STORAGE TECHNOLOGY CORP
Form 10-Q
November 12, 2002

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended September 27, 2002

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: 1-7534

STORAGE TECHNOLOGY CORPORATION
(Exact name of registrant as specified in its charter)

Delaware	84-0593263
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)
One StorageTek Drive, Louisville, Colorado	80028-4309
(Address of principal executive offices)	(Zip Code)

303-673-5151
(Registrant's telephone number, including area code)

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. [X] Yes [ ] No

The registrant had 106,505,944 shares of common stock outstanding as of November 4, 2002.

STORAGE TECHNOLOGY CORPORATION
INDEX TO FORM 10-Q
September 27, 2002

STORAGE TECHNOLOGY CORPORATION
CONSOLIDATED BALANCE SHEETS
(In Thousands, Except Share Amounts)

	09/27/02	12/28/01
	(Unaudited)	
ASSETS		

Current assets:		
Cash and cash equivalents	$ 549,957	$ 453,217
Accounts receivable	506,886	505,630
Inventories	115,250	183,980
Deferred income tax assets	95,352	95,459
Other current assets	2,307	16,240
Total current assets	1,269,752	1,254,526
Property, plant, and equipment	252,457	232,289
Spare parts for maintenance	37,856	35,674
Deferred income tax assets	121,359	121,826
Other assets	122,237	114,568
Total assets	$ 1,803,661	$ 1,758,883
LIABILITIES		
Current liabilities:		
Credit facilities	$ --	$ 73,401
Current portion of long-term debt	754	812
Accounts payable	94,354	66,648
Accrued liabilities	382,457	361,113
Income taxes payable	214,503	212,566
Other current liabilities	16,425	--
Total current liabilities	708,493	714,540
Long-term debt	9,923	9,523
Total liabilities	718,416	724,063
Commitments and contingencies (Note 6)		
STOCKHOLDERS' EQUITY		
Common stock, $0.10 par value, 300,000,000 shares authorized; 106,169,965 shares issued at September 27, 2002, and 105,032,665 shares issued at December 28, 2001	10,617	10,503
Capital in excess of par value	895,777	875,379
Retained earnings	199,086	150,129
Accumulated other comprehensive income (loss)	(8,456)	7,642
Treasury stock, 200,643 shares at September 27, 2002, and December 28, 2001, at cost	(3,777)	(3,777)
Unearned compensation	(8,002)	(5,056)
Total stockholders' equity	1,085,245	1,034,820

Total liabilities and stockholders' equity	$ 1,803,661
	$ 1,758,883

The accompanying notes are an integral part of the consolidated financial statements.

STORAGE TECHNOLOGY CORPORATION
CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)
(In Thousands, Except Per Share Amounts)

	Quarter Ended		Nine Months Ended	
	09/27/02	09/28/01	09/27/02	09/28/01
Revenue				
Storage products	$307,335	$322,960	$ 889,379	$ 974,591
Storage services	194,370	175,039	560,167	504,361
Total revenue	501,705	497,999	1,449,546	1,478,952
Cost of revenue				
Storage products	166,719	174,204	497,027	538,184
Storage services	106,801	101,768	311,096	301,702
Total cost of revenue	273,520	275,972	808,123	839,886
Gross profit	228,185	222,027	641,423	639,066
Research and product development costs	53,354	60,563	162,385	185,770
Selling, general, administrative, and other income and expense, net	141,958	135,055	412,952	414,138
Operating profit	32,873	26,409	66,086	39,158
Interest income	2,837	2,465	7,439	7,222
Interest expense	(540)	(1,759)	(1,568)	(5,219)
Income before income taxes	35,170	27,115	71,957	41,161
Provision for income taxes	(11,300)	(9,200)	(23,000)	(14,000)
Net income	$ 23,870	$ 17,915	$ 48,957	$ 27,161

EARNINGS PER COMMON SHARE

Basic earnings per share	$ 0.23	$ 0.17	$ 0.47	$ 0.26
Weighted-average shares	105,268	103,352	104,903	102,886
Diluted earnings per share	$ 0.22	$ 0.17	$ 0.46	$ 0.26
Weighted-average and dilutive potential shares	107,121	105,140	107,360	104,500

The accompanying notes are an integral part of the consolidated financial statements.

STORAGE TECHNOLOGY CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)
(In Thousands)

	Nine Months Ended	
	09/27/02	09/28/01
OPERATING ACTIVITIES		
Cash received from customers	$ 1,465,480	$ 1,548,705
Cash paid to suppliers and employees	(1,202,442)	(1,414,958)
Interest received	7,078	7,222
Interest paid	(1,288)	(4,197)
Income taxes paid	(11,229)	(11,252)
Net cash provided by operating activities	257,599	125,520
INVESTING ACTIVITIES		
Purchases of property, plant, and equipment	(83,003)	(50,029)
Proceeds from sale of property, plant, and equipment	354	82
Other assets	(14,321)	(6,173)
Net cash used in investing activities	(96,970)	(56,120)
FINANCING ACTIVITIES		
Repayments of credit facilities, net	(73,401)	(3,163)
Proceeds from employee stock plans	14,280	8,437
Proceeds from other debt	1,166	1,913
Repayments of other debt	(1,868)	(8,607)
Net cash used in financing activities	(59,823)	(1,420)
Effect of exchange rate changes on cash	(4,066)	4,712
Increase in cash and cash equivalents	96,740	72,692

Cash and cash equivalents - beginning of the period	453,217	279,731
Cash and cash equivalents - end of the period	$ 549,957	$ 352,423
RECONCILIATION OF NET INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES		
Net income	$ 48,957	$ 27,161
Depreciation and amortization expense	70,501	87,418
Inventory writedowns	28,996	40,417
Translation gain	(461)	(19,433)
Other non-cash adjustments to income	17,433	25,116
Decrease in accounts receivable	15,934	70,120
(Increase) decrease in other current assets	531	(1,831)
(Increase) decrease in inventories	42,695	(62,364)
Increase in spare parts	(17,724)	(7,391)
(Increase) decrease in deferred income tax assets	993	(500)
Increase (decrease) in accounts payable	26,934	(24,231)
Increase (decrease) in accrued liabilities	8,938	(12,210)
Increase in other current liabilities	3,694	--
Increase in income taxes payable	10,178	3,248
Net cash provided by operating activities	$ 257,599	$ 125,520

The accompanying notes are an integral part of the consolidated financial statements.

STORAGE TECHNOLOGY CORPORATION
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(Unaudited)
(In Thousands)

	Quarter Ended		Nine Months Ended	
	09/27/02	09/28/01	09/27/02	09/28/01
Net income	$ 23,870	$ 17,915	$ 48,957	$ 27,161
Other comprehensive income (loss), net of tax (benefit):				
Cumulative effect of change in accounting principle on adoption of Statement of Financial Accounting Standards No. 133 and 138, net of tax (benefit) of $0, $0, $0, and $(3,881)	--	--	--	(7,535)
Net gain (loss) on foreign currency cash flow hedges, net of tax (benefit) of $322, $(3,482), $(11,431), and $8,411	516	(6,759)	(18,338)	16,328
Reclassification adjustment for net (gains) losses included in net income, net of (tax) benefit of $3,402, $(432), $1,396, and $(3,725)	5,457	(838)	2,240	(7,231)
Other comprehensive income (loss)	5,973	(7,597)	(16,098)	1,562

Comprehensive income	$ 29,843	$ 10,318	$ 32,859	$ 28,723

The accompanying notes are an integral part of the consolidated financial statements.

STORAGE TECHNOLOGY CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

NOTE 1 - BASIS OF PREPARATION

The accompanying interim consolidated financial statements of Storage Technology Corporation and its wholly owned subsidiaries (StorageTek or the Company) have been prepared on substantially the same basis as the Company's annual consolidated financial statements and should be read in conjunction with the Company's Annual Report on Form 10-K for the year ended December 28, 2001. In the opinion of management, the interim consolidated financial statements reflect all adjustments necessary for the fair presentation of results for the periods presented, and such adjustments are of a normal, recurring nature.

The consolidated results for interim periods are not necessarily indicative of expected results for the full fiscal year.

NOTE 2 - INVENTORIES

Inventories, net of associated reserves, consist of the following (in thousands of dollars):

	09/27/02	12/28/01
Raw materials	$ 8,836	$ 41,850
Work-in-process	42,365	57,641
Finished goods	64,049	84,489
	$115,250	$183,980

NOTE 3 - AGREEMENTS WITH EDS

On March 29, 2002, StorageTek and Electronic Data Systems Corporation (EDS) entered into a 10-year master secondary storage services agreement. On April 1, 2002, StorageTek and EDS entered into a 10-year agreement under which StorageTek outsourced certain internal information technology and customer call center operations to EDS. There are no cross-default provisions between the two agreements, and performance under each agreement by both StorageTek and EDS is not contingent upon performance under the other agreement. These agreements have been accounted for individually at their estimated fair values consistent with the provisions of Accounting Principles Board (APB) Opinion No. 29, "Accounting for Nonmonetary Transactions," based on management's estimates of fair value and a third-party appraisal.

Under the terms of the secondary storage services agreement, StorageTek will provide tape storage services for certain EDS-operated data center sites within the United States. StorageTek will receive a fee for these services calculated using a monthly base service fee adjusted for certain increases and decreases in

the actual amount of data stored. The agreement also provides for adjustments to the fees in the event specified service level metrics are not achieved.

The secondary storage services agreement can be renewed on an annual basis after the expiration of the initial 10-year term. The agreement can be cancelled by either party upon certain events, and can be cancelled by EDS for convenience with six months notice no sooner than two-and-one-half years from the effective date of the agreement. In the event EDS terminates the agreement for convenience, a termination fee is payable to StorageTek with the amount of the fee based upon a declining scale from the effective date.

In connection with the secondary storage services agreement, StorageTek purchased certain secondary storage equipment for a purchase price of $52,200,000. Substantially all of the purchase price paid to EDS relates to equipment previously sold by StorageTek to EDS; however, none of the equipment purchased by StorageTek was sold to EDS subsequent to the companies entering into definitive negotiations of the secondary storage services agreement. The purchase price was paid in April 2002. Because StorageTek is only responsible for delivering secondary storage pursuant to the service level agreement, StorageTek makes all decisions on secondary storage equipment additions and retirements within the data centers. Upon the expiration or termination of the agreement, EDS has the option to purchase any secondary storage equipment owned by StorageTek at the data center sites at a purchase price equal to the greater of the net book value of the equipment or the fair market value of the equipment. In limited situations, EDS also has the right to repurchase a portion of the equipment prior to expiration or termination of the agreement at an assigned value declining on a straight-line basis over five years. The estimated fair value of the equipment subject to this repurchase right was $12,271,000 as of March 29, 2002. In the event EDS exercises this repurchase right, the exercise will not affect any other terms of the agreement.

StorageTek has agreed to reimburse certain lease payments made by EDS on equipment used to deliver secondary storage services under the agreement. EDS' gross remaining lease obligation associated with this equipment, assuming no lease terminations, was approximately $8,599,000 as of March 29, 2002.

Revenue is recognized under the secondary storage services agreement on a straight-line basis over the ten-year term of the agreement, based on the average per gigabyte price over the term of the contract. The Company had approximately $4,535,000 of billings to EDS for which the revenue has been deferred as of September 27, 2002. Lease reimbursement payments made to EDS are recognized as a reduction of service revenue. Costs and expenses to provide these services are recognized as incurred. The purchase price of $52,200,000 paid to EDS for the secondary storage equipment has been recorded within Property, Plant, and Equipment on the Consolidated Balance Sheet. The Company is depreciating the equipment on a straight-line basis over the estimated useful lives of the assets. Useful lives were determined based on the individual characteristics of the equipment, and range from one to seven years. The revenue and costs are included within storage services for segment reporting purposes.

