investors for the sale of (i) $250,000 in callable secured convertible notes and (ii) warrants to purchase 150,000 shares of its common stock. The investors disbursed $250,000 to the Company on December 24, 2007.

Under the terms of the December 24, 2007 securities purchase agreement, the Company agreed that it would not, without the prior written consent of a majority-in-interest of the investors, negotiate or contract with any party to obtain additional equity financing (including debt financing with an equity component) that involves (i) the issuance of common stock at a discount to the market price of the common stock on the date of issuance (taking into account the value of any warrants or options to acquire common stock in connection therewith), (ii) the issuance of convertible securities that are convertible into an indeterminate number of shares of common stock, or (iii) the issuance of warrants during the lock-up period beginning December 24, 2007 and ending on the later of (a) 270 days from December 24, 2007, or (b) 180 days from the date the registration statement is declared effective.

In addition, the Company agreed not to conduct any equity financing (including debt financing with an equity component) during the period beginning December24, 2007 and ending two years after the end of the above lock-up period unless it first provided each investor an option to purchase its pro-rata share (based on the ratio of each investor's purchase under the securities purchase agreement) of the securities being offered in any proposed equity financing. Each investor must be provided written notice describing any proposed equity financing at least 20 business days prior to the closing of such proposed equity financing and the option must be extended to each investor during the 15-day period following delivery of such notice.

The $250,000 in convertible notes bear interest at 8% per annum from the date of issuance. Interest is computed on the basis of a 365-day year and is payable quarterly in cash, with six months of interest payable up front. The interest rate resets to zero percent for any month in which the stock price is greater than 125% of the initial market price, or $2.75, for each trading day during that month. Any amount of principal or interest on the callable secured convertible notes that is not paid when due will bear interest at the rate of 15% per annum from the date due thereof until such amount is paid. The convertible notes mature in three years from the date of issuance, and are convertible into the Company's common stock at the noteholders' option, at the lower of (i) $2.00 or (ii) 50% of the average of the three lowest intraday trading prices for the common stock on the OTC Bulletin Board for the 20 trading days before but not including the conversion date. Accordingly, there is no limit on the number of shares into which the notes may be converted.

The convertible notes are secured by the Company's assets, including the Company's inventory, accounts receivable and intellectual property. Moreover, the Company has a call option under the terms of the notes. The call option provides the Company with the right to prepay all of the outstanding convertible notes at any time, provided there is no event of default by the Company and its stock is trading at or below $10.00 per share. An event of default includes the failure by the Company to pay the principal or interest on the convertible notes when due or to timely file a registration statement as required by the Company or obtain effectiveness with the Securities and Exchange Commission of the registration statement. Prepayment of the convertible notes is to be made in cash equal to either (a) 125% of the outstanding principal and accrued interest for prepayments occurring within 30 days following the issue date of the notes; (b) 130% of the outstanding principal and accrued interest for prepayments occurring between 31 and 60 days following the issue date of the notes; or (c) 145% of the outstanding principal and accrued interest for prepayments occurring after the 60th day following the issue date of the notes.

The warrants are exercisable until seven years from the date of issuance at a purchase price of $.10 per share. The investors may exercise the warrants on a cashless basis if the shares of common stock underlying the warrants are not then registered pursuant to an effective registration statement. In the event the investors exercise the warrants on a cashless basis, the Company will not receive any proceeds therefrom. In addition, the exercise price of the warrants will be adjusted in the event the Company issues common stock at a price below market, with the exception of any securities issued as of the date of the warrants or issued in connection with the convertible notes issued pursuant to the securities purchase agreement.

The noteholders have agreed to restrict their ability to convert their convertible notes or exercise their warrants and receive shares of the Company's common stock such that the number of shares of common stock held by them in the aggregate and their affiliates after such conversion or exercise does not exceed 4.99% of the then issued and outstanding shares of common stock. However, the noteholders may repeatedly sell shares of common stock in order to reduce their ownership percentage, and subsequently convert additional convertible notes, provided, however, that such conversions do not exceed $75,000 per calendar month, or the average daily dollar volume calculated during the ten business days prior to conversion multiplied by the number of trading days of that calendar month, per calendar month.

The Company is required to register the shares of its common stock issuable upon the conversion of the convertible notes and the exercise of the warrants that were issued to the noteholders pursuant to the securities purchase agreement the Company entered in to on December 24, 2007. The registration statement must be filed with the Securities and Exchange Commission within 60 days of the December 24, 2007 closing date and the effectiveness of the registration is to be within 135 days of such closing date. Penalties of 2% of the outstanding principal balance of the convertible notes plus accrued interest are to be applied for each month the registration is not effective within the required time. The penalty may be paid in cash or stock at the Company's option.

As of December 31, 2008, there have been no conversions of these convertible notes. Upon conversion of the convertible notes, the Company extinguishes the convertible debt and related embedded derivatives and no gain or loss is recorded on the Company's statements of operations as a result of said conversion.

June 16, 2008 Sale of $310,000 in Convertible Notes: To obtain additional funding for the Company's ongoing operations, the Company entered into a fifth securities purchase agreement on June 16, 2008 with three accredited investors for the sale of (i) $310,000 in convertible notes and (ii) warrants to purchase 100,000 shares of its common stock. The sale of the convertible notes and warrants is to occur in three traunches and the investors are obligated to provide the Company with an aggregate of $310,000 as follows:

- $110,000 were disbursed on June 16, 2008;
- $100,000 were disbursed on July 14, 2008 after the Company filed a Schedule 14A preliminary proxy statement for a reverse stock split with the Securities and Exchange Commission; and
- $100,000 was disbursed on January 20, 2009.

Under the terms of the June 16, 2008 securities purchase agreement, the Company agreed that it would not, without the prior written consent of a majority-in-interest of the investors, negotiate or contract with any party to obtain additional equity financing (including debt financing with an equity component) that involves (i) the issuance of common stock at a discount to the market price of the common stock on the date of issuance (taking into account the value of any warrants or options to acquire common stock in connection therewith), (ii) the issuance of convertible securities that are convertible into an indeterminate number of shares of common stock, or (iii) the issuance of warrants during the lock-up period beginning June 16, 2008 and ending on the later of (a) 270 days from June 16, 2008, or (b) 180 days from the date the registration statement is declared effective.

In addition, the Company agreed not to conduct any equity financing (including debt financing with an equity component) during the period beginning June 16, 2008 and ending two years after the end of the above lock-up period unless it first provided each investor an option to purchase its pro-rata share (based on the ratio of each investor's purchase under the securities purchase agreement) of the securities being offered in any proposed equity financing. Each investor must be provided written notice describing any proposed equity financing at least 20 business days prior to the closing of such proposed equity financing and the option must be extended to each investor

during the 15-day period following delivery of such notice.

The $310,000 in convertible notes bear interest at 8% per annum from the date of issuance. Interest is computed on the basis of a 365-day year and is payable quarterly in cash, with six months of interest payable up front. The interest rate resets to zero percent for any month in which the stock price is greater than 125% of the initial market price, or $2.75, for each trading day during that month. Any amount of principal or interest on the callable secured convertible notes that is not paid when due will bear interest at the rate of 15% per annum from the date due thereof until such amount is paid. The convertible notes mature in three years from the date of issuance, and are convertible into the Company's common stock at the noteholders' option, at the lower of (i) $2.00 or (ii) 45% of the average of the three lowest intraday trading prices for the common stock on the OTC Bulletin Board for the 20 trading days before but not including the conversion date. Accordingly, there is no limit on the number of shares into which the notes may be converted.

The convertible notes are secured by the Company's assets, including the Company's inventory, accounts receivable and intellectual property. Moreover, the Company has a call option under the terms of the notes. The call option provides the Company with the right to prepay all of the outstanding convertible notes at any time, provided there is no event of default by the Company and its stock is trading at or below $2.00 per share. An event of default includes the failure by the Company to pay the principal or interest on the convertible notes when due or to timely file a registration statement as required by the Company or obtain effectiveness with the Securities and Exchange Commission of the registration statement. Prepayment of the convertible notes is to be made in cash equal to either (a) 125% of the outstanding principal and accrued interest for prepayments occurring within 30 days following the issue date of the notes; (b) 130% of the outstanding principal and accrued interest for prepayments occurring between 31 and 60 days following the issue date of the notes; or (c) 145% of the outstanding principal and accrued interest for prepayments occurring after the 60th day following the issue date of the notes.