NOTE 4 - GOODWILL

In July 2001, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 142, "Goodwill and Other Intangible Assets." This statement addresses the accounting for goodwill and intangible assets subsequent to their acquisition. SFAS No. 142 requires that goodwill no longer be amortized. Under SFAS No. 142, goodwill will be tested for impairment on an annual basis or as necessary. The Company adopted SFAS No. 142 on the first day of the Company's fiscal year 2002. In the second quarter of 2002, the

Company completed the initial goodwill impairment test. No accounting charge resulted from the completion of this initial impairment test.

The following table presents the adjusted net income and earnings per share had SFAS No. 142 been in effect for all periods presented (in thousands, except per share amounts):

	Quarter Ended		Nine Months Ended	
	09/27/02	09/28/01	09/27/02	09/28/01
Reported net income	$ 23,870	$ 17,915	$ 48,957	$ 27,161
Add back: Goodwill amortization	--	1,445	--	4,362
Adjusted net income	$ 23,870	$ 19,360	$ 48,957	$ 31,523
Basic earnings per common share:				
Reported net income	$ 0.23	$ 0.17	$ 0.47	$ 0.26
Goodwill amortization	--	0.01	--	0.04
Adjusted net income	$ 0.23	$ 0.18	$ 0.47	$ 0.30
Diluted earnings per common share:				
Reported net income	$ 0.22	$ 0.17	$ 0.46	$ 0.26
Goodwill amortization	--	0.01	--	0.04
Adjusted net income	$ 0.22	$ 0.18	$ 0.46	$ 0.30

NOTE 5 - DEBT AND FINANCING ARRANGEMENTS

The Company had a financing agreement with a bank that provided for the sale of promissory notes in the principal amount of up to $75,000,000 at any one time. This agreement expired in January 2002, and all outstanding promissory notes under the agreement were repaid at that time. The Company has historically utilized foreign currency forwards embedded in borrowing commitments under this financing agreement to hedge forecasted cash flows associated with revenue denominated in foreign currencies. The Company is currently using stand-alone foreign currency options and forwards to mitigate the risk that forecasted cash flows associated with revenue denominated in foreign currencies may be adversely affected by changes in foreign currency exchange rates.

See the Company's Annual Report on Form 10-K for the year ended December 28, 2001, for additional information regarding the Company's debt and financing arrangements, and derivative instruments.

NOTE 6 - LITIGATION

In 1994, Stuff Technology Partners II, a Limited Partnership (Stuff), filed suit in Boulder County, Colorado, District Court alleging that the Company breached a 1990 settlement that had resolved earlier litigation between the parties involving an unsuccessful optical disk drive storage development project. The suit seeks injunctive relief and damages. In September 2002, a jury confirmed the Company's interpretation of the settlement agreement that the limitations on the Company's use of the development project technology is restricted to its use in optical disk drives. Remaining claims to be tried include Stuff's allegation that the Company did not transfer all of the technology to it as required under

the 1990 settlement agreement and its allegation that the Company is using the technology in optical disk drives. The Company will vigorously defend these claims and, at this time, the Company believes that the likelihood of a material adverse result on the remaining claims is remote.

The Company also is involved in various other less significant legal actions. While the Company currently believes that the amount of any ultimate potential loss would not be material to the Company's financial position, the outcome of these actions is inherently difficult to predict. In the event of an adverse outcome, the ultimate potential loss could have a material adverse effect on the Company's financial position or reported results of operations in a particular quarter. An unfavorable decision, particularly in patent litigation, could require material changes in production processes and products or result in the Company's inability to ship products or components found to have violated third-party patent rights.

NOTE 7 - OPERATIONS OF BUSINESS SEGMENTS

The Company is organized into two reportable segments based on the definitions provided in SFAS No. 131, "Disclosures about Segments of an Enterprise and Related Information": storage products and storage services. The storage products segment includes sales of tape and tape automation products, disk products, and network products. The storage services segment includes maintenance and various storage consulting activities.

The Company does not have any intersegment revenue, and segment operating performance is evaluated based on gross profit. The aggregate gross profit by segment equals the consolidated gross profit, and the Company does not allocate research and product development costs; selling, general, administrative, and other income and expense; interest income; interest expense; or benefit (provision) for income taxes to the segments. The revenue and gross profit by segment is as follows (in thousands of dollars):

	Quarter Ended		Nine Months Ended	
	09/27/02	09/28/01	09/27/02	09/28/01
Revenue:				
Storage products	$307,335	$322,960	$ 889,379	$ 974,591
Storage services	194,370	175,039	560,167	504,361
Total revenue	$501,705	$497,999	$1,449,546	$1,478,952
Gross profit:				
Storage products	$140,616	$148,756	$ 392,352	$ 436,407
Storage services	87,569	73,271	249,071	202,659
Total gross profit	$228,185	$222,027	$ 641,423	$ 639,066

The following table provides supplemental financial data regarding revenue from the Company's storage products segment (in thousands of dollars):

	Quarter Ended		Nine Months Ended	
	09/27/02	09/28/01	09/27/02	09/28/01
Tape and tape automation				

products	$239,736	$258,125	$ 702,500	$ 791,325
Disk products	33,309	23,500	88,570	75,098
Network and other products	34,290	41,335	98,309	108,168
Total storage products revenue	$307,335	$322,960	$ 889,379	$ 974,591

NOTE 8 - EARNINGS PER COMMON SHARE

The following table presents the calculation of basic and diluted earnings per share (in thousands, except per share amounts):

	Quarter Ended		Nine Months Ended	
	09/27/02	09/28/01	09/27/02	09/28/01
Net income	$ 23,870	$ 17,915	$ 48,957	$ 27,161
Weighted average common shares outstanding:				
Basic	105,268	103,352	104,903	102,886
Effect of dilutive common stock equivalents	1,853	1,788	2,457	1,614
Diluted	107,121	105,140	107,360	104,500
Earnings per common share:				
Basic	$ 0.23	$ 0.17	$ 0.47	$ 0.26
Diluted	$ 0.22	$ 0.17	$ 0.46	$ 0.26

For the quarters ended September 27, 2002, and September 28, 2001, options to purchase 7,239,457 and 6,081,221 shares of common stock, respectively, were excluded from the computation of diluted earnings per share because the exercise price of the options was greater than the average market price of the Company's common stock, and therefore, the effect would have been antidilutive. For the nine months ended September 27, 2002, and September 28, 2001, options to purchase 5,352,769 and 6,755,375 shares of common stock, respectively, were excluded from the computation of diluted earnings per share for the same reason.

NOTE 9 - RECENT ACCOUNTING PRONOUNCEMENTS

In August 2001, the FASB issued SFAS No. 143, "Accounting for Obligations Associated with the Retirement of Long-Lived Assets." This statement addresses the accounting for the recognition and measurement of an asset retirement obligation and its associated asset retirement cost. SFAS No. 143 is effective for the Company's financial statements for the year ending December 26, 2003. The adoption of this statement is not currently anticipated to have a material impact on the Company's financial position or results of operations.

In July 2002, the Financial Accounting Standards Board (FASB) issued SFAS No. 146, "Accounting for Costs Associated with Exit or Disposal Activities." This statement addresses the accounting for costs associated with an exit activity or with a disposal of long-lived assets. SFAS No. 146 is effective for the Company's financial statements for the year ending December 26, 2003. The

adoption of this statement is not currently anticipated to have a material impact on the Company's financial position or results of operations.

STORAGE TECHNOLOGY CORPORATION
MANAGEMENT'S DISCUSSION AND ANALYSIS OF
FINANCIAL CONDITION AND RESULTS OF OPERATIONS
SEPTEMBER 27, 2002

FORWARD-LOOKING STATEMENTS

All assumptions, anticipations, expectations, and forecasts contained in the following discussion regarding the Company, its future products, business plans, financial results, performance, and future events are forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. The Company's actual results may differ materially because of a number of risks and uncertainties. Some of these risks are detailed below in "Factors That May Affect Future Results" and elsewhere in this Form 10-Q. Forward-looking statements can be identified by the use of words such as "may," "will," "should," "expects," "plans," "anticipates," "believes," "estimates," "predicts," "intends," "potential," "continue," or the negative of such terms, or other comparable words. Forward-looking statements also include the assumptions underlying or relating to any such statements. The forward-looking statements contained herein represent a good-faith assessment of the Company's future performance for which management believes there is a reasonable basis. The Company disclaims any obligation to update the forward-looking statements contained herein, except as may be otherwise required by law.

CONSOLIDATED STATEMENTS OF OPERATIONS DATA

The following table, stated as a percentage of total revenue, presents Consolidated Statements of Operations information and revenue by segment:

	Quarter Ended		Nine Months Ended	
	09/27/02	09/28/01	09/27/02	09/28/01
Storage products revenue:				
Tape and tape automation products	47.8%	51.9%	48.5%	53.5%
Disk products	6.7	4.7	6.1	5.1
Network and other products	6.8	8.3	6.8	7.3
Total storage products revenue	61.3	64.9	61.4	65.9
Storage services revenue	38.7	35.1	38.6	34.1
Total revenue	100.0	100.0	100.0	100.0
Cost of revenue	54.5	55.4	55.7	56.8
Gross profit	45.5	44.6	44.3	43.2
Research and product development costs	10.6	12.2	11.2	12.5
Selling, general, administrative, and other income and expense, net	28.3	27.1	28.5	28.0
Operating profit	6.6	5.3	4.6	2.7
Interest income, net	0.4	0.1	0.4	0.1
Income before income taxes	7.0	5.4	5.0	2.8
Provision for income taxes	(2.2)	(1.8)	(1.6)	(1.0)

Net income	4.8%	3.6%	3.4%	1.8%

REVENUE

STORAGE PRODUCTS

The Company's storage products revenue consists of sales of tape and tape automation products, disk products, and network products for the enterprise and open-systems markets. The open-systems market consists of products designed to operate in the UNIX, NT, and other non-MVS operating environments. Storage products revenue decreased 5% and 9% during the third quarter and nine months of 2002, respectively, compared to the same periods in 2001, primarily due to decreased revenue from tape and tape automation products.

Tape and Tape Automation Products

Tape and tape automation product revenue decreased 7% and 11% during the third quarter and nine months of 2002, respectively, compared to the same periods in 2001, primarily due to a reduction in the number of tape and tape automation units sold. The Company believes this decline is primarily attributable to the current economic conditions and the associated weakness in information technology spending. The Company has experienced a higher ratio of tape drives sold relative to tape libraries as customers appear to be buying only products essential to meeting their immediate storage needs. Also contributing to the decline in tape and tape automation product revenue during the third quarter of 2002 was the shift from storage products revenue to storage services revenue as a result of the secondary storage services agreement signed with EDS. These decreases were partially offset by increased revenue from LTO tape drives and enterprise and open-systems tape media products.

During the third quarter of 2002, the Company introduced two new tape drive offerings: the T9940B, which is a high-speed, high-capacity tape drive for the high-end tape market, and Quantum's SDLT 320, which is a high-speed, high-capacity tape drive for the mid-range tape market. See "New Products" under "Factors That May Affect Future Results" for a discussion of the risks associated with these and other new products.

Disk Products

Disk product revenue increased 42% and 18% during the third quarter and nine months of 2002, respectively, compared to the same periods in 2001, primarily due to increased sales of open-systems disk products. In January 2002, the Company announced a distribution agreement with LSI Logic Storage Systems (LSI). Under the terms of the agreement, StorageTek will sell LSI's full line of open-systems disk products. The increased revenue from open-systems disk products was partially offset by decreased revenue from the V-Series product family. The Company is focusing its disk sales efforts on opportunities to sell disk products in combination with its tape, network, and service offerings. Disk revenue continues to be affected by pricing pressures and intense competition in the disk market, as well as the current economic conditions and associated weakness in information technology spending.

During the third quarter of 2002, the Company introduced its V2X Shared Virtual Array (SVA(TM)) disk storage system, which is the latest V-Series offering for both mainframe and open-systems environments. The V2X is designed to eliminate the under-allocation and over-purchasing of disk storage capacity that is required with conventional enterprise disk storage systems. See "New Products" under "Factors That May Affect Future Results" for a discussion of the risks

associated with this and other new products.

Network and Other Products

Network and other product revenue decreased 17% and 9% during the third quarter and nine months of 2002, respectively, compared to the same periods in 2001, primarily due to decreased sales of connectivity, software, and other miscellaneous products. The decrease was partially offset by increased sales of storage area networking (SAN) hardware, which includes the StorageNet(TM) 6000 series of domain managers and third-party equipment such as switches and bridges. Although sales of the Company's StorageNet(TM) 6000 increased during the third quarter and nine months of 2002, compared to the same periods in 2001, sales unit growth has been limited by the size of the market that this product can address. In October 2002, the Company announced its decision to outsource the development and manufacture of its StorageNet(TM) 6000 series of domain managers. This initiative will help the Company meet customer service objectives and improve time-to-market, cost, and manufacturing efficiency.

STORAGE SERVICES

The Company's storage services revenue primarily includes revenue associated with the maintenance of the Company's and third-party storage products, as well as service revenue associated with various storage consulting activities. Storage services revenue increased 11% during the third quarter and nine months of 2002, compared to the same periods in 2001. The growth in service revenue has been driven largely by an expanded effort to sell services that help customers successfully manage their storage requirements, as well as increased service revenue from the EDS agreement. See Note 3 of Notes to Consolidated Financial Statements for further discussion of the EDS secondary storage services agreement.

GROSS PROFIT

Gross profit margins remained flat at 45% for the third quarter of 2002, compared to the same period in 2001. Gross profit margins increased to 44% for the nine months of 2002, compared to 43% for the same period in 2001. The increase in gross profit margins for the nine months of 2002 is primarily a result of improvements in storage services profit margins. Gross profit margins for the storage products segment remained flat at 46% for the third quarter of 2002, compared to the same period in 2001. Gross profit margins decreased to 44% for the nine months of 2002, compared to 45% for the same period in 2001. Gross margins for the storage services segment increased to 45% and 44% for the third quarter and nine months of 2002, respectively, compared to 42% and 40% for the same periods in 2001. The increase in gross margins for the storage services segment reflects improvements in spare parts utilization and the service delivery process. The Company is continuing to assess its service delivery processes in an effort to improve efficiencies and eliminate unnecessary costs. These improvements may require additional investments and costs that could adversely impact service margins in future periods. Service margins may also decrease in future periods to the extent professional services, which generally carry lower margins, become a more significant source of service revenue.

RESEARCH AND PRODUCT DEVELOPMENT

Research and product development expenses decreased 12% and 13% during the third quarter and nine months of 2002, respectively, compared to the same periods in 2001, primarily due to engineering initiatives designed to improve research and development productivity, increase strategic alignment, and eliminate non-essential spending. The Company continues to evaluate and prioritize

research and product development programs and is focusing on the core businesses of tape automation, disk, virtual storage, and SAN products.

SELLING, GENERAL, ADMINISTRATIVE, AND OTHER INCOME AND EXPENSE

Selling, general, administrative, and other income and expense (SG&A) increased 5% during the third quarter of 2002, compared to the same period in 2001, primarily due to a pre-tax impairment charge of $4.5 million in connection with an equity investment. SG&A was unchanged during the nine months of 2002, as compared to the same period in 2001. As a percentage of revenue, SG&A was largely unchanged from the third quarter and nine months of 2001. In light of the prolonged economic downturn, the Company is continuing its efforts to control discretionary spending and identify new opportunities to drive increased profitability.

LITIGATION

In 1994, Stuff Technology Partners II, a Limited Partnership (Stuff), filed suit in Boulder County, Colorado, District Court alleging that the Company breached a 1990 settlement that had resolved earlier litigation between the parties involving an unsuccessful optical disk drive storage development project. The suit seeks injunctive relief and damages. In September 2002, a jury confirmed the Company's interpretation of the settlement agreement that the limitations on the Company's use of the development project technology is restricted to its use in optical disk drives. Remaining claims to be tried include Stuff's allegation that the Company did not transfer all of the technology to it as required under the 1990 settlement agreement and its allegation that the Company is using the technology in optical disk drives. The Company will vigorously defend these claims and, at this time, the Company believes that the likelihood of a material adverse result on the remaining claims is remote.

The Company also is involved in various other less significant legal actions. While the Company currently believes that the amount of any ultimate potential loss would not be material to the Company's financial position, the outcome of these actions is inherently difficult to predict. In the event of an adverse outcome, the ultimate potential loss could have a material adverse effect on the Company's financial position or reported results of operations in a particular quarter. An unfavorable decision, particularly in patent litigation, could require material changes in production processes and products or result in the Company's inability to ship products or components found to have violated third-party patent rights.

INTEREST INCOME AND EXPENSE

Interest income was largely unchanged during the third quarter and nine months of 2002, compared to the same periods in 2001. Interest expense decreased $1.2 million and $3.7 million during the third quarter and nine months of 2002, respectively, compared to the same periods in 2001, primarily due to a decrease in outstanding debt.

INCOME TAXES

The Company's effective tax rate was 32% for the third quarter and nine months of 2002, compared to 34% for the same periods in 2001. The decrease in the effective tax rate is primarily due to the Company's global tax strategies associated with the Company's manufacturing operations in Puerto Rico.

Statement of Financial Accounting Standards (SFAS) No. 109 requires that deferred income tax assets be recognized to the extent realization of such

assets is more likely than not. Based on the currently available information, management has determined that the Company will more likely than not realize $216.7 million of deferred income tax assets as of September 27, 2002. The Company's valuation allowance of approximately $20.9 million as of September 27, 2002, relates principally to net deductible temporary differences, tax credit carryforwards, and net operating loss carryforwards.

RECENT ACCOUNTING PRONOUNCEMENTS

In July 2001, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 142, "Goodwill and Other Intangible Assets." This statement addresses the accounting for goodwill and intangible assets subsequent to their acquisition. SFAS No. 142 requires that goodwill no longer be amortized. Under SFAS No. 142, goodwill will be tested for impairment on an annual basis or as necessary. The Company adopted SFAS No. 142 on the first day of the Company's fiscal year 2002. During the second quarter of 2002, the Company completed the initial goodwill impairment test. No accounting charge resulted from the completion of this initial impairment test. See Note 4 of Notes to Consolidated Financial Statements for a discussion of the financial impact on the Company's results of operations had SFAS No. 142 been in effect for all periods presented.

In August 2001, the Financial Accounting Standards Board (FASB) issued SFAS No. 143, "Accounting for Obligations Associated with the Retirement of Long-Lived Assets." This statement addresses the accounting for the recognition and measurement of an asset retirement obligation and its associated asset retirement cost. SFAS No. 143 is effective for the Company's financial statements for the year ending December 26, 2003. The adoption of this statement is not currently anticipated to have a material impact on the Company's financial position or results of operations.

In July 2002, the Financial Accounting Standards Board (FASB) issued SFAS No. 146, "Accounting for Costs Associated with Exit or Disposal Activities." This statement addresses the accounting for costs associated with an exit activity or with a disposal of long-lived assets. SFAS No. 146 is effective for the Company's financial statements for the year ending December 26, 2003. The adoption of this statement is not currently anticipated to have a material impact on the Company's financial position or results of operations.

LIQUIDITY AND CAPITAL RESOURCES

Working Capital

The Company's cash balance increased $96.7 million during the nine months of 2002 as a result of progress in the Company's efforts to more effectively manage working capital. The Company's operating activities provided cash of $257.6 million during the nine months of 2002, compared to cash of $125.5 million generated from operations during the same period in 2001. The increase in cash generated from operations during the nine months of 2002, compared to the same period in 2001, was primarily a result of significantly lower purchases of inventory, as well as other efforts to more effectively manage working capital. Cash used in investing activities increased to $97.0 million during the nine months of 2002 from $56.1 million during the nine months of 2001, primarily due to the repurchase of $52.2 million of secondary storage equipment from EDS in connection with the secondary storage services agreement. Cash used in financing activities increased to $59.8 million during the nine months of 2002, as compared to $1.4 million during the nine months of 2001. The increase in cash used in financing activities was primarily due to the repayment of borrowings under the Company's credit facilities during the nine months of 2002, partially

offset by increased proceeds from employee stock plans.

Sources of Liquidity and Capitalization

The Company has a $150.0 million revolving credit facility (the Revolver) that expires in October 2004. The interest rates for borrowing under the Revolver are dependent on the Company's Total Debt to rolling four quarter Earnings Before Interest Expense, Taxes, Depreciation, and Amortization (EBITDA) ratio and the term of the outstanding borrowing. The rate ranges from the applicable LIBOR plus 1.75% to 2.50% or the agent bank's base rate plus 0.00% to 0.50%. The

Company had no outstanding borrowings under the Revolver as of September 27, 2002. The Revolver is secured by the Company's domestic accounts receivable and domestic inventory, and contains certain financial and other covenants, including restrictions on the payment of cash dividends on the Company's common stock.

The Company had a financing agreement with a bank that provided for the sale of promissory notes in the principal amount of up to $75.0 million at any one time. This agreement expired in January 2002, and all outstanding promissory notes under the agreement were repaid at that time.

The Company's cash flows from operations are currently expected to serve as the principal source of working capital. Cash flows from operations could be negatively impacted by a decrease in demand for the Company's products and services as a result of rapid technological changes and other risks described under "Factors That May Affect Future Results."

The Company believes it has adequate working capital and financing capabilities to meet its anticipated operating and capital requirements for the next 12 months. Over the longer term, the Company may choose to fund these activities through the issuance of additional debt or equity financing. The issuance of equity or convertible debt securities could result in dilution to the Company's stockholders. There can be no assurance that any additional long-term financing, if required, can be completed on terms that are favorable to the Company.

The Company's debt-to-capitalization ratio decreased from 7% as of December 28, 2001, to 1% as of September 27, 2002, primarily because of the repayment of borrowings under the Company's credit facilities. See "Working Capital" above for a discussion of cash sources and uses.

INTERNATIONAL OPERATIONS

International operations accounted for approximately 48% and 49% of the Company's revenue during the third quarter and nine months of 2002, respectively, compared to 49% and 50% during the same periods of 2001. The Company also sells products through domestic indirect distribution channels that have end-user customers located outside the United States. The Company expects that it will continue to generate a significant portion of its revenue from international operations. See "International Business" under "Factors That May Affect Future Results" for a discussion of the risks associated with conducting business outside the United States.

The majority of the Company's international operations involve transactions denominated in the local currencies of countries within western Europe, principally Germany, France, and the United Kingdom; Australia; Canada; and Japan. An increase in the exchange value of the U.S. dollar reduces the value of revenue and profits generated by the Company's international operations. As a result, the Company's operating and financial results can be materially affected

by fluctuations in foreign currency exchange rates. In an attempt to mitigate the impact of foreign currency fluctuations, the Company employs a foreign currency hedging program. See "Market Risk Management" below.

MARKET RISK MANAGEMENT

Foreign Currency Exchange Rate Risk

The Company's primary market risk relates to changes in foreign currency exchange rates. The functional currency for the Company's foreign subsidiaries is the U.S. dollar. A significant portion of the Company's revenue is generated by its international operations. As a result, the Company's financial position, earnings, and cash flows can be materially affected by changes in foreign currency exchange rates. The Company attempts to mitigate this exposure as part

of its foreign currency hedging program. The primary goal of the Company's foreign currency hedging program is to reduce the risk of adverse foreign currency movements on the reported financial results of its non-U.S. dollar transactions. Factors that could have an impact on the effectiveness of the Company's hedging program include the accuracy of forecasts and the volatility of foreign currency markets. All foreign currency derivatives are authorized and executed pursuant to the Company's policies. The Company does not hold or issue derivatives for trading purposes.