The warrants are exercisable until seven years from the date of issuance at a purchase price of $.10 per share. The investors may exercise the warrants on a cashless basis if the shares of common stock underlying the warrants are not then registered pursuant to an effective registration statement. In the event the investors exercise the warrants on a cashless basis, the Company will not receive any proceeds therefrom. In addition, the exercise price of the warrants will be adjusted in the event the Company issues common stock at a price below market, with the exception of any securities issued as of the date of the warrants or issued in connection with the convertible notes issued pursuant to the securities purchase agreement.

The noteholders have agreed to restrict their ability to convert their convertible notes or exercise their warrants and receive shares of the Company's common stock such that the number of shares of common stock held by them in the aggregate and their affiliates after such conversion or exercise does not exceed 4.99% of the then issued and outstanding shares of common stock. However, the noteholders may repeatedly sell shares of common stock in order to reduce their ownership percentage, and subsequently convert additional convertible notes, provided, however, that such conversions do not exceed $75,000 per calendar month, or the average daily dollar volume calculated during the ten business days prior to conversion multiplied by the number of trading days of that calendar month, per calendar month.

The Company is required to register the shares of its common stock issuable upon the conversion of the convertible notes and the exercise of the warrants that were issued to the noteholders pursuant to the securities purchase agreement the Company entered in to on June 16, 2008. The registration statement must be filed with the Securities and Exchange Commission within 60 days of the June 16, 2008 closing date and the effectiveness of the registration is to be within 135 days of such closing date. Penalties of 2% of the outstanding principal balance of the convertible notes plus accrued interest are to be applied for each month the registration is not effective within the required time. The penalty may be paid in cash or stock at the Company's option.

As of December 31, 2008, there have been no conversions of these convertible notes. Upon conversion of the convertible notes, the Company extinguishes the convertible debt and related embedded derivatives and no gain or loss is recorded on the Company's statements of operations as a result of said conversion.

August 29, 2008 Issuance of $191,913 in Convertible Notes: On August 29, 2008, the Company was notified by the holders of the convertible notes that there was a past due interest owing on the outstanding convertible notes. The total amount of interest owed was $191,913. To pay this interest, the noteholders were willing to accept $191,913 in additional convertible notes due on August 29, 2011. Accordingly, on August 29, 2008, the Company issued $191,913 in convertible notes to the noteholders as full payment of the past due interest.

The $191,913 in convertible notes bear interest at 2% per annum from August 29, 2008. Interest is computed on the basis of a 365-day year and is payable quarterly in cash. Any amount of principal or interest on the callable secured convertible notes that is not paid when due will bear interest at the rate of 15% per annum from the date due thereof until such amount is paid. The convertible notes mature on August 29, 2011, and are convertible into the Company's common stock at the noteholders' option, at the lower of (i) $2.00 or (ii) 45% of the average of the three lowest intraday trading prices for the common stock on the OTC Bulletin Board for the 20 trading days before but not including the conversion date. Accordingly, there is no limit on the number of shares into which the notes may be converted.

The convertible notes have a call option under the terms of the notes. The call option provides the Company with the right to prepay all of the outstanding convertible notes at any time, provided there is no event of default by the Company and its stock is trading at or below $.43 per share. An event of default includes the failure by the Company to pay the principal or interest on the convertible notes when due. Prepayment of the convertible notes is to be made in cash equal to either (a) 135% of the outstanding principal and accrued interest for prepayments occurring within 30 days following the issue date of the notes; (b) 145% of the outstanding principal and accrued interest for prepayments occurring between 31 and 90 days following the issue date of the notes; or (c) 150% of the outstanding principal and accrued interest for prepayments occurring after the 90th day following the issue date of the notes.

The noteholders have agreed to restrict their ability to convert their convertible notes and receive shares of the Company's common stock such that the number of shares of common stock held by them in the aggregate and their affiliates after such conversion does not exceed 4.9% of the then issued and outstanding shares of common stock. However, the noteholders may repeatedly sell shares of common stock in order to reduce their ownership percentage, and subsequently convert additional convertible notes, provided, however, that such conversions do not exceed the average daily dollar volume calculated during the ten business days prior to conversion multiplied by the number of trading days of that calendar month, per calendar month.

As of December 31, 2008, there have been no conversions of these convertible notes. Upon conversion of the convertible notes, the Company extinguishes the convertible debt and related embedded derivatives and no gain or loss is recorded on the Company's statements of operations as a result of said conversion.

The convertible notes include certain features that are considered embedded derivative financial instruments. These features are described as follows:

- The fixed conversion feature that allows the investor to convert the notes at a fixed price per share;
- The variable conversion feature that allows the investor to convert the notes at a specified percentage of the market price at the time of conversion;
- The variable interest rate provision that calls for no interest to be paid if the stock price exceeds a predetermined amount for a given number of months; and
- The value of the warrants issued in conjunction with each funding.

The initial fair value assigned to the embedded derivatives and warrants was $4,169,000, which consisted of the fair value of the embedded derivatives of $2,588,000 and the fair value of the warrants of $1,582,000. The Company recorded the first $2,500,000 of fair value of the derivatives and warrants to debt discount (equal to the total proceeds received as of June 30, 2005), which will be amortized to interest expense over the term of the notes. The remaining balance of $1,669,000 was recorded as loss of derivative valuation for the period ended June 30, 2005.

As of December 31, 2005, the carrying amount on the notes was $340,000, net of the unamortized debt discount of $1,698,000. Interest expense on the notes totaled $739,000 for the period ended December 31, 2005, which consisted of $369,000 of normal accretion of the note discount and $370,000 of accrued interest on the outstanding note balance for the period. The fair value of the embedded derivatives and warrants decreased to $195,000 during the year ended December 31, 2005, which consisted of a fair value of the embedded derivatives of $137,000 and the fair value of the warrants of $58,000. The corresponding decrease in derivative value was reflected as a gain on derivative valuation on the statements of operations in the amount of $3,975,000.

During 2006, the Company entered into another securities purchase agreement in the amount $1,000,000. The initial fair value assigned to the embedded derivatives and warrants was $541,000 for this note, which consisted of the fair value of the embedded derivatives of $464,000 and the fair value of the warrants of $77,000. The Company recorded the $541,000 of fair value of the derivatives and warrants to debt discount, which will be amortized to interest expense over the term of the notes.

As of December 31, 2006, the carrying amount on the notes was $1,421,000, net of the unamortized debt discount of $1,235,000. Interest expense on the notes totaled $935,000 for the period ended December 31, 2006, which consisted of $721,000 of normal accretion of the note discount and $214,000 of accrued interest on the outstanding note balance for the period. The fair value of the embedded derivatives and warrants decreased by a total of $536,000 during the year ended December 31, 2006, which consisted of a decrease in the fair value of the embedded derivatives of $451,000 and the fair value of the warrants of $85,000. Accordingly, the Company recorded a gain on derivative

valuation to the statement of operations of $536,000 for the year ended December 31, 2006.

During 2007, the Company entered into four securities purchase agreements in the aggregate amount of $1,639,000. The initial fair value assigned to the embedded derivatives and warrants was $466,000 for these notes, which consisted of the fair value of the embedded derivatives of $344,000 and the fair value of the warrants of $122,000. The Company recorded $466,000 of fair value of the derivatives and warrants to debt discount, which will be amortized to interest expense over the term of the notes.

At December 31, 2007, the carrying amount on the notes was $3,100,000, net of the unamortized debt discount of $828,000. Interest expense on the notes totaled $992,000 for the period ended December 31, 2007, which consisted of $771,000 of normal accretion of the note discount and $221,000 of accrued interest on the outstanding note balance for the period. The fair value of the embedded derivatives and warrants decreased by a total of $413,000 during the year ended December 31, 2007, which consisted of a decrease in the fair value of the embedded derivatives of $391,000 and the fair value of the warrants of $22,000. Accordingly, the Company recorded a gain on derivative valuation to the statement of operations of $413,000 for the year ended December 31, 2007.

At December 31, 2008, the carrying amount on the notes was $3,854,000, net of the unamortized debt discount of $278,000. Interest expense on the notes totaled $827,000 for the period ended December 31, 2008, which consisted of $515,000 of normal accretion of the note discount and $312,000 of accrued interest on the outstanding note balance for the period. The fair value of the embedded derivatives and warrants decreased by a total of $207,000 during the twelve months ended December 31, 2008, which consisted of a decrease in the fair value of the embedded derivatives of $139,000 and the fair value of the warrants of $68,000. Accordingly, the Company recorded a gain on derivative valuation to the statement of operations of $207,000 for the twelve months ended December 31, 2008.