To implement its foreign currency hedging program, the Company uses foreign currency options and forwards. These derivatives are used to hedge the risk that forecasted revenue denominated in foreign currencies might be adversely affected by changes in foreign currency exchange rates. Foreign currency forwards are also used to reduce the Company's exposure to foreign currency exchange rate fluctuations in connection with monetary assets and liabilities denominated in foreign currencies.

A hypothetical 10% adverse movement in foreign exchange rates applied to the Company's foreign currency exchange rate sensitive instruments held as of September 27, 2002, and as of December 28, 2001, would result in a hypothetical loss of approximately $65.6 million and $55.6 million, respectively. These hypothetical losses do not take into consideration the Company's underlying international operations. The Company anticipates that any hypothetical loss associated with the Company's foreign currency exchange rate sensitive instruments would be substantially offset by gains associated with its underlying international operations.

Interest Rate Risk

Changes in interest rates affect interest income earned on the Company's cash investments, as well as interest expense on short-term borrowings. A hypothetical 10% adverse movement in interest rates applied to cash investments and short-term borrowings held as of September 27, 2002, and as of December 28, 2001, would not have a material adverse effect on the Company's financial position, earnings, or cash flows.

Credit Risk

The Company is exposed to credit risk associated with cash investments, foreign currency derivatives, and trade receivables. The Company does not believe that its cash investments and foreign currency derivatives present significant credit risks, because the counterparties to the instruments consist of major financial institutions, and the Company manages the notional amount of contracts entered into with any one counterparty. Substantially all trade receivable balances are

unsecured. The concentration of credit risk with respect to trade receivables is limited due to the large number of customers in the Company's customer base and their dispersion across various industries and geographic areas. Although the Company has a large number of customers who are dispersed across different industries and geographic areas, a prolonged economic downturn could increase the Company's exposure to credit risk on its trade receivables. The Company performs ongoing credit evaluations of its customers and maintains an allowance for potential credit losses.

FACTORS THAT MAY AFFECT FUTURE RESULTS

New Products

Short product life cycles are inherent in high-technology industries. The Company's results of operations and competitive strength depend on its ability to successfully develop, manufacture, and market innovative new products, as well as adapt its current products and services to new technologies.

The Company devotes significant resources to research and product development projects and must effectively manage the risks associated with new products. Developing new products is complex and involves various uncertainties, including possible delays in product development, manufacturing, or in customer evaluation and purchasing decisions. The manufacture of new products involves integrating complex designs and processes, collaborating with sole source suppliers for key components, and increasing manufacturing capacities to accommodate demand. A design flaw, inaccurate forecasting of customer demand, failure to obtain sufficient quantities of key components, or manufacturing constraints could adversely affect the Company's operating and financial results. The Company has experienced product development and manufacturing delays in the past that adversely affected its financial results and competitive position. There can be no assurance that the Company will be able to successfully manage the development and introduction of new products in the future.

New Services

As the Company and its competitors introduce new products, the Company must ensure that services related to those new products are in place, including the appropriate resources, training, and management. Proper training is key in delivering the Company's maintenance and professional services, and a lack of proper training could have a material adverse effect on the Company's financial condition and results of operations. In addition, the Company must accurately forecast the demand for maintenance and professional services, and must manage its employee base accordingly. Any failure by the Company to properly manage its new and existing services business could have a material adverse effect on the Company's financial condition and results of operations.

Emerging Markets

Future revenue growth is partially dependent on successfully developing and introducing products and services for two primary emerging markets: the open-systems market and the SAN market.

The open-systems market includes products designed to operate in the UNIX, NT, and other non-MVS operating environments. Competition in the open-systems market is aggressive and is based primarily on functionality, technology, performance, reliability, quality, system scalability, price, product availability, customer service, and brand recognition. The open-systems market encompasses a broad range of customers, including customers outside of the Company's traditional customer base. Many of the Company's potential customers in the open-systems

market purchase their storage requirements as part of a bundled product, which may provide a competitive advantage to the Company's competitors. The Company expects to address these competitive factors by delivering storage solutions that utilize its expertise in tape, disk, and SANs in order to provide customers with superior functionality, performance, and quality. The Company's customer base continues to shift to the open-systems market, and there can be no assurance that the Company's strategy will be effective in expanding its open-systems market revenue.

The current and potential market for SAN solutions and technologies is continually evolving, and is characterized by rapidly changing technology and standards. The Company is still developing the necessary product modifications and professional services knowledge to successfully implement its SAN solutions in various operating environments. Customers may be reluctant to adopt new data storage standards, and competing standards may emerge that will be preferred by customers. Because this market is new and standards are still being defined, it is difficult to predict the potential size of the SAN market or the future rate of adoption of the Company's SAN solutions.

Competition

In the third quarter and nine months of 2002, approximately 80% of the Company's storage products revenue was derived from sales of tape and tape automation products. Additionally, a significant portion of the Company's service revenue is derived from the service of tape and tape automation products. One of the key competitive advantages that the Company's tape and tape automation products have over the competition's disk storage products is that the Company's tape and tape automation products store digitized data at a fraction of the cost of disk storage. The Company must continue to develop and introduce new tape and tape automation products that reduce the cost of storage at a rate that is similar to the decline in disk storage costs in order to maintain this competitive advantage.

Competition has resulted in price erosion in the past, and the Company expects this trend to continue. The cost of disk storage continues to decrease at a rapid rate due to competition and new disk drive technologies such as Advanced Technology Attachment (ATA). The Company recently announced that its ATA solution, the BladeStore disk subsystem, is scheduled for general availability in the fourth quarter of 2002. The Company believes that its ATA solution will complement enterprise-class disk by driving down costs and will complement tape with faster access. While the Company has unique competitive advantages with respect to its established customer base and a broad range of storage solution offerings, the Company's ability to compete in the disk market may be limited by the resources available for further development of its disk products, the effectiveness of disk product distribution, the competition, and market dynamics, including significant annual price erosion.

Price competition for the Company's products and services may have a significant impact on the Company's gross profit margins. The Company's ability to sustain or improve total gross margins is significantly dependent on designing, developing, and manufacturing competitive products, as well as reducing costs associated with the sourcing of production materials. This pressure on product margins is expected to increase as the Company's disk revenue shifts from its enterprise-class products to open-systems products developed and manufactured by a third party. Storage product gross margins also may be affected in future periods by inventory reserves and writedowns resulting from rapid technological changes or delays in gaining market acceptance for products.

The Company continues to purchase and use third-party products in delivering

storage solutions to customers. Some of these third-party products are manufactured by the Company's competitors, including LTO tape drives and certain SAN products. The Company may be at a cost disadvantage in acquiring these products, and gross margins may be adversely affected by the use of these products in storage solutions.

Indirect Channels

The Company continues to develop its indirect distribution channels, including original equipment manufacturers (OEMs), value-added distributors (VADs), value-added resellers (VARs), and other distributors. Increasing the Company's sales through these indirect channels is critical to the Company's successful expansion into the open-systems market. There can be no assurance that the Company will be successful in expanding its indirect channel sales. Furthermore, there can be no assurance that profit margins on indirect channel sales will not deteriorate due to competitive pressures. Maintenance revenue also may be adversely affected in future periods to the extent that customers of these indirect channel partners elect to purchase maintenance services from vendors other than the Company.

The Company's ability to forecast future demand for its products may be adversely affected by unforeseen changes in demand from its indirect channel partners. The Company's worldwide indirect channel sales were adversely impacted

during 2001 by the global economic downturn. Although there was slight improvement in U.S. indirect channel sales during the nine months of 2002, the Company has limited visibility to future indirect channel sales and the future financial condition of its channel partners. The Company's financial results may be negatively affected if the financial condition of one or more of these channel partners weakens or if the current economic downturn continues.

Key Personnel

The future success of the Company depends in large part on its ability to attract, retain, and motivate its management team and other key employees. The Company faces significant competition for individuals who possess the skills required to design, develop, manufacture, and market the Company's products and services. An inability to successfully attract, retain, and motivate these employees could have an adverse effect on future operating results.

Ability to Develop and Protect Intellectual Property Rights

The Company relies heavily on its ability to develop new intellectual property rights that do not infringe on the rights of others in order to remain competitive and to develop and manufacture products that are competitive in terms of technology and cost. There can be no assurance that the Company will continue to be able to develop such new intellectual property.

The Company relies on a combination of U.S. patent, copyright, trademark, and trade secret laws to protect its intellectual property rights. With respect to certain of the Company's international operations, the Company files patent and trademark registration applications with foreign governments. However, many foreign countries do not have intellectual property laws that are as well developed as those of the United States. The Company enters into confidentiality agreements relating to its intellectual property with its employees and consultants. In addition, the Company includes confidentiality provisions in license and non-exclusive sales agreements with its customers.

Despite all of the Company's efforts to protect its intellectual property

rights, unauthorized parties may attempt to copy or otherwise obtain or use the Company's intellectual property. Monitoring the unauthorized use of the Company's intellectual property rights is difficult, particularly in foreign countries. There can be no assurance that the Company will be able to protect its intellectual property rights, particularly in foreign countries.

Suppliers

The Company has reduced its inventory levels by over 35% during the nine months of 2002 in its efforts to more effectively manage working capital. The Company generally uses standard parts and components for its products and believes that, in most cases, there are a number of alternative, competent vendors for most of those parts and components. Many nonstandard parts are obtained from a limited group of suppliers. However, the Company believes there are other vendors who could produce these parts in satisfactory quantities after a period of prequalification and product ramping. Certain suppliers have experienced occasional technical, financial, or other problems that have delayed deliveries in the past. An unanticipated failure of suppliers to meet the Company's requirements for an extended period, or the inability to secure comparable components in a timely manner, could result in a shortage of key components or products, longer lead times, reduced control over production and delivery schedules, and an inability to fulfill customer orders in a timely manner. In addition, the Company will become increasingly dependent on a limited supplier base as it moves toward a lean manufacturing environment. An inability of a supplier to deliver required components or products could have a material adverse effect on revenue and operating results.

Sole Source Suppliers

Certain key components and products are purchased from sole source suppliers that the Company believes are currently the only manufacturers of the particular components that meet the Company's qualification requirements and other specifications or for which alternative sources of supply are not readily available. In the event a sole source supplier did not continue to supply components, the Company would need to identify and qualify other acceptable suppliers. This process could take an extended period, and there can be no assurance that any additional source would become available or would be able to satisfy production requirements on a timely basis or at a price acceptable to the Company.

Significant sole source suppliers include Imation Corporation (Imation), Sanmina-SCI Corporation (Sanmina), and Herald Datanetics Ltd. (HDL). There can be no assurance that significant sole source suppliers will be able to meet the Company's ongoing quality or delivery requirements necessary to satisfy customer needs. Failure to meet these requirements may have a material adverse impact on the Company's financial condition and results of operations.

Imation is a sole source supplier for the 9840 and 9940 tape media, and the Company is dependent on Imation to economically produce large volumes of high-quality tape media at a cost acceptable to the Company and its customers. In the second quarter of 2002, the Company announced it had outsourced its card manufacturing to Sanmina. The Company is dependent on Sanmina for the manufacture of printed circuit boards and for certain other manufacturing and repair services.

HDL is a sole subcontractor that manufactures a key component used in certain tape products. HDL is located in the People's Republic of China (PRC). The Company's dependence on HDL is subject to additional risks beyond those associated with other sole source suppliers, including the lack of a

well-established court system or acceptance of the rule of law in the PRC, the degree to which the PRC permits economic reform policies to continue, the political relationship between the PRC and the United States, and broader political and economic factors. To date, the Company has not experienced any material problems with HDL; however, there can be no assurance that the Company will not experience any material problems with HDL in the future.

Manufacturing

The Company manufactures and assembles a significant portion of its products in Puerto Rico, and the Company's ability to perform these activities may be significantly affected by weather-related risks beyond the control of the Company. If the Puerto Rico facility were significantly affected by adverse weather, the Company believes it could relocate operations within a reasonable period of time without substantial delays or disruption. However, there can be no assurance that the Company would be able to relocate its Puerto Rico operations in a timely manner to avoid a material adverse impact on its financial condition or results of operations.

International Business

The Company's international business may be affected by changes in demand resulting from global and localized economic, business, and political conditions. The Company is subject to the risks of conducting business outside the United States, including adverse political and economic conditions; impositions of, or changes in, tariffs, quotas, and legislative or regulatory requirements; difficulty in obtaining export licenses; potentially adverse taxes; the burdens of complying with a variety of foreign laws; and other factors outside the Company's control. The Company expects these risks to increase in the future as it expands its operations in eastern Europe, Asia, and Latin America. There can be no assurance that these factors will not have a

material adverse effect on the Company's business or financial results in the future.

Restructuring Activities

The Company's ability to generate revenue growth during 2001 and the nine months of 2002 was adversely affected by the slowdown in the global economy as some customers delayed purchase decisions, reevaluated their information technology spending budgets, required higher purchase approval levels, and reduced capital expenditures by maximizing the current capacities of their data storage equipment. The Company does not currently foresee any significant improvement in information technology spending during the fourth quarter of 2002 or during 2003. In light of this economic environment, the Company has implemented various cost-saving measures, including reduced discretionary spending, delayed employee merit increases, and the outsourcing of certain manufacturing and development activities. There can be no assurance that a prolonged economic downturn will not have additional adverse effects on the Company's future revenue or operating results. Furthermore, there can be no assurance that these cost-saving measures will be successful or sufficient to allow the Company to continue to generate improved operating results in future periods. The Company has recognized significant restructuring charges in the past and it is possible that changes in the Company's business or its industry may necessitate restructuring activities in the future. The necessity for restructuring activities may result in expenses that adversely affect results of operations and may require incremental cash payments.

Earnings Fluctuations

The Company's financial and operating results may fluctuate from quarter to quarter for a number of reasons. Many of the Company's customers undertake detailed procedures relating to the evaluation, testing, implementation, and acceptance of the Company's products, which results in a variable sales cycle and makes it difficult to predict if or when revenue will be earned. Furthermore, gross margins may be adversely impacted in an effort to complete the sales cycle.

In the past, the Company's results have followed a seasonal pattern, which reflects the tendency of customers to make their purchase decisions at the end of a calendar year. During any fiscal quarter, a disproportionately large percentage of the total product sales are earned in the last weeks or days of the quarter. It is difficult to predict the extent to which these historical trends will continue in the future, especially in light of the recent slowdown in the global economy.

A number of other factors also may cause revenue to fall below expectations, such as product and technology transitions announced by the Company or its competitors, delays in the availability of new products, inability to manufacture to meet customer demand, changes in the purchasing patterns of the Company's customers and distribution partners, or adverse global economic conditions. The Company has recently experienced changes in the purchasing patterns of its customers in the form of smaller purchases, delayed purchase decisions, and higher level approvals. The mix of sales among the Company's business segments and sales concentration in particular geographic regions may carry different gross profit margins and may cause the Company's operating margins to fluctuate. These factors make the forecasting of revenue inherently difficult. Because the Company plans its operating expenses on expected revenue, a shortfall in revenue may cause earnings to be below expectations in that period.

ITEM 3 - QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The information required under this Item 3 is included in the section above entitled "Market Risk Management."

ITEM 4 - CONTROLS AND PROCEDURES

Under the supervision and with the participation of management, including the principal executive officer and principal financial officer, the Company conducted an evaluation of its disclosure controls and procedures, as such term is defined under Rule 13a-14 promulgated under the Securities Exchange Act of 1934, within 90 days of the filing date of this report. Based on their evaluation, the principal executive officer and principal financial officer concluded that the Company's disclosure controls and procedures are effective.

There have been no significant changes in the Company's internal controls or in other factors that could significantly affect these controls subsequent to the date of the evaluation referenced above.

STORAGE TECHNOLOGY CORPORATION
PART II - OTHER INFORMATION

ITEM 1 - LEGAL PROCEEDINGS

In 1994, Stuff Technology Partners II, a Limited Partnership (Stuff), filed suit in Boulder County, Colorado, District Court alleging that the Company breached a 1990 settlement that had resolved earlier litigation between the parties involving an unsuccessful optical disk drive storage development project. The suit seeks injunctive relief and damages. In September 2002, a jury confirmed the Company's interpretation of the settlement agreement that the limitations on the Company's use of the development project technology is restricted to its use in optical disk drives. Remaining claims to be tried include Stuff's allegation that the Company did not transfer all of the technology to it as required under the 1990 settlement agreement and its allegation that the Company is using the technology in optical disk drives. The Company will vigorously defend these claims and, at this time, the Company believes that the likelihood of a material adverse result on the remaining claims is remote.

The Company also is involved in various other less significant legal actions. While the Company currently believes that the amount of any ultimate potential loss would not be material to the Company's financial position, the outcome of these actions is inherently difficult to predict. In the event of an adverse outcome, the ultimate potential loss could have a material adverse effect on the Company's financial position or reported results of operations in a particular quarter. An unfavorable decision, particularly in patent litigation, could require material changes in production processes and products or result in the Company's inability to ship products or components found to have violated third-party patent rights.

ITEM 6 - EXHIBITS AND REPORTS ON FORM 8-K

(a) Exhibits:

The exhibits listed below are filed as part of this Quarterly Report on Form 10-Q or are incorporated by reference into this Quarterly Report on Form 10-Q:

3.1 Restated Certificate of Incorporation of Storage Technology Corporation dated July 28, 1987 (previously filed as Exhibit 3.1 to the Company's Annual Report on Form 10-K for the fiscal year ended December 29, 2000, filed on February 21, 2001, and incorporated herein by reference)

3.2 Certificate of Amendment dated May 22, 1989, to the Restated Certificate of Incorporation dated July 28, 1987 (previously filed as Exhibit 3.2 to the Company's Annual Report on Form 10-K for the fiscal year ended December 29, 2000, filed on February 21, 2001, and incorporated herein by reference)

3.3 Certificate of Second Amendment dated May 28, 1992, to the Restated Certificate of Incorporation dated July 28, 1987 (previously filed as Exhibit 3.3 to the Company's Annual Report on Form 10-K for the fiscal year ended December 29, 2000, filed on February 21, 2001, and incorporated herein by reference)

3.4 Certificate of Third Amendment dated May 21, 1999, to the Restated Certificate of Incorporation dated July 28, 1987 (previously filed as Exhibit 3.1 to the Company's Quarterly Report on Form 10-Q for the fiscal quarter ended June 25, 1999, filed on August 9, 1999, and incorporated herein by reference)

3.5	Restated Bylaws of Storage Technology Corporation, as amended through November 11, 1998 (previously filed as Exhibit 3.1 to the Company's Current Report on Form 8-K dated November 19, 1998, and incorporated herein by reference)
4.1	Specimen Certificate of Common Stock, $0.10 par value of Registrant (previously filed as Exhibit (c)(2) to the Company's Current Report on Form 8-K dated June 2, 1989, and incorporated herein by reference)
10.1(1)	Storage Technology Corporation Amended and Restated 1987 Employee Stock Purchase Plan, as amended (previously filed as Exhibit 10.1 to the Company's Quarterly Report on Form 10-Q for the fiscal quarter ended June 29, 2001, filed on August 9, 2001, and incorporated herein by reference)
10.2(1)	Storage Technology Corporation Amended and Restated 1995 Equity Participation Plan (previously filed as Exhibit 10.6 to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 1999, filed on March 10, 2000, and incorporated herein by reference)
10.3(1)	Storage Technology Corporation Management by Objective Bonus Plan (previously filed as Exhibit 10.3 to the Company's Quarterly Report on Form 10-Q for the fiscal quarter ended March 30, 2001, filed on May 14, 2001, and incorporated herein by reference)

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1 Contract or compensatory plan or arrangement in which directors and/or officers participate.
2 Indicates exhibits filed with this Quarterly Report on Form 10-Q.

10.4(1)	Storage Technology Corporation Amended and Restated Stock Option Plan for Non-Employee Directors (previously filed as Exhibit 10.2 to the Company's Quarterly Report on Form 10-Q for the fiscal quarter ended June 28, 1996, filed on August 12, 1996, and incorporated herein by reference)
10.5(1)	Storage Technology Corporation Flexible Option Plan, dated December 2001 (previously filed as Exhibit 10.5 to the Company's Annual Report on Form 10-K for the fiscal year ended December 28, 2001, filed on March 4, 2002, and incorporated herein by reference)
10.6(1)	Agreement between the Company and Gary Francis, dated August 19, 1997 (previously filed as Exhibit 10.25 to the Company's Annual Report on Form 10-K for the fiscal year ended December 26, 1997, filed on March 6, 1998, and incorporated herein by reference)
10.7(1)	CEO Employment Agreement, dated July 11, 2000, between the Company and Patrick J. Martin (previously filed as Exhibit 10.1 to the Company's Quarterly Report on Form 10-Q for the fiscal quarter ended June 30, 2000, filed on August 11, 2000, and incorporated herein by reference)
10.8(1)	Severance Agreement, dated as of July 1, 2001, between the Company and Robert S. Kocol (previously filed as Exhibit 10.9 to the Company's Quarterly Report on Form 10-Q for the fiscal quarter ended September 28, 2001, filed on November 8, 2001, and incorporated herein by reference)
10.9(1)	Restricted Stock Award Agreement, dated as of September 27, 2001, by

and between the Company and Robert S. Kocol (previously filed as Exhibit 10.9 to the Company's Annual Report on Form 10-K for the fiscal year ended December 28, 2001, filed on March 4, 2002, and incorporated herein by reference)

10.10(1) Offer Letter, dated May 10, 2001, from the Company to Michael McLay (previously filed as Exhibit 10.17 to the Company's Quarterly Report on Form 10-Q for the fiscal quarter ended June 29, 2001, filed on August 9, 2001, and incorporated herein by reference)

10.11(1) Offer Letter, dated February 9, 2001, from the Company to Jill F. Kenney (previously filed as Exhibit 10.19 to the Company's Quarterly Report on Form 10-Q for the fiscal quarter ended March 30, 2001, filed on May 14, 2001, and incorporated herein by reference)

10.12(1) Offer Letter, dated February 9, 2001, from the Company to Roger Gaston (previously filed as Exhibit 10.20 to the Company's Quarterly Report on Form 10-Q for the fiscal quarter ended March 30, 2001, filed on May 14, 2001, and incorporated herein by reference)

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10.14(1) Promissory Note, dated May 11, 2001, from Michael McLay to the Company, in the principal amount of $160,000 (previously filed as Exhibit 10.24 to the Company's Quarterly Report on Form 10-Q for the fiscal quarter ended June 29, 2001, filed on August 9, 2001, and incorporated herein by reference)

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10.20 Credit Agreement, dated as of October 10, 2001, among the Company, the several financial institutions thereto, Bank of America, N.A., as letter of credit issuing bank and sole administrative agent for the Banks, Key Corporate Capital, Inc. as Documentation Agent, Fleet National Bank as Syndication Agent, and Banc of America Securities LLC as sole lead arranger and sole book manager (previously filed as Exhibit 10.13 to the Company's Quarterly Report on Form 10-Q for the fiscal quarter ended September 28, 2001, filed on November 8, 2001, and incorporated herein by reference)

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10.22 Guaranty, dated as of October 10, 2001, by StorageTek Holding Corporation, in favor of the Banks party to a certain Credit Agreement and Bank of America, N.A., as Agent and Issuing Bank and Collateral Agent (previously filed as Exhibit 10.15 to the Company's Quarterly Report on Form 10-Q for the fiscal quarter ended September 28, 2001, filed on November 8, 2001, and incorporated herein by reference)

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(b) Reports on Form 8-K.