The market price of the Company’s common stock significantly impacts the extent to which the Company may be required or may be permitted to convert the unrestricted and restricted portion of the notes into shares of the Company's common stock. The lower the market price of the Company's common stock at the respective times of conversion, the more shares the Company will need to issue to convert the principal and interest payments then due on the notes. If the market price of the Company's common stock falls below certain thresholds, the Company will be unable to convert any such repayments of principal and interest into equity, and the Company will be forced to make such repayments in cash. The Company's operations could be materially impacted, in an adverse way, if the Company is forced to make repeated cash payments on the notes.

Simple Conversion Calculation

The number of shares of common stock issuable upon conversion of the convertible notes issued on April 27, 2005, February 28, 2006, June 11, 2007, December 19, 2007, December 23, 2007, and June 16, 2008 is determined by dividing that portion of the principal of the notes to be converted and interest by the conversion price. For example, assuming conversion of $4,132,665 principal amount of the convertible notes on December 31, 2008 (consisting of $5,060,000 in convertible notes that were sold to the four investors pursuant to securities purchase agreements dated April 27, 2005, February 28, 2006, June 11, 2007, December 24, 2007, and June 16, 2008, plus $389,010 in convertible notes issued on December 19, 2007, and $191,913 in convertible notes issued on August 29, 2008, in payment of past due interest on the notes, less $1,422,587 in notes converted during the period from June 12, 2005 to December 31, 2008) and a conversion price of $.0095 per share with a 55% discount, the number of shares issuable upon conversion would be:

$4,132,665/$.0095 x 45% = 966,705,263 shares.

The Company's obligation to issue shares upon conversion of the convertible notes issued on April 27, 2005, February 28, 2006, June 11, 2007, December 19, 2007, December 24, 2007, June 16, 2008, and August 29, 2008 is essentially limitless. The following is an example of the amount of shares of common stock that are issuable upon conversion of $4,132,665 principal amount of the convertible notes (including accrued interest), based on market prices 25%, 50%, and 75% below the market price, as of December 31, 2008 of $.0095 with a 55% discount:

% Below Market	Price Per Share	With 55% Discount	Number of Shares Issuable	% of Outstanding Shares*
25%	.007125	.003206	1,289,040,800	8,503%
50%	.00475	.002138	1,932,958,300	12,750%
75%	.002375	.001069	3,865,916,700	25,501%

*Based on 15,159,807 shares outstanding.

As illustrated, the number of shares of common stock issuable upon conversion of the Company's convertible notes will increase if the market price of the Company's common stock declines, which will cause dilution to existing stockholders.

Adjustable Conversion Price of Convertible Notes

The convertible notes are convertible into shares of the Company's common stock at a 40% discount to the trading price of the common stock prior to the conversion. The significant downward pressure on the price of the common stock as the noteholders convert and sell material amounts of common stock could encourage short sales by investors. This could place further downward pressure on the price of the common stock. The noteholders could sell common stock into the market in anticipation of covering the short sale by converting their securities, which could cause further downward pressure on the stock price. In addition, not only the sale of shares issued upon conversion or exercise of notes, warrants and options, but also the mere perception that these sales could occur, may have a depressive effect on the market price of the common stock.

Possible Dilution to Stockholders

The issuance of shares upon conversion of convertible notes and exercise of warrants may result in substantial dissolution to the interests of other stockholders since the holders of the convertible notes may ultimately convert and sell the full amount issuable upon conversion. Although the noteholders may not convert their callable secured convertible notes and/or exercise their warrants if such conversion or exercise price would cause them to own more than 4.99% of the Company's outstanding common stock, this restriction does not prevent the noteholders from converting and/or exercising some of their holdings and then converting the rest of their holdings. In this way, the noteholders could sell more than this limit while never holding more than this limit. There is no upper limit on the number of shares that may be issued, which will have the effect of further diluting the proportionate equity interest and voting power of holders of the Company's common stock.

Failure to Repay Convertible Notes May Require Company Operations to Cease

On April 27, 2005, the Company entered into a securities purchase agreement for the sale of an aggregate of $2,500,000 principal amount of convertible notes. On February 28, 2006, the Company entered into a second securities purchase agreement for the sale of an aggregate of $1,500,000 principal amount of convertible notes. On June 11, 2007, December 24, 2007, and June 16, 2008 the Company entered into third, fourth and fifth securities purchase agreements for the sale of an aggregate of $1,160,000 principal amount of convertible notes. On December 19, 2007, the Company issued an additional $389,010 in convertible notes and, on August 29, 2008, the Company issued an additional $191,913 in convertible notes as payment of past due interest owing on the outstanding convertible notes. These convertible notes are all due and payable, with 8% interest, three years from the date of issuance, unless sooner converted into shares of the Company's common stock. Any event of default such as the Company's failure to repay the principal or interest when due on the notes, the Company's failure to issue shares of common stock upon conversion by the noteholders, the Company's breach of any covenant, representation or

Warranty in the securities purchase agreement or related convertible notes, the assignment or appointment of a receiver to control a substantial part of the Company's property or business, the filing of a money judgment, writ or similar process against the Company in excess of $50,000, the commencement of a bankruptcy, insolvency, reorganization or liquidation proceeding against the Company, and the delisting of the Company's common stock could require the early repayment of the convertible notes, including a default interest rate of 15% on the outstanding principal balance of the notes if the default is not cured within the specified grace period.

The Company anticipates that the full amount of convertible notes will be converted into shares of its common stock, in accordance with the terms of the convertible notes. If the Company is required to repay the convertible notes, it would be required to use its limited working capital and raise additional funds. If the Company were unable to repay the notes when required, the noteholders could commence legal action against the Company and foreclose on all of its assets to recover the amounts due. Any such action would require the Company to curtail or cease operations.

Results of Operations

Fiscal Year Ended December 31, 2008 Compared to Fiscal Year Ended December 31, 2007

Net sales for the twelve months ended December 31, 2008 decreased by $613,000 to $1,259,000, or 33%, as compared to $1,872,000 for the same period of 2007. This reduction in sales was primarily due to decreased sales of the P40, P45 and P60 Ultrasound Biomicroscopes, the Blood Flow Analyzer™, the P37-II, P2700 and P3700 A/B Scan Ocular Ultrasound Diagnostic, and the LD400 and TKS 500 autoperimeters.

For the twelve months ended December 31, 2008, sales from the Company's diagnostic products totaled $1,079,000, or 86% of total revenues, compared to $1,707,000, or 91% of total revenues for the same period of 2007. The remaining 14% of sales, or $180,000 during the twelve months ended December 31, 2008 was from parts, disposables, and service revenue. Sales of the Glaid device, or Perg, were $197,000, or 16%, during the twelve months ended December 31, 2008 compared to no sales for the same period in 2007. Sales of the P40, P45 and P60 UBM Ultrasound Biomicroscopes decreased to $258,000 during the twelve months ended December 31, 2008, or 20% of total revenues for the period, compared to $513,000, or 27% of total revenues, for the same period last year. Sales of the Blood Flow AnalyzerTM decreased by $199,000 to $58,000, or 5% of total revenues, for the twelve months ended December 31, 2008, compared to net sales of $257,000, or 14% of total revenues during the same period in 2007. Sales from the P37-II, P2700 and P3700 A/B Scan Ocular Ultrasound Diagnostic decreased to $227,000, or 18% of total revenues, for the twelve month period ended December 31, 2008, up compared to $432,000, or 23% of total revenues, for the same period last year. Combined sales of the LD 400 and TKS 5000 autoperimeters and the CT 200 Corneal Topographer were $296,000, or 23% of the total revenues, for the twelve months ended December 31, 2008, compared to $512,000, or 27% of total revenues, for the same period of 2007.

Sales of the Blood Flow AnalyzerTM decreased due in part from the reorganization of the Company's sales force. The Company anticipates continuing the upward trend in Blood Flow AnalyzerTM sales through additional efforts by the Company to gain more wide spread support from the Blood Flow AnalyzerTM through increased clinical awareness, product development and improved marketing plans.