Current Report on Form 8-K, filed on July 24, 2002, relating to an Item 5, Other Events and Regulation FD Disclosure, regarding an announcement by the Company of its results of operations for the fiscal quarter ended June 28, 2002, including a copy of the script of the prepared remarks of the Company's Chief Executive Officer and Chief Financial Officer from a conference call regarding such results of operation.

Current Report on Form 8-K, filed on August 13, 2002, relating to an Item 5, Other Events and Regulation FD Disclosure, regarding an announcement by the Company that the Chief Executive Officer and the Chief Financial Officer had filed sworn statements with the Securities and Exchange Commission in compliance with SEC Order No. 4-460.

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

STORAGE TECHNOLOGY CORPORATION
(Registrant)

November 11, 2002
(Date)

/s/ ROBERT S. KOCOL
Robert S. Kocol
Corporate Vice President

and Chief Financial Officer
(Principal Financial Officer)

November 11, 2002 /s/ THOMAS G. ARNOLD

(Date) Thomas G. Arnold
Vice President and Corporate Controller
(Principal Accounting Officer)

CERTIFICATIONS

I, Patrick J. Martin, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Storage Technology Corporation;

2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;

3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;

4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:

a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;

b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and

c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;

5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):

a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and

b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and

6. The registrant's other certifying officers and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: November 11, 2002

/s/ PATRICK J. MARTIN

Patrick J. Martin
Chairman, President and CEO

I, Robert S. Kocol, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Storage Technology Corporation;

2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;

3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;

4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:

a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;

b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and

c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our

evaluation as of the Evaluation Date;

5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):

a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and

b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and

6. The registrant's other certifying officers and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: November 11, 2002

/s/ ROBERT S. KOCOL

Robert S. Kocol
Corporate Vice President, Chief Financial Officer

EXHIBIT INDEX

Exhibit No.	Description
3.1	Restated Certificate of Incorporation of Storage Technology Corporation dated July 28, 1987 (previously filed as Exhibit 3.1 to the Company's Annual Report on Form 10-K for the fiscal year ended December 29, 2000, filed on February 21, 2001, and incorporated herein by reference)
3.2	Certificate of Amendment dated May 22, 1989, to the Restated Certificate of Incorporation dated July 28, 1987 (previously filed as Exhibit 3.2 to the Company's Annual Report on Form 10-K for the fiscal year ended December 29, 2000, filed on February 21, 2001, and incorporated herein by reference)
3.3	Certificate of Second Amendment dated May 28, 1992, to the Restated Certificate of Incorporation dated July 28, 1987 (previously filed as Exhibit 3.3 to the Company's Annual Report on Form 10-K for the fiscal year ended December 29, 2000, filed on February 21, 2001, and incorporated herein by reference)
3.4	Certificate of Third Amendment dated May 21, 1999, to the Restated Certificate of Incorporation dated July 28, 1987 (previously filed as Exhibit 3.1 to the Company's Quarterly Report on Form 10-Q for the fiscal quarter ended June 25, 1999, filed on August 9, 1999, and incorporated herein by reference)

3.5	Restated Bylaws of Storage Technology Corporation, as amended through November 11, 1998 (previously filed as Exhibit 3.1 to the Company's Current Report on Form 8-K dated November 19, 1998, and incorporated herein by reference)
4.1	Specimen Certificate of Common Stock, $0.10 par value of Registrant (previously filed as Exhibit (c)(2) to the Company's Current Report on Form 8-K dated June 2, 1989, and incorporated herein by reference)
10.1(1)	Storage Technology Corporation Amended and Restated 1987 Employee Stock Purchase Plan, as amended (previously filed as Exhibit 10.1 to the Company's Quarterly Report on Form 10-Q for the fiscal quarter ended June 29, 2001, filed on August 9, 2001, and incorporated herein by reference)
10.2(1)	Storage Technology Corporation Amended and Restated 1995 Equity Participation Plan (previously filed as Exhibit 10.6 to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 1999, filed on March 10, 2000, and incorporated herein by reference)
10.3(1)	Storage Technology Corporation Management by Objective Bonus Plan (previously filed as Exhibit 10.3 to the Company's Quarterly Report on Form 10-Q for the fiscal quarter ended March 30, 2001, filed on May 14, 2001, and incorporated herein by reference)
10.4(1)	Storage Technology Corporation Amended and Restated Stock Option Plan for Non-Employee Directors (previously filed as Exhibit 10.2 to the Company's Quarterly Report on Form 10-Q for the fiscal quarter ended June 28, 1996, filed on August 12, 1996, and incorporated herein by reference)

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10.5(1)	Storage Technology Corporation Flexible Option Plan, dated December 2001 (previously filed as Exhibit 10.5 to the Company's Annual Report on Form 10-K for the fiscal year ended December 28, 2001, filed on March 4, 2002, and incorporated herein by reference)
10.6(1)	Agreement between the Company and Gary Francis, dated August 19, 1997 (previously filed as Exhibit 10.25 to the Company's Annual Report on Form 10-K for the fiscal year ended December 26, 1997, filed on March 6, 1998, and incorporated herein by reference)
10.7(1)	CEO Employment Agreement, dated July 11, 2000, between the Company and Patrick J. Martin (previously filed as Exhibit 10.1 to the Company's Quarterly Report on Form 10-Q for the fiscal quarter ended June 30, 2000, filed on August 11, 2000, and incorporated herein by reference)
10.8(1)	Severance Agreement, dated as of July 1, 2001, between the Company and Robert S. Kocol (previously filed as Exhibit 10.9 to the Company's Quarterly Report on Form 10-Q for the fiscal quarter ended September 28, 2001, filed on November 8, 2001, and incorporated herein by reference)

10.9(1) Restricted Stock Award Agreement, dated as of September 27, 2001, by and between the Company and Robert S. Kocol (previously filed as Exhibit 10.9 to the Company's Annual Report on Form 10-K for the fiscal year ended December 28, 2001, filed on March 4, 2002, and incorporated herein by reference)

10.10(1) Offer Letter, dated May 10, 2001, from the Company to Michael McLay (previously filed as Exhibit 10.17 to the Company's Quarterly Report on Form 10-Q for the fiscal quarter ended June 29, 2001, filed on August 9, 2001, and incorporated herein by reference)

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mily: 'Times New Roman', Times; color: #000000; background: #FFFFFF"> Supporting the application for U.S. approval of the Toric ICL.

Research and development expenses were approximately $7,080,000, $5,573,000, and $6,246,000 for our 2006, 2005 and 2004 fiscal years, respectively. STAAR expects to pay a similar amount for research and development in 2007.

Environmental Matters

The Company is subject to federal, state, local and foreign environmental laws and regulations. We believe that our operations comply in all material respects with applicable environmental laws and regulations in each country where we do business. We do not expect compliance with these laws to materially affect our capital expenditures, earnings or competitive position. We currently have no plans to invest in material capital expenditures for environmental control facilities for the remainder of our current fiscal year or for the next fiscal year. We are not aware of any pending actions, litigation or significant financial obligations arising from current or past environmental practices that are likely to have a material adverse impact on our financial position. However, environmental problems relating to our properties could develop in the future, and such problems could require significant expenditures. In addition, we cannot predict changes in environmental legislation or regulations that may be adopted or enacted in the future and that may adversely affect us.

Significant Subsidiaries

The Company s only significant subsidiary is STAAR Surgical AG, a wholly owned entity incorporated in Switzerland. This subsidiary develops, manufactures and distributes products worldwide including Collamer IOLs, ICLs, TICLs and the AquaFlow Device. STAAR Surgical AG also controls 100% of Domilens GmbH, a German sales subsidiary, which distributes both STAAR products and products from other ophthalmic manufacturers.

Canon Staar Joint Venture

In 1988, STAAR entered into a Joint Venture Agreement with Canon Inc. and Canon Marketing Japan Inc., creating a company for the principal purpose of designing, manufacturing, and selling in Japan intraocular lenses and other ophthalmic products. The joint venture company, Canon Staar Co., Inc., markets its products worldwide through Canon, Canon Marketing, their subsidiaries and/or STAAR or such other distributors as the Board of Directors of the joint venture may approve. The terms of any such distribution arrangements require the unanimous approval of the Board of Directors of the joint venture. Of the five members of the Board of Directors of the joint venture, STAAR and Canon Marketing are each entitled to appoint two directors and Canon may appoint one. The president of the joint venture is to be appointed by STAAR. Several matters require the unanimous approval of the directors, including appointment of officers, acquiring or disposing of assets exceeding 20% of the joint venture s total book value, and borrowing money or granting a lien exceeding 20% of the joint venture s total book value. Upon the occurrence of a merger, a sale of substantially all of the assets or change in the management of one of the parties, any of the other parties may have the right to acquire the first party s interest in the joint venture at book value.

In 1988, STAAR also entered into a Technical Assistance and Licensing Agreement with the joint venture to further its purposes, granting to the joint venture a perpetual exclusive license to use STAAR technology to make and sell products in Japan, and a perpetual non-exclusive license to use STAAR technology to sell products in the rest of the world, subject to the requirements of the Joint Venture Agreement that all sales take place through a distribution agreement unanimously approved by the directors of the joint venture. STAAR also granted to the joint venture a right of first refusal on the distribution of STAAR s products in Japan.

In 2001, the parties entered into a settlement agreement whereby (i) they reconfirmed the Joint Venture Agreement and the Technical Assistance and Licensing Agreement, (ii) they agreed that the Company would promptly commence the transfer of STAAR s technology to the joint venture, (iii) the Company granted the joint venture an exclusive license to make any products in China and sell such products in Japan and China (subject to STAAR s existing licenses and the existing rights of third parties), (iv) the Company agreed to provide the joint venture with raw materials under a supply agreement to be entered into with the joint venture, (v) Canon Marketing is to enter into a distribution agreement with the joint venture providing a minimum 50-70% share of sales revenue

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to the joint venture and having such other terms as unanimously approved by the directors of the joint venture, and (vi) the parties settled certain patent disputes.

The joint venture has a single class of capital stock, of which STAAR owns 50%. Accordingly, STAAR is entitled to 50% of any dividends or distributions by the joint venture and 50% of the proceeds of any liquidation.

The foregoing description of the joint venture agreement, technical assistance and license agreement and settlement agreement is qualified in its entirety by the full text of such agreements, which have been filed as exhibits or incorporated by reference to this report. See *Item 1A. Risk Factors We have licensed our technology to our joint venture company and have granted certain rights to the partners that could be exercised in the event of a change in control of the Company.*

Employees

As of March 23, 2007, we employed approximately 284 persons.

Code of Ethics

The Company has adopted a Code of Ethics that applies to all Company directors, officers, and employees. The Code of Ethics is posted on the Company s website, *www.staar.com Investor Relations: Corporate Governance.*

Additional Information

The Company makes available free of charge through our website, *www.staar.com*, our Annual Report on Form 10-K, Quarterly Reports on Form 10-Q and Current Reports on Form 8-K and amendments to those reports filed or furnished pursuant to Section 13(a) of the Securities Exchange Act of 1934, as soon as reasonably practicable after those reports are filed with or furnished to the Securities and Exchange Commission (SEC).

The public may read any of the items we file with the SEC at the SEC s Public Reference Room at 450 Fifth Street, NW, Washington, DC 20549. The public may obtain information about the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. The SEC also maintains an Internet site that contains reports, proxy and information statements, and other information regarding the Company and other issuers that file electronically with the SEC at http://www.sec.gov.