Sales of surgical products are at a standstill pending FDA approval of the PhotonTM laser system. In the twelve month period ended December 31, 2008, the Company realized no sales in the surgical line consisting of the PhotonTM laser system. There were also no sales in the surgical line for the comparable period of 2007.

Gross profit for the twelve months ended December 31, 2008 decreased to 44% of total revenues, compared to 46% of total revenues for the same period in 2007. This increase in gross profit in 2008 was mainly due to reductions in corporate expenditures due to improved operating efficiencies during the twelve months ending December 31, 2008. There was no increase to cost of sales as a result of a charge to the reserve for obsolete inventory in 2007.

Marketing and selling expenses decreased by $162,000, or 24%, to $500,000 for the twelve months ended December 31, 2008, from $662,000 for the comparable period in 2007. This decrease was due primarily a reduced number of sales representatives and higher travel related and associated sales expenses.

General and administrative expenses decreased by $90,000, or 9%, to $922,000 for the twelve months ended December 31, 2008, from $1,012,000 for the comparable period in 2007. Commission expenses decreased by $13,000 from $88,000 in 2007 to $75,000 in 2008 due to a reduced amount of the Company's diagnostic products sold in 2008 compared to 2007. The bad debt allowance decreased by $34,000 from $109,000 in 2007 to $75,000 in 2008 due to an decreased amount of the Company's accounts receivable over 90 days during 2008 as compared to 2007.

Also during 2008, the Company collected $36,000 in receivables that were previously allowed in the allowance for doubtful accounts.

Research, development and service expenses decreased by $89,000, or 26%, to $255,000 for the twelve months ended December 31, 2008, compared to $344,000 for the same period of 2007. This decrease was mainly due to the decreased expenses in 2007 for the development of the new software package for the P60 UBM.

Liquidity and Capital Resources

The Company used $504,000 in cash in operating activities for the twelve months ended December 31, 2008, compared to $1,135,000 for the twelve months ended December 31, 2007. The decrease in cash used for operating activities for the twelve months ended December 31, 2008 was primarily attributable to the Company's net loss, decreases in accounts receivable, and a significant decrease of the change of the fair value of derivative liabilities and accretion of debt discount. There was no cash used for investment activities for the twelve months ended December 31, 2008, compared to no cash used for investment activities for the same period in 2007. Net cash provided by financing activities was $210,000 for the twelve months ended December 31, 2008, compared to net cash used of $1,250,000 in the same period in 2007. The Company had working capital deficit of $2,296,000 as of December 31, 2008. In the past, the Company has relied heavily upon sales of the Company's common and preferred stock to fund operations. There can be no assurance that such equity funding will be available on terms acceptable to the Company in the future.

As of December 31, 2008, the Company had net operating loss carryforwards (NOLs) of approximately $56 million. These loss carryforwards are available to offset future taxable income, if any, and have begun to expire in 2006 and extend through 2028. The Company's ability to use net operating loss carryforwards (NOLs) to offset future income is dependent upon certain limitations as a result of the pooling transaction with Vismed and the tax laws in effect at the time of the NOLs being 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 change of ownership.

As of December 31, 2008, the Company had accounts payable of $594,000, a significant portion of which was over 90 days past due. The Company has contacted many of the vendors or companies that have significant amounts of payables past due in an effort to delay payment, renegotiate a reduced settlement payment, or establish a longer term payment plan. While some companies have been willing to renegotiate the outstanding amounts, others have demanded payment in full. Under certain conditions, including but not limited to judgments rendered against the Company in a court of law, a group of creditors could force the Company into bankruptcy due to its inability to pay the liabilities arising out of such judgments at that time. In addition to the accounts payable noted above, the Company also has noncancelable capital lease obligations and operating lease obligations that required the payment of $110,000 in 2008 and $108,000 in 2007. The Company leases its office and warehouse space on a month to month basis.

The Company has taken numerous steps to reduce costs and increase operating efficiencies. These steps consist of the following:

1. The Company closed its San Diego facility. In so doing, numerous manufacturing, accounting and management responsibilities were consolidated. In addition, such closure resulted in significant head count reductions as well as savings in rent and other overhead costs.

2. The Company has reduced the size of its manufacturing facility and corporate office in Salt Lake City. In doing so, management responsibilities were consolidated. Such reduction in space resulted in a reduction in the number of employees, as well as savings in rent and other overhead expenses.

3. The Company has significantly reduced the use of consultants, which has resulted in a large decrease to these expenses.

4. The Company has reduced its direct sales force to two representatives, which has resulted in less payroll, travel and other selling expenses.

Because the Company has significantly fewer sales representatives, its ability to generate sales has been reduced.

The Company has 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 27% of total outstanding receivables as of December 31, 2008 and 15% as of December 31, 2007. The allowance for doubtful accounts decreased from $109,000 at December 31, 2007 to $75,000 at December 31, 2008.

The Company intends to continue its efforts to reduce the allowance for doubtful accounts as a percentage of accounts receivable. The Company has ongoing efforts to collect a significant portion of the sales price in advance of the sale or in a timely manner after delivery. During the twelve months ended December 31, 2008, the Company added a net recovery of receivables previously allowed of $36,000, and during the twelve months ended December 31, 2007, the Company had a net recovery of receivable previously allowed of $22,000. The Company believes that by requiring a large portion of payment prior to shipment, it has greatly improved the collectibility of its receivables.

The Company carried an allowance for obsolete or estimated non-recoverable inventory of $231,000 at December 31, 2008 and $244,000 at December 31, 2007, or 26% and 22% of total inventory, respectively. The Company's 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, the Company has acquired substantial inventory, some of which the eventual use and recoverability was uncertain. On December 31, 2008, the Company disposed of $13,000 in obsolete inventory, which had been previously reserved.

On a quarterly basis, the Company attempts to identify inventory items that have shown relatively no movement or very slow movement. Generally, if an item has shown little or no movement for over a year, it is determined not to be recoverable and a reserve is established for that item. In addition, if the Company identifies products that have become obsolete due to product upgrades or enhancements, a reserve is established for such products. The Company intends to make efforts to sell these items at significantly discounted prices. If items are sold, the cash received would be recorded as revenue, but there would be no cost of sales on such items due to the reserve that has been recorded. At the time of sale, the inventory would be reduced for the item sold and the corresponding inventory reserve would also be reduced.

At this time, the Company's Photon™ Laser Ocular Surgery Workstation requires regulatory FDA approval in order to be sold in the United States. Any possible future efforts to complete the clinical trials on the Photon™ in order to file for FDA approval would depend on the Company obtaining adequate funding. The Company estimates that the funds needed to complete the clinical trials in order to obtain the necessary regulatory approval on the Photon™ to be approximately $2,500,000. This does not include the necessary funds for product development and to bring the Photon™ to market.

Effect of Inflation and Foreign Currency Exchange

The Company has not realized a reduction in the selling price of its products as a result of domestic inflation. Nor has it experienced unfavorable profit reductions due to currency exchange fluctuations or inflation with its foreign customers. All sales transactions to date have been denominated in U.S. Dollars. The Company has experienced a higher cost for equipment manufactured for the Company by Tinsley in England due to the exchange rate value of the pound sterling.

Impact of New Accounting Pronouncements

In February 2007, the FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities, including an amendment of FASB Statement No. 115. SFAS 159 permits companies to choose to measure many financial instruments and certain other items at fair value that are not currently required to be measured at fair value, and establishes presentation and disclosure requirements designed to facilitate comparisons between companies that choose different measurement attributes for similar types of assets and liabilities. SFAS 159 is effective on January 1, 2008, and is not expected to have a material effect on the Company's consolidated financial statements.

In December 2007, the FASB issued SFAS No. 160, Noncontrolling Interests in Consolidated Financial Statements, an amendment of ARB No. 51. SFAS 160 will change the accounting and reporting for minority interests, which will be recharacterized as noncontrolling interests and classified as a component of equity. This new consolidation method will significantly change the accounting for transactions with minority interest holders. SFAS 160 is effective on January 1, 2009, and is not expected to have a material effect on the Company's consolidated financial statements.

In December 2007, the FASB issued SFAS No.141(R), Business Combinations, and SFAS No. 160, Noncontrolling Interests in Consolidated Financial Statements. SFAS No. 141(R) requires an acquirer to measure the identifiable assets acquired, the liabilities assumed and any non-controlling interest in the acquiree at their fair values on the acquisition date, with goodwill being the excess value over the net identifiable assets acquired. SFAS No. 160 clarifies that a non-controlling interest in a subsidiary should be reported as equity in the consolidated financial statements, consolidated net income should be adjusted to include the net income attributed to the non-controlling interest and consolidated comprehensive income shall be adjusted to include the comprehensive income attributed to the non-controlling interest. The calculation of earnings per share will continue to be based on income amounts attributable to the parent. SFAS No. 141(R) and SFAS No. 160 are effective for financial statements issued for fiscal years beginning after December 15, 2008. Early adoption is prohibited. The Company does not expect that the adoption of SFAS No. 141(R) or SFAS No. 160 will have a material impact on its consolidated financial statements.

In February 2008, the FASB issued FASB Staff Position (FSP) FAS No. 140-3, Accounting for Transfers of Financial Assets and Repurchase Financing Transactions. FSP FAS 140-3 requires an initial transfer of a financial asset and a repurchase financing that was entered into contemporaneously or in contemplation of the initial transfer to be evaluated as a linked transaction under SFAS No. 140 unless certain criteria are met, including that the transferred asset must be readily obtainable in the marketplace. FSP FAS 140-3 is effective for fiscal years beginning after November 15, 2008, and will be applied to new transactions entered into after the date of adoption. Early adoption is prohibited. The Company does not expect that the adoption of FSP FAS 140-3 will have a material impact on its consolidated financial statements.

In March 2008, the FASB issued SFAS No. 161, Disclosures about Derivative Instruments and Hedging Activities. SFAS No. 161 is intended to improve financial reporting about derivative instruments and hedging activities by requiring enhanced disclosures to enable investors to better understand their effects on an entity's financial position, financial performance, and cash flows. SFAS No. 161 is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008, with early application encouraged. The Company does not expect that the adoption of SFAS No. 161 will have a material impact on its consolidated financial statements.

In April 2008, the FASB issued FSP FAS 142-3, Determination of the Useful Life of Intangible Assets. FSP FAS 142-3 amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset under SFAS No. 142, Goodwill and Other Intangible Assets. The intent of this FSP is to improve the consistency between the useful life of a recognized intangible asset under FAS FAS 142 and the period of expected cash flows used to measure the fair value of the asset under SFAS No. 141(R) and other generally accepted accounting principles. FSP FAS 142-3 is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2008. The Company does not expect that the adoption of FSP FAS 142-3 will have a material impact in its consolidated financial statements.

In May 2008, the FASB issued SFAS 162, The Hierarchy of Generally Accepted Accounting Principles. SFAS No. 162 identifies the sources of accounting principles and provides entities with a framework for selecting the principles used in preparation of financial statements that are presented in conformity with GAAP. The current GAAP hierarchy has been criticized because it is directed to the auditor rather than the entity, it is complex, and it ranks FASB Statements of Financial Accounting Concepts, which are subject to the same level of due process as FASB Statements of Financial Accounting Standards, below industry practices that are widely recognized as generally accepted but that are not subject to due process. The Board believes the GAAP hierarchy should be directed to entities because it is the entity (not its auditors) that is responsible for selecting accounting principles for financial statements that are presented in conformity with GAAP. The Company does not expect that adoption of FASB 162 will have a material impact on its consolidated financial statements.

In May 2008, the FASB issued SFAS No. 163, Accounting for Financial Guarantee Insurance Contracts. SFAS 163 requires that an insurance enterprise recognize a claim liability prior to an event of default (insured event) when there is evidence that credit deterioration has occurred in an insured financial obligation. This Statement also clarifies how SFAS 60, Accounting and Reporting by Insurance Enterprises, as amended, applies to financial guarantee insurance contracts, including the recognition and measurement to be used to account for premium revenue and claim liabilities. This Statement also requires expanded disclosures about financial guarantee insurance contracts. SFAS 163 is effective for financial statements issued for fiscal years beginning after December 15, 2008, and all interim periods within those fiscal years, except for some disclosures about the insurance enterprise's risk-management activities. Early application is not permitted. The Company does not expect that the adoption of FSP FAS 163 will have a material impact in its consolidated financial statements.

In June 2008, the FASB ratified EITF Issue No. 08-3, Accounting for Lessees for Maintenance Deposits Under Lease Arrangements. EITF 08-3 provides guidance for accounting for nonrefundable maintenance deposits. It also provides revenue recognition accounting guidance for the lessor. EITF 08-3 is effective for fiscal years beginning after December 15, 2008. The Company does not expect that the adoption of EITF 08-3 will have a material impact in its consolidated financial statements.

In June 2008, the FASB issued FSP EITF 03-6-1, Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities. FSP EITF 03-6-1 clarified that all outstanding unvested share-based payment awards that contain rights to nonforfeitable dividends participate in undistributed earnings with common shareholders. Awards of this nature are considered participating securities and the two-class method of computing basic and diluted earnings per share must be applied. FSP EITF 03-6-1 is effective for fiscal years beginning after December 15, 2008. The Company does not expect that the adoption of FSP EITF 03-6-1 will have a material impact on its consolidated financial statements.

In October 2008, the FASB issued FSP FAS 157-3 Determining Fair Value of a Financial Asset in a Market That Is Not Active. FSP FAS 157-3 clarified the application of SFAS No. 157 in an inactive market. It demonstrated how the fair value of a financial asset is determined when the market for that financial asset is inactive. FSP FAS 157-3 was effective upon issuance, including prior periods for which financial statements had not been issued. The Company does not expect that the adoption of FSP FAS 157-3 will have a material impact on its consolidated financial statements.

In November 2008, the FASB ratified EITF Issue No. 08-6, Equity Method Investment Accounting Considerations. EITF 08-6 clarifies the accounting for certain transactions and impairment considerations involving equity method investments. EITF 08-6 is effective for fiscal years beginning after December 15, 2008, with early adoption prohibited. The Company does not expect that the adoption of EITF 08-6 will have a material impact on its consolidated financial statements.

In December 2008, the FASB issued FASB Staff Position FAS 140-4 and FIN 46(R)-8, Disclosures by Public Entities (Enterprises) about Transfers of Financial Assets and Interests in Variable Interest Entities. FSP FAS 140-4 and FIN 46(R)-8 amends SFAS 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities and FIN 46(R), FASB Interpretation No. 46 (R), Consolidation of Variable Interest Entities, an interpretation of Accounting Research Bulletin No. 51, to require public entities to provide additional disclosures about transfers of financial assets and their involvement with variable interest entities. FSP FAS 140-4 and FIN 46(R)-8 is effective for the first interim or annual reporting period ending after December 15, 2008. The Company does not expect that the adoption of FSP FAS 140 and FIN 46(R)-8 will have a material impact in its consolidated financial statements.

Item 7. Financial Statements

PARADIGM MEDICAL INDUSTRIES, INC.
Financial Statements
December 31, 2008 and 2007

PARADIGM MEDICAL INDUSTRIES, INC.

Index to Financial Statements

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To The Board of Directors and Shareholders
Paradigm Medical Industries, Inc.
Salt Lake City, Utah

We have audited the accompanying balance sheets of Paradigm Medical Industries, Inc. as of December 31, 2008 and 2007, and the related statements of operations, stockholders' equity, and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal controls over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing our procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company’s internal control over financial reporting. As such we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Paradigm Medical Industries, Inc. as of December 31, 2008 and 2007 and the results of their operations and their cash flows for the years then ended in conformity with accounting principles generally accepted in the United States.

The accompanying financial statements have been prepared assuming that the Company will continue as a going concern. As discussed in Note 2 to the financial statements, the Company has incurred substantial losses from operations, negative working capital, and recurring negative cash flows from operations which raises substantial doubt about its ability to continue as a going concern. Management's plans in regard to these matters are also described in Note 2. The financial statements do not include any adjustments that might result from the outcome of this uncertainty.

Chisholm, Bierwolf, Nilson & Morrill, LLC
Bountiful, Utah
April 10, 2009

PARADIGM MEDICAL INDUSTRIES, INC.