Item 1A. *Risk Factors*

Our short and long-term success is subject to many factors that are beyond our control. Investors and prospective investors should consider carefully the following risk factors, in addition to other information contained in this report. This Annual Report on Form l0-K/A contains forward-looking statements, which are subject to a variety of risks and uncertainties. Our actual results could differ materially from those anticipated in these forward-looking statements as a result of various factors, including those set forth below.

Risks Related to Our Business

We have a history of losses and anticipate future losses.

We have reported losses in each of the last several fiscal years and have an accumulated deficit of $86.7 million as of December 29, 2006. There can be no assurance that we will report net income in any future period.

We have only limited working capital and limited access to financing.

While STAAR has experienced increased sales in recent periods, our cash requirements continue to exceed the level of cash generated by operations and we expect to continue to seek additional resources to support and expand our business, such as debt or equity financing. Because of our history of losses and negative cash flows, our ability to obtain adequate financing on satisfactory terms is limited. Our ability to raise financing through sales of equity securities depends on general market conditions and the demand for STAAR s common stock. We may be unable to raise adequate capital through sales of equity securities, and if our stock has a low market price at the time of such

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sales our existing stockholders could experience substantial dilution. An inability to secure additional financing could limit the expansion of our business and jeopardize our ability to continue operations.

Our history of losses limits our access to credit and increases the risk of a default on our loan agreements.

Under its U.S. and international bank credit facilities and lease lines of credit, STAAR had $3 million in outstanding indebtedness and $1.4 million available for borrowing as of December 29, 2006. The credit facilities are subject to various financial covenants, and if our losses continue we risk defaulting on the terms of our credit facilities. Our limited borrowing capacity could cause a shortfall in working capital or prevent us from making expenditures to expand or enhance our business. To the extent we borrow under our credit facilities, a subsequent default could cause our obligations to be accelerated, make further borrowing difficult and jeopardize our ability to continue operations.

We may be subject to limitations in fully utilizing our recorded tax loss carryforwards.

We have accumulated approximately $37.4 million of tax carryfowards to be used in future periods. If we were to experience a significant change in ownership, Internal Revenue Code Section 382 may restrict the future utilization of these tax loss carry forwards.

FDA compliance issues have harmed our reputation, and we expect to devote significant resources to maintaining compliance in the future.

The Office of Compliance of the FDA s Center for Devices and Radiological Health regularly inspects STAAR s facilities to determine whether we are in compliance with the FDA Quality System Regulations relating to such things as manufacturing practices, validation, testing, quality control, product labeling and complaint handling, and in compliance with FDA Medical Device Reporting regulations.

Based on the results of the FDA inspections of STAAR s Monrovia, California facilities in 2005 and 2006, STAAR believes that it is substantially in compliance with the FDA s Quality System Regulations and Medical Device Reporting regulations. However, between December 29, 2003 and July 5, 2005 we received Warning Letters and other correspondence indicating that the FDA found STAAR s Monrovia, California facility in violation of applicable regulations, warning of possible enforcement action and suspending approval of new implantable devices. The FDA s findings of compliance deficiencies during that period harmed our reputation in the ophthalmic industry, affected our product sales and delayed FDA approval of the ICL.

STAAR s ability to continue its U.S. business depends on the continuous improvement of its quality systems and its compliance with FDA regulations. Accordingly, for the foreseeable future STAAR s management expects its strategy to include devoting significant resources and attention to those efforts. STAAR cannot ensure that its efforts will always be successful, and any failure to demonstrate substantial compliance with FDA regulations can result in enforcement actions that terminate, suspend or severely restrict our ability to continue manufacturing and selling medical devices. Please see the related risks discussed under the headings *We are subject to extensive government regulation, which increases our costs and could prevent us from selling our products* and *We are subject to federal and state regulatory investigations.*

Our strategy to restore profitability in the near term relies on successfully penetrating the U.S. refractive market.

While products to treat cataracts continue to account for the majority of our revenue, we believe that increasing sales of our Visian® ICL refractive products, especially in the U.S., present the best near term opportunity for a return to profitability. The FDA approved the Visian ICL for treatment of myopia on December 22, 2005. Selling and marketing the ICL has presented a challenge to our sales and marketing staff and to our independent manufacturers

representatives. In the United States patients who might benefit from the ICL have already been exposed to a great deal of advertising and publicity about laser refractive surgery, but have little if any awareness of the ICL. In addition, established refractive surgeons frequently have large and well developed practices that are oriented entirely toward the delivery of laser procedures. In countries where the ICL has been approved to date, our

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sales have grown steadily but slowly, and the U.S. appears to be following this pattern. A surgeon interested in implanting the ICL must first schedule training and certification and invest time in the training process. While STAAR has sufficient resources to make training available to qualified surgeons with minimal delay, the need to undergo training continues to limit the pace at which interested surgeons can begin providing the ICL to their patients. STAAR employs advertising and promotion targeted to potential patients through providers, but has limited resources for these purposes. Failure to successfully market the ICL in the United States will delay and possibly prevent our planned growth and return to profitability.

Our core domestic business has suffered declining sales, which sales of new products have only begun to offset.

STAAR pioneered the foldable IOL for use in cataract surgery, and the foldable silicone IOL remains our largest source of sales. Since we introduced the product, however, competitors have introduced IOLs employing a variety of designs and materials. Over the years these products have gradually taken a larger share of the IOL market, while the market share for STAAR silicone IOLs has decreased. In particular, many surgeons now choose lenses made of acrylic material rather than silicone for their typical patients. In addition, our competitors have begun to offer multifocal or accommodating lenses that claim to reduce the need for cataract patients to use reading glasses; the market for these presbyopic lenses is expected to grow as a segment of the cataract market. Our newer line of IOLs made of our proprietary biocompatible Collamer® material have helped reverse the trend of declining domestic cataract product sales, but it is too early to assess the potential for sustained growth and whether we can recover a significant amount of the market share lost over the last several years.

Strikes, slow-downs or other job actions by doctors can reduce sales of cataract-related products.

In many countries where STAAR sells its products, doctors, including ophthalmologists, are employees of the government, government-sponsored enterprises or large health maintenance organizations. In recent years employed doctors who object to salary limitations, working rules, reimbursement policies or other conditions have sought redress through strikes, slow-downs and other job actions. These actions often result in the deferral of non-essential procedures, such as cataract surgeries, which can affect sales of our products. For example, in fiscal year 2006, strikes and slow-downs by doctors in Germany were partly responsible for a drop in sales by our wholly owned subsidiary Domilens GmbH, which distributes ophthalmic products in Germany. Such problems could occur again in Germany or other regions and, depending on the importance of the affected region to STAAR s business, the length of the action and its pervasiveness, job actions by doctors can materially reduce our sales revenue and earnings.

Because state-sponsored healthcare systems, health maintenance organizations and insurance reimbursement usually do not cover refractive surgery, job actions by doctors are unlikely to affect ICL sales.

Our sales are subject to significant seasonal variation.

We generally experience lower sales during the third quarter due to the effect of summer vacations on elective procedures. In particular, because sales activity in Europe drops dramatically in July and August, and European sales have recently accounted for a greater proportion of our total sales, this seasonal variation in our results has become even more pronounced.

We depend on independent manufacturers representatives.

In an effort to manage costs and bring our products to a wider market, we have entered into long-term agreements with independent regional manufacturers representatives, who introduce our products to eye surgeons and provide the training needed to begin using some of our products. Under our agreements with these representatives, each receives a commission on all of our sales within a specified region, including sales on products we sell into their territories

without their assistance. Because they are independent contractors, we have a limited ability to manage these representatives or their employees. In addition, a representative may represent manufacturers other than STAAR, although not in competing products. STAAR s strategy for growth involves the marketing of innovative products like the ICL, Collamer IOLs, Toric IOLs and the AquaFlow Device. We have relied on the

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independent representatives to implement the marketing of these products and to sustain the market for our more established products. Because our independent representatives generally have little experience dealing with surgeons who specialize in refractive procedures, we have faced greater challenges in developing the domestic market for the ICL. If our independent manufacturers representatives do not devote sufficient resources to marketing our products, or if they lack the skills or resources to market our new products, our new products will fail to reach their full sales potential and sales of our established products could decline.

Product recalls have been costly and may be so in the future.

Medical devices must be manufactured to the highest standards and tolerances, and often incorporate newly developed technology. Despite all efforts to achieve the highest level of quality control and advance testing, from time to time defects or technical flaws in our products may not come to light until after the products are sold or consigned. In those circumstances, we have previously made voluntary recalls of our products. We may also be subject to recalls initiated by manufacturers of products we distribute. In February 2006, our German subsidiary recalled all lots of a balanced salt solution it distributes due to the manufacturer s recall for possible endotoxin content. In 2005, we recalled one lot of phaco tubing manufactured by a third party, due to incorrect labeling, and we recalled one lot of STAARVISC, also manufactured by a third party, due to a potential sterility breach of the packaging of the cannula that is packaged with the STAARVISC. The last recall of STAAR products took place during 2004, when we initiated several voluntary recalls of STAAR-manufactured product including 33 lots of IOL cartridges, three lots of injectors, and 529 lenses, and in February 2004, in an action considered a recall but with no requirement for product to be returned to us, we issued a letter to healthcare professionals advising them of the potential for a change in manifest refraction over time in rare cases involving the single-piece Collamer IOL. While the majority of the direct costs associated with the recalls have not been material, we believe recalls have harmed our reputation and adversely affected our product sales, although the impact cannot be quantified. Similar recalls could take place again. Courts or regulators can also impose mandatory recalls on us, even if we believe our products are safe and effective.

Recalls can result in lost sales of the recalled products themselves, and can result in further lost sales while replacement products are manufactured, especially if the replacements must be redesigned. If recalled products have already been implanted, we may bear some or all of the cost of corrective surgery. Recalls may also damage our professional reputation and the reputation of our products. The inconvenience caused by recalls and related interruptions in supply, and the damage to our reputation, could cause some professionals to discontinue using our products.

We could experience losses due to product liability claims.

We have been subject to product liability claims in the past and continue to be so. As part of our risk management policy, we have obtained third-party product liability insurance coverage. In recent periods this insurance has become more expensive and difficult to procure. Product liability claims against us may exceed the coverage limits of our insurance policies or cause us to record a loss in excess of our deductible. A product liability claim in excess of applicable insurance could have a material adverse effect on our business, financial condition and results of operations. Even if any product liability loss is covered by an insurance policy, these policies have retentions or deductibles that provide that we will not receive insurance proceeds until the losses incurred exceed the amount of those retentions or deductibles. To the extent that any losses are below these retentions or deductibles, we will be responsible for paying these losses. The payment of retentions or deductibles for a significant amount of claims could have a material adverse effect on our business, financial condition, and results of operations.

Any product liability claim would divert managerial and financial resources and could harm our reputation with customers. We cannot assure you that we will not have product liability claims in the future or that such claims would not have a material adverse effect on our business.

We compete with much larger companies.

Our competitors, including Alcon, Advanced Medical Optics, and Bausch & Lomb have much greater financial resources than we do and some of them have large international markets for a full suite of ophthalmic

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products. Their greater resources for research, development and marketing, and their greater capacity to offer comprehensive products and equipment to providers, make it difficult for us to compete. We have lost significant market share to some of our competitors.

Most of our products have single-site manufacturing approvals, exposing us to risks of business interruption.

We manufacture all of our products either at our facilities in California or at our facility in Switzerland. Most of our products are approved for manufacturing only at one of these sites. Before we can use a second manufacturing site for an implantable device we must obtain the approval of regulatory authorities. Because this process is expensive we have generally not sought approvals needed to manufacture at an additional site. If a natural disaster, fire, or other serious business interruption struck one of our manufacturing facilities, it could take a significant amount of time to validate a second site and replace lost product. We could lose customers to competitors, thereby reducing sales, profitability and market share.

The global nature of our business may result in fluctuations and declines in our sales and profits.