Balance Sheets

	December 31,2008	December 31,2007
Assets		
Current assets:		
Cash	$ 27,000	$ 321,000
Receivables, net	207,000	624,000
Inventories, net	659,000	847,000
Prepaid and other assets	16,000	27,000
Total current assets	909,000	1,819,000
Property and equipment, net	11,000	16,000
Goodwill	339,000	339,000
Total assets	$ 1,259,000	$ 2,174,000
Liabilities and Stockholders' (Deficit)		
Current liabilities:		
Accounts payable	$ 463,000	$ 370,000
Related party payable	131,000	46,000
Accrued liabilities	559,000	644,000
Convertible note payble, net of debt discount of $39,000 and $240,000	2,052,000	1,203,000
Total current liabilities	3,205,000	2,263,000
Convertible notes payable, net of debt discount of $239,000 and $588,000	1,802,000	1,897,000
Derivative liabilities	10,000	210,000
Total long-term liabilities	1,812,000	2,107,000
Total liabilities	5,017,000	4,370,000
Commitments and contingencies	-	
Stockholders' (Deficit):		
Preferred stock, $.001 par value, 5,000,000 shares authorized, 612,497 shares issued and outstanding (aggregate liquidation preference of $456,000)	1,000	1,000
Common stock, $.001 par value, 1,400,000,000 shares authorized, 15,159,807 and 5,449,869 respectively	15,000	5,000
Additional paid-in capital	58,359,000	58,202,000
Accumulated deficit	(62,133,000)	(60,404,000)
Total stockholders' (Deficit)	(3,758,000)	(2,196,000)

Total liabilities and stockholders' (Deficit)	$ 1,259,000	$ 2,174,000

The accompanying notes are an integral part of these financial statements

PARADIGM MEDICAL INDUSTRIES, INC.

Statements of Operations

Years Ended December 31,

	2008	2007
Sales	$ 1,259,000	$ 1,872,000
Cost of sales	704,000	1,020,000
Gross profit	555,000	852,000
Operating expenses:		
General and administrative	(922,000)	(1,012,000)
Marketing and selling	(500,000)	(662,000)
Research and development	(255,000)	(344,000)
Total operating expenses	(1,677,000)	(2,018,000)
Operating loss	(1,122,000)	(1,166,000)
Other income (expense):		
Other income	10,000	-
Interest expense - Accretion of debt discount	(515,000)	(771,000)
Interest income	3,000	11,000
Interest expense	(312,000)	(221,000)
Gain on derivative valuation	207,000	413,000
Gain on settlement of liabilities	-	91,000
Total other income (expense)	(607,000)	(477,000)
Income (loss) before provision for income taxes	(1,729,000)	(1,643,000)
Provision for income taxes	-	-
Net (loss)	$ (1,729,000)	$ (1,643,000)
Basic and fully diluted loss per share:		
Earnings (loss) per common share - basic	$ (0.15)	$ (0.62)
Earnings (loss) per common share - diluted	$ (0.15)	$ (0.62)
Weighted average common shares - basic	11,394,793	2,647,360
Weighted average common shares - diluted	11,394,793	2,647,360

The accompanying notes are an integral part of these financial statements

F-4

PARADIGM MEDICAL INDUSTRIES, INC.

Statements of Stockholders' Deficit

For the Period January 1, 2007 through December 31, 2008

	Preferred Stock (See Note 8)	Common Shares	Amount	Additional Paid-In Capital	Accumulated Deficit
Balance at January 1, 2007	1,000	2,019,590	2,000	57,901,000	(58,761,000)
Issuance of common stock for:					
Stock option valuation	-	-	-	14,000	-
Conversion of convertible debentures	-	3,430,172	3,000	376,000	-
Unamortized discount associated to convertible debenture conversions				(100,000)	
Pro rata portion of derivative liability associated with debenture conversions				11,000	
Conversion of preferred stock	-	107	-		-
Net loss	-	-	-	-	(1,643,000)
Balance at December 31, 2007	1,000	5,449,869	5,000	58,202,000	(60,404,000)
Issuance of common stock for:					
Stock option valuation	-	-	-	14,000	-
Conversion of convertible debentures	-	9,709,938	10,000	185,000	-
Unamortized discount associated to convertible debenture conversions		-	-	(42,000)	
Net loss	-	-	-	-	(1,729,000)
Balance at December 31, 2008	1,000	15,159,807	15,000	58,359,000	(62,133,000)

The accompanying notes are an integral part of these financial statements

PARADIGM MEDICAL INDUSTRIES, INC.

Statements of Cash Flows

Years Ended December 31,

	2008	2007
Cash flows from operating activities:		
Net income (loss)	$ (1,729,000)	$ (1,643,000)
Adjustments to reconcile net income (loss) to net cash used in operating activities:		
Depreciation and amortization	5,000	5,000
Stock option valuation	14,000	14,000
Change in fair value of derivative liabilities	(207,000)	(413,000)
Accretion of debt discount	515,000	772,000
Provision for losses on receivables	45,000	56,000
(Gain) loss on settlement of liabilities	-	(91,000)
(Increase) decrease in:		
Accounts Receivables	372,000	(251,000)
Inventories	188,000	98,000
Prepaid and other assets	11,000	(16,000)
Increase (decrease) in:		
Accounts payable	178,000	17,000
Accrued liabilities	104,000	317,000
Net cash used in operating activities	(504,000)	(1,135,000)
Cash flows from investing activities:		
	-	-
Net cash used in investing activities	-	-
Cash flows from financing activities:		
Proceeds from issuance of convertible notes	210,000	1,250,000
Net cash provided by financing activities	210,000	1,250,000
Net change in cash	(294,000)	115,000
Cash, beginning of year	321,000	206,000
Cash, end of year	$ 27,000	$ 321,000

The accompanying notes are an integral part of these financial statements

PARADIGM MEDICAL INDUSTRIES, INC.
Notes to Financial Statements

1. Organization and Significant Accounting Policies

Organization

Paradigm Medical Industries, Inc. (the Company) is a Delaware Corporation incorporated in October 1989. The Company is engaged in the design, development, manufacture, and sale of high technology surgical and diagnostic eye care products. Its surgical equipment is designed to perform minimally invasive cataract surgery and is comprised of surgical devices and related instruments and accessories, including disposable products. Its diagnostic products include a Blood Flow Analyzer, a pachymeter, an A/B Scan, ultrasound biomicroscopes, perimeters, and a corneal topographer.

Fair Value of Financial Instruments

On January 1, 2008, the Company adopted SFAS No. 157, “Fair Value Measurements. SFAS No. 157 defines fair value, establishes a three-level valuation hierarchy for disclosures of fair value measurement and enhances disclosure requirements for fair value measures. The three levels are defined as follows:

· Level 1 inputs to the valuation methodology are quoted prices (unadjusted) for identical assets or liabilities in active markets.

· Level 2 inputs to the valuation methodology include quoted prices for similar assets and liabilities in active markets, and inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument.

· Level 3 inputs to valuation methodology are unobservable and significant to the fair measurement.

The fair value of the Company's cash and cash equivalents, receivables, accounts payable and accrued liabilities approximate carrying value based on their effective interest rates compared to current market prices.

The Company’s financial instruments consist of cash, receivables, payables, and notes payable. The carrying amount of cash, receivables and payables approximates fair value because of the short-term nature of these items. The carrying amount of the notes payable approximates fair value as the individual borrowings bear interest at market interest rates.

Cash Equivalents

For purposes of the statement of cash flows, cash includes all cash and investments with original maturities to the Company of three months or less.

1. Organization and Significant Accounting Policies
Continued

The Company maintains its cash in bank deposit accounts which, at times, may exceed federally insured limits. The Company has not experienced any losses in such accounts and believes it is not exposed to any significant credit risk on cash and cash equivalents.

Accounts Receivable
Accounts receivable are carried at original invoice amount less an estimate made for doubtful receivables based on a review of all outstanding amounts on a monthly basis. Specific reserves are estimated by management based on certain assumptions and variables, including the customer's financial condition, age of the customer's receivables, and changes in payment histories. Trade receivables are written off when deemed uncollectible. Recoveries of trade receivables previously written off are recorded when received.

A trade receivable is considered to be past due if any portion of the receivable balance has not been received by the contractual pay date. Interest is not charge on trade receivables that are past due.

Allowance for Doubtful Accounts:
The Company records an allowance for doubtful accounts to offset estimated uncollectible accounts receivable. Bad debt expense associated with the increases in the allowance for doubtful accounts is recorded as part of general and administrative expense. The
Company's accounting policy generally is to record an allowance for receivables over 90 days past due unless there is significant evidence to support that the receivable is collectible.

During 2008, the Company collected $36,000 in receivables that were previously allowed in the allowance for doubtful accounts. During 2008, the Company decreased net allowance for doubtful accounts by $34,000.

The Company has 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 was27% of total outstanding receivables as of December 31, 2008 and 15% as of December 31, 2007. The allowance for doubtful accounts decreased from $109,000 at December 31, 2007 to $75,000 at December 31, 2008.

1. Organization and Significant Accounting Policies Continued

Inventories
Inventories are stated at the lower of cost or market, cost is determined using the weighted average method.

Property and Equipment
Property and equipment are recorded at cost, less accumulated depreciation. Depreciation on property and equipment is determined using the straight-line method over the estimated useful lives of the assets or terms of the lease, usually between 3-7 years. Expenditures for maintenance and repairs are expensed when incurred and betterments are capitalized.

Gains and losses on sale of property and equipment are reflected in operations. Leasehold improvements are depreciated over the lesser of the term of the lease or the useful life of the related asset. During the years ended 2008 and 2007 depreciation expense was $5,000 and $5,000 respectively. Newly acquired assets that have a value of $3,000 or more are capitalized and included on the depreciation schedule.

Goodwill
As of December 31, 2008, the Company had recorded on their books goodwill related to the purchase of Ocular Blood Flow, Ltd., during 2001. In accordance with SFAS 142, “Goodwill and Other Intangible Assets,” goodwill is not amortized.

The Company performs tests for impairment of goodwill annually or more frequently if events or circumstances indicate it might be impaired. Such tests include comparing the fair value of a reporting unit with its carrying value, including goodwill. The analysis of the impairment test of goodwill did not result in a charge to the statements of operations for impairment for the years ended December 31, 2008 and 2007, respectively.

Impairment assessments are performed using a variety of methodologies, including cash flow analysis and estimates of sales proceeds. Where applicable, an appropriate discount rate is used, based on the Company’s cost of capital rate or location-specific economic factors.

1. Organization and Significant Accounting Policies Continued

Evaluation of Other Long-Lived Assets

The Company evaluates the carrying value of the unamortized balances of other long-lived assets to determine whether any impairment of these assets has occurred or whether any revision to the related amortization periods should be made, in accordance with Statement of Financial Accounting Standards No. 144," Accounting for the Impairment or Disposal of Long-Lived Assets" ('SFAS 144"), which addresses financial accounting and reporting for the impairment or disposal of long-lived assets. This evaluation is based on management's projections of the undiscounted future cash flows associated with each asset. If management's evaluation were to indicate that the carrying values of these assets were impaired, such impairment would be recognized by a write down of the applicable asset.

Income Taxes

Deferred income taxes are provided in amounts sufficient to give effect to temporary differences between financial and tax reporting, principally related to net operating loss carry forwards, depreciation, impairment of intangible assets, stock compensation expense, and accrued liabilities.

Stock – Based Compensation

On January 1, 2006, the Company adopted SFAS No. 123 (revised 2004), Share-Based Payment, ("SFAS 123(R)") which establishes standards for the accounting of transactions in which an entity exchanges its equity instruments for goods or services, primarily focusing on accounting for transactions where an entity obtains employee services in share-based payment transactions. SFAS 123(R) requires a public entity to measure the cost of employee services received in exchange for an award of equity instruments, including stock options, based on the grant-date fair value of the award and to recognize it as compensation expense over the period the employee is required to provide service in exchange for the award, usually the vesting period. In March 2005, the SEC issued Staff Accounting Bulletin No. 107 ("SAB 107") relating to SFAS 123(R). The Company has applied the provisions of SAB 107 in its adoption of SFAS 123(R).

Stock-based compensation expense recognized during the period is based on the value of the portion of share-based payment awards that is ultimately expected to vest during the period. Stock-based compensation expense recognized in the Company's consolidated statement of operations for the year ended December 31, 2008 included compensation expense for the share-based payment awards granted based on the grant date fair value estimated in accordance with the provisions of SFAS 123(R). Stock based compensation expense for the years ended December 31, 2008 and 2007 was $14,000 and $14,000, respectively.

1. Organization and Significant Accounting Policies Continued

Basic and Fully Diluted Loss Per Share

Net loss per common share is computed on the weighted average number of common stock and common stock equivalent shares outstanding during each year. Common stock equivalents consist of convertible preferred stock, and common stock options and warrants. Common stock equivalent shares are excluded from the computation when their effect is anti-dilutive.

Common stock equivalents consisting of options and warrants to purchase the Company's common stock were 66,214,392 and 65,534,392; shares of common stock and preferred stock convertible into 862,438 and 862,438 shares of common stock, and outstanding commitments to issue shares underlying the convertible notes into 966,705,263 and 36,372,800 shares of common stock at December 31, 2008 and 2007, respectively, have not been included in the fully diluted loss per share because their inclusion would have been anti-dilutive.

The following table is a reconciliation of basic earnings per share for the years ended December 31, 2008 and 2007.

	Years ended December 31, 2008	2007
Net loss	$ (1,729,000)	$ (1,643,000)
Basic and fully diluted weighted average shares outstanding	11,394,793	2,647,360
Basic and fully diluted loss per share	$ (0.15)	$ (0.62)

Revenue Recognition

Revenues for sales of products that require specific installation and acceptance by the customer are recognized upon such installation and acceptance by the customer. Revenues for sales of other surgical systems, ultrasound diagnostic devices, and disposable products are recognized when the product is shipped. A signed purchase agreement and a deposit or payment in full from customers is required before a product leaves the premises. Title passes at time of shipment (F.O.B. shipping point). The products of the Company contain both hardware and software components. The Company does not recognize revenue for the software components of the products separate from the product as a whole because the software is incidental to the product, as defined in paragraph 2 of SOP 97-2.

1. Organization and Significant Accounting Policies Continued

Research and Development

Costs incurred in connection with research and development activities are expensed as incurred. These costs consist of direct and indirect costs associated with specific projects as well as fees paid to various entities that perform certain research on behalf of the Company. The total research and development expenses for the years ended December 2008 and 2007 was $255,000 and $344,000, respectively.

Concentration of Risk

The market for ophthalmic lasers is subject to rapid technological change, including advances in laser and other technologies and the potential development of alternative surgical techniques or new pharmaceutical products. Development by others of new or improved products, processes or technologies may make products developed by the Company obsolete or less competitive. The Company's high technology product line requires the Company to deal with suppliers and subcontractors supplying highly specialized parts, operating highly sophisticated and narrow tolerance equipment and performing highly technical calculations and tasks. Although there are a limited number of suppliers and manufacturers that meet the standards required of a regulated medical device, management believes that other suppliers and manufacturers could provide similar components and services.

A significant portion of the Company's product sales is in foreign countries. The economic and political instability of some foreign
countries may affect the ability of medical personnel to purchase the Company's products and the ability of the customers to pay for the procedures for which the Company's products are used. Such circumstances could cause a possible loss of sales, which would affect operating results adversely.

During the years ended December 31, 2008 and 2007 no single customer represented more than 10% of total net sales for the respective years . Accounts receivable are due from medical distributors, surgery centers, hospitals, optometrists and ophthalmologists located throughout the U.S. and a number of foreign countries. The receivables are generally due within thirty days for domestic customers with extended terms offered for some international customers. The Company maintains an allowance for estimated potentially uncollectible amounts.

PARADIGM MEDICAL INDUSTRIES, INC.
Notes to Financial Statements
Continued

1. Organization and Significant Accounting Policies Continued

Warranty

The Company provides product warranties on the sale of certain products that generally extend for one year from the date of sale. The Company maintains a reserve for estimated warranty costs based on historical experience and management's best estimates

	Years ended December 31, 2008	2007
Beginning warranty liability balance	$ 227,000	$ 155,000
Less: Reductions for payments	(163,000)	(20,000)
Plus: Increase for accrual	-	92,000
Ending warranty liability balance	$ 64,000	$ 227,000

Use of Estimates in the Preparation of Financial Statements

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Contingencies

The Company has adopted the guidance in Statement of Financial Accounting Standards No. 5, "Accounting for Contingencies," when booking for loss contingencies. The Company accrues a charge to income when (1) information available prior to issuance of the financial statements indicates that it is probable that an asset has been impaired or a liability has been incurred at the date of the financial statements, and (2) the amount of loss can be reasonably estimated. Loss contingencies related to litigation for the year ended December 31, 2008 and 2007 were $236,000 and 255,000.

1. Organization and Significant Accounting Policies Continued

Derivative Financial Instruments

The Company's derivative financial instruments consist of embedded derivatives related to the Secured Convertible Term Notes ("the Notes") entered into agreements on April 27, 2005; June 23, 2005; June 30, 2005; February 28, 2006; June 28, 2006; April 30, 2007; June 11, 2007; December 19, 2007; December 24, 2007, June 16, 2008, July 14, 2008, and August 29, 2008. These Notes contain interrelated embedded derivatives, which include the fixed conversion feature, the variable conversion feature, the variable interest feature, and the contingent put feature. Although the put feature was determined to be an embedded derivative which requires bifurcation, we believe the likelihood of this feature being exercised is remote and accordingly no value was ascribed to this particular put feature. We are required to continue to evaluate our accounting and valuation for this put feature. We will continue to monitor the probability of this particular put feature being exercised and its impact to our valuation of embedded derivatives in future periods.

In the event the value of the put feature becomes material in the future, we will use a different model to value this feature along with the other embedded derivatives.

Based on the complex nature of these terms (including the put feature), the Company chose to employ a binomial lattice model to value these features. The Company used the lattice model because it allows for the consideration of the dynamic and interrelated nature of the unique terms of these securities. It takes into consideration that in each discrete period of time a stock can either go up or down (described as its "volatility") and produces a range of potential future stock prices (and thus multiple values at those future points in time). A binomial lattice model assumes the price of the stock underlying the derivative follows one of the two price paths (stock price can either go up or down). There are three general steps in constructing a binomial lattice model: (1) calculation of the stock price lattice, (2) calculation of the potentially applicable option values at each node based on the terms and conditions of the specific security, and (3) progressively calculating the security value at each node starting at the maturity of the security and working back to the present testing for the greater of the current period value or the probability weighted holding value of the security. The following key inputs and assumptions were used to calculate the fair values of the embedded derivatives and the warrants:

1. Organization and Significant Accounting Policies
Continued

§ Stock Price: This is the stock price as of the respective valuation date.

§ Fixed Conversion Price: The fixed conversion price used in the valuation analysis was set equal to fixed conversion price (ranging from $0.2 to $0.09) per share for each of the Notes. This is the fixed price at which the Investor can convert the Note into common stock.

§ Volatility: Volatility is a measure of the standard deviation of the stocks continuously compounded return over the life of the security. The ideal volatility for an accurate calculation of fair value is the future volatility of the security. This cannot be known with certainty, so an approximation is derived using historical return volatility for a period of time equal to the remaining life of the instrument as a proxy, and professional judgment. As part of our valuation, we performed extensive analysis of the historical volatility of returns for the Company's stock. Based on our analysis, we chose a standard deviation of 200% as our best estimate of future volatility.

§ Risk-Free Rate: The appropriate risk free rate is the interest rate of a U.S. treasury note with a maturity equal to the maturity of the respective security. As of December 31, 2008, the risk free interest rates ranged from 0.11% to 0.88%. As of December 31, 2007, the risk free interest rates ranged from 3.06% to3.49%.

§ Time to Maturity: The time to maturity is measured based on the remaining term of the security as of the valuation date.

§ 20-day Minimum Price vs. Closing Stock Price: The variable conversion feature allows the Investor to convert the Notes at a price equal to 60% - 50% (ranges per note) of the average of the lowest three trading prices during the twenty trading days preceding a conversion notice. We analyzed the historical relationship between the common stock closing price and the lowest trading price. Based on this analysis, we determined that on average the lowest trading price in any 20-day period during the time period analyzed was approximately 70% of the closing price. We used this as a conservative proxy for the average of the three lowest closing prices during the 20-day period. This result was used in the test of the stock price relative to the fixed conversion price.

1. Organization and Significant Accounting Policies Continued

- Monthly Intraday Trading Price: The variable interest rate provision waives interest for a given month if the intraday trading price of the common stock exceeds $0.0945 or $0.0275 (depending on Note) per share for every day within a given month. We assumed that our various node prices were equivalent to this intraday trading price.

- Trading Liquidity: We assumed that adequate stock trading liquidity is available for the Investors to sell converted / exercised shares.

- Probability of Contingent Put Feature: We assumed that the likelihood of this feature being exercised is remote and accordingly no value was ascribed to this particular put feature. We will continue to monitor the probability of this particular put feature being exercised and its impact to our valuation of embedded derivatives in future periods.

The warrants were valued using the Black-Scholes Option Pricing Model with the following assumptions for 2008 and 2007, respectively: dividend yield of 0% and 0%; annual volatility of 200% and 200%; and risk free interest rates ranging from of 0.37% to 1.8% and 3.06% to 3.7%.

1. Organization and Significant Accounting Policies Continued

The accounting treatment of derivative instruments requires that the Company record the derivatives and related warrants at their fair values as of the inception date of the agreement and at a fair value of each subsequent balance sheet date. In addition, under the provisions of SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities", as a result of entering into the Notes, the Company is required to classify all other non-employee stock options and warrants as derivative liabilities and mark them to market at each reporting date. Any change in the fair value will be recorded as non-operating, non-cash income or expense at each reporting date. If the fair value of the derivatives is lower at the subsequent balance sheet date, the Company will record a non-operating, non-cash income.

In the event that the Company is required to convert the debentures into common stock, the Company is required to eliminate the pro rata portion of the derivative liability associated with the conversion, with a corresponding entry recorded to additional paid-in-capital.

2. Going Concern

Going Concern

The accompanying financial statements have been prepared on a going concern basis, which contemplates the realization of assets and the satisfaction of liabilities in the normal course of business.

Historically, the Company has not demonstrated the ability to generate sufficient cash flows from operations to satisfy its liabilities and sustain operations, and the Company has incurred significant losses from operations. The company had a working capital deficit of $2,296,000 and has used $504,000 in cash in operating activities as of December 31, 2008. These factors raise substantial doubt about the Company's ability to continue as a going concern.

2. Going Concern Continued

Management's focus on the going concern that has plagued the organization for recent years concerning the inability of the company to generate sufficient cash flow from operations is a primary one. In the past three years, little has been done to create and maintain a domestic sales force within the US. In the international market, sales have diminished due to the company's inability or unwillingness to update or find replacements for its current product offerings. Management's plan is two-fold; complete a full product review of current products and take steps to re-engineer those products selected within a rapid time frame and re-introduce them to the world markets. If products are found to be incapable of being re-engineered, management will take steps to remove them from product listings. Management will take the necessary steps to locate new products manufactured by another organization to sell in the markets through its sales organizations. This important step will provide Paradigm the opportunity to generate sales, revenues and time to complete the final step, that of beginning to develop its own additional devices for sale in the market. This "partnering" benefit will help with sales and revenue but will not be enough to make up for prior years omissions of product development and essential partnering efforts. Therefore, the organization will require additional funding to support these efforts and that funding has been arranged and completed in April of 2009. It will be management's primary responsibility to carefully manage these capital infusions to assure that they begin to serve as a safety net rather than the only source of cash for growth. It is the goal of management to closely manage its capital resources during the remainder of 2009 and to begin to generate the sales and continuing revenue to move into 2010 more self-sufficient and move closer to profitability. As mentioned earlier, the addition of 20 new independent sales representatives in the US market and the addition of 15 new international distributors in the international market will provide the proper platform to introduce both re-engineered and "partnered" products to the respective markets.

3. Detail of Certain Balance Sheet Accounts

Receivables	2008	2007
Trade receivables	$ 282,000	$ 733,000
Allowance for doubtful accounts	(75,000)	(109,000)
	$ 207,000	$ 624,000

Inventories	2008	2007
Raw materials	$ 514,000	$ 558,000
Finished goods	376,000	533,000
Reserve for obsolence	(231,000)	(244,000)
	$ 659,000	$ 847,000

3. Detail of Certain Balance Sheet Accounts
Continued

Accrued liabilities:	2008	2007
Litigation reserve	$ 236,000	$ 256,000
Interest expense on notes payable	116,000	-
Payroll and employment benefits	24,000	64,000
Sales tax payable	4,000	20,000
Customer deposits	57,000	20,000
Accrued royalties	1,000	3,000
Warranty and return allowance	64,000	227,000
Consulting and other accrued liabilities	57,000	54,000
Total accrued liabilities	$ 559,000	$ 644,000

4. Property and Equipment

	2008	2007
Machinery and equipmen		