Our products are sold in approximately 50 countries. Sales from international operations make up a significant portion of our total sales. For the year ended December 29, 2006, sales from international operations were 60% of total sales. The results of operations and the financial position of certain of our offshore operations are reported in the relevant local currencies and then translated into United States dollars at the applicable exchange rates for inclusion in our consolidated financial statements, exposing us to translation risk. In addition, we are exposed to transaction risk because some of our expenses are incurred in a different currency from the currency in which our sales are received. Our most significant currency exposures are to the Euro, the Swiss Franc, and the Australian dollar. The exchange rates between these and other local currencies and the United States dollar may fluctuate substantially. We have not attempted to offset our exposure to these risks by investing in derivatives or engaging in other hedging transactions. Fluctuations in the value of the United States dollar against other currencies have not had a material adverse effect on our operating margins and profitability in the past.

Economic, social and political conditions, laws, practices and local customs vary widely among the countries in which we sell our products. Our operations outside of the United States are subject to a number of risks and potential costs, including lower profit margins, less stringent protection of intellectual property and economic, political and social uncertainty in some countries, especially in emerging markets. Our continued success as a global company depends, in part, on our ability to develop and implement policies and strategies that are effective in anticipating and managing these and other risks in the countries where we do business. These and other risks may have a material adverse effect on our operations in any particular country and on our business as a whole. We price some of our products in U.S. dollars, and as a result changes in exchange rates can make our products more expensive in some offshore markets and reduce our sales. Inflation in emerging markets also makes our products more expensive there and increases the credit risks to which we are exposed.

The success of our international operations depends on our successfully managing our foreign subsidiaries.

We conduct most of our international business through wholly owned subsidiaries. Managing distant subsidiaries and fully integrating them into STAAR s business is challenging. While STAAR seeks to fully integrate its foreign subsidiaries into its operations, direct supervision of every aspect of their operations is impossible, and as a result STAAR relies on its local managers and staff. Cultural factors and language differences can result in misunderstandings among internationally dispersed personnel. In early 2007, STAAR learned that the president of its German sales subsidiary, Domilens, had misappropriated corporate assets. While STAAR has implemented remedial efforts to reinforce its Code of Ethics and increase its oversight of Domilens, the risk that unauthorized conduct may go undetected will always be greater in foreign subsidiaries. Some countries may also have laws or cultural factors

that make it difficult to impose uniform standards and practices. For example, while STAAR s Code of Ethics requires all employees to certify they are not aware of code violations by others, German legal counsel has advised STAAR that in Germany it cannot legally compel ordinary employees (i.e., non-supervisors) to notify STAAR of breaches by others. STAAR believes the absence of such a requirement in its Code

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of Ethics for German employees is a risk inherent to doing business in Germany that may be mitigated, but not entirely eliminated, by other controls.

We obtain some of the components of our products from a single source, and an interruption in the supply of those components could reduce our sales.

We obtain some of the components for our products from a single source. For example, only one supplier produces our viscoelastic product. Although we believe we could find alternate supplies for any of these components, the loss or interruption of any of these suppliers could increase costs, reducing our sales and profitability, or harm our customer relations by delaying product deliveries. Even when substitute suppliers are available, the need to certify regulatory compliance and quality standards of substitute suppliers could cause significant delays in production and a material reduction in our sales revenue. We try to mitigate this risk by stockpiling raw materials when practical and identifying secondary suppliers, but the risk cannot be entirely eliminated. For example, the failure of one of our suppliers could be the result of an unforeseen industry-wide problem, or the failure of our supplier could create an industry-wide shortage affecting secondary suppliers as well.

Our activities involve hazardous materials and emissions and may subject us to environmental liability.

Our manufacturing, research and development practices involve the controlled use of hazardous materials. We are subject to federal, state and local laws and regulations in the various jurisdictions in which we have operations governing the use, manufacturing, storage, handling and disposal of these materials and certain waste products. Although we believe that our safety and environmental procedures for handling and disposing of these materials comply with legally prescribed standards, we cannot completely eliminate the risk of accidental contamination or injury from these materials. Remedial environmental actions could require us to incur substantial unexpected costs, which would materially and adversely affect our results of operations. If we were involved in a major environmental accident or found to be in substantial non-compliance with applicable environmental laws, we could be held liable for damages or penalized with fines.

We risk losses through litigation.

From time to time we are party to various claims and legal proceedings arising out of the normal course of our business. These claims and legal proceedings relate to contractual rights and obligations, employment matters, and claims of product liability. While we do not believe that any of the claims known to us is likely to have a material adverse effect on our financial condition or results of operations, new claims or unexpected results of existing claims could lead to significant financial harm.

We depend on key employees.

We depend on the continued service of our senior management and other key employees. The loss of a key employee could hurt our business. We could be particularly hurt if any key employee or employees went to work for competitors. Our future success depends on our ability to identify, attract, train and motivate other highly skilled personnel. Failure to do so may adversely affect future results.

We have licensed our technology to our joint venture company and have granted rights to the partners that could be exercised in the event of a change in control of STAAR.

We have granted to the Canon Staar joint venture, an irrevocable, exclusive license to make and sell products using our technology in Japan. We have also granted the joint venture an irrevocable, exclusive license to make products using our technology in China and to sell in China and Japan the products made in China. In addition, we have granted

Canon Staar an irrevocable, non-exclusive license to sell products using our technology in the rest of the world. Subject to the unanimous approval of the Board of Directors of the joint venture, such licenses may allow the Canon Staar joint venture to sell products in the rest of the world directly or through distributors.

If a party to the Canon Staar joint venture undergoes a merger, sale of substantially all of its assets or changes its management, any of the other joint venture partners has the right to acquire that party s interest in the joint

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venture at book value. The terms of the principal agreements governing the joint venture are described in this Annual Report on Form 10-K/A under the heading *Business Canon Staar Joint Venture.*

Changes in accounting standards could affect our financial results.

The accounting rules applicable to public companies like STAAR are subject to frequent revision. Future changes in accounting standards could require us to change the way we calculate income, expense or balance sheet data, resulting in significant changes in our reported results of operation or financial condition.

We are subject to international taxation laws that could affect our financial results.

STAAR conducts international operations through its subsidiaries. Tax laws affecting international operations are highly complex and subject to change. STAAR s payment of income tax in the different countries where it operates depends in part on internal settlement prices and administrative charges among STAAR and its subsidiaries. These arrangements require judgments by STAAR and are subject to risk that tax authorities will disagree with those judgments and impose additional taxes, penalties or interest on STAAR. STAAR engages in dialogue with tax authorities in some of the countries where it operates to mitigate this risk, but it cannot be entirely eliminated. In addition, transactions that STAAR has arranged in light of current tax rules could have unforeseeable negative consequences if tax rules change.

If we suffer loss to our facilities due to catastrophe, our operations could be seriously harmed.

We depend on the continuing operation of all of our manufacturing facilities in California and Switzerland, which have little redundancy or overlap among their activities. Our facilities are subject to catastrophic loss due to fire, flood, earthquake, terrorism or other natural or man-made disasters. In particular, our California facilities are in areas where earthquakes could cause catastrophic loss. If any of these facilities were to experience a catastrophic loss, it could disrupt our operations, delay production, shipments and revenue and result in large expenses to repair or replace the facility. Although we carry insurance for property damage and business interruption, we do not carry insurance or financial reserves for interruptions or potential losses arising from earthquakes or terrorism.

If we are unable to protect our information systems against data corruption, cyber-based attacks or network security breaches, our operations could be disrupted.

We are significantly dependent on information technology networks and systems, including the Internet, to process, transmit and store electronic information. In particular, we depend on our information technology infrastructure for electronic communications among our locations around the world and between our personnel and our subsidiaries, customers, and suppliers. Security breaches of this infrastructure can create system disruptions, shutdowns or unauthorized disclosure of confidential information. If we are unable to prevent such security breaches, our operations could be disrupted or we may suffer financial damage or loss because of lost or misappropriated information.

Risks Related to the Ophthalmic Products Industry

If we fail to keep pace with advances in our industry or fail to persuade physicians to adopt the new products we introduce, customers may not buy our products and our sales may decline.

Constant development of new technologies and techniques, frequent new product introductions and strong price competition characterize the ophthalmic industry. The first company to introduce a new product or technique to market usually gains a significant competitive advantage. Our future growth depends, in part, on our ability to develop products to treat diseases and disorders of the eye that are more effective, safer, or incorporate emerging technologies

better than our competitors products. Sales of our existing products may decline rapidly if one of our competitors introduces a substantially superior product, or if we announce a new product of our own. Similarly, if we fail to make sufficient investments in research and development or if we focus on technologies that do not lead to better products, our current and planned products could be surpassed by more effective or advanced products.

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In addition, we must manufacture these products economically and market them successfully by persuading a sufficient number of eye care professionals to use them. For example, glaucoma requires ongoing treatment over a long period of time; thus, many doctors are reluctant to switch a patient to a new treatment if the patient s current treatment for glaucoma remains effective. This has been a challenge in selling our AquaFlow Device.

Resources devoted to research and development may not yield new products that achieve commercial success.

We spent 12.6% of our sales on research and development during the year ended December 29, 2006, and we expect to spend approximately 10% for this purpose in future periods. Development of new implantable technology, from discovery through testing and registration to initial product launch, is expensive and typically takes from three to seven years. Because of the complexities and uncertainties of ophthalmic research and development, products we are currently developing may not complete the development process or obtain the regulatory approvals required for us to market the products successfully. It is possible that few or none of the products currently under development will become commercially successful.

Changes in reimbursement for our products by third-party payors could reduce sales of our products or make them less profitable.

Many of our products, in particular IOLs and products related to the treatment of glaucoma, are used in procedures that are typically covered by health insurance, HMO plans, Medicare, Medicaid, or other governmental sponsored programs in the U.S. and Europe. Third party payors in both government and the private sector continue to seek to manage costs by restricting the types of procedures they reimburse to those viewed as most cost-effective and by capping or reducing reimbursement rates. Whether they limit reimbursement prices for our products and or limit the surgical fees for a procedure that uses our products, these policies can reduce the sales volume of our reimbursed products, their selling prices or both.

In some countries government agencies control costs by limiting the number of surgical procedures they will reimburse. For example, a recent reduction in the number of authorized cataract procedures in Germany has affected the sales of our German subsidiary, Domilens. Similar changes could occur in our other markets.

The U.S. Congress has considered legislative proposals that would significantly change the system of public and private health care reimbursement, and will likely consider such changes again in the future. We are not able to predict whether new legislation or changes in regulations will take effect at the state or federal level, but if enacted these changes could have a significant effect on our business.

We are subject to extensive government regulation, which increases our costs and could prevent us from selling our products.

STAAR is regulated by regional, national, state and local agencies, including the Food and Drug Administration, the Department of Justice, the Federal Trade Commission, the Office of the Inspector General of the U.S. Department of Health and Human Services and other regulatory bodies, as well as governmental authorities in those foreign countries in which we manufacture or distribute products. The Federal Food, Drug, and Cosmetic Act, the Public Health Service Act and other federal and state statutes and regulations govern the research, development, manufacturing and commercial activities relating to medical devices, including their pre-clinical and clinical testing, approval, production, labeling, sale, distribution, import, export, post-market surveillance, advertising, dissemination of information and promotion. We are also subject to government regulation over the prices we charge and the rebates we offer to customers. Complying with government regulation substantially increases the cost of developing, manufacturing and selling our products.

In the United States, we must obtain approval from the FDA for each product that we market. Competing in the ophthalmic products industry requires us to continuously introduce new or improved products and processes, and to submit these to the FDA for approval. Obtaining FDA approval is a long and expensive process, and approval is never certain. In addition, our operations in the United States are subject to periodic inspection by the FDA. An unfavorable outcome in an FDA inspection may result in the FDA ordering changes in our business practices or taking other enforcement action, which could be costly and severely harm our business.

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Products distributed outside of the United States are also subject to government regulation, which may be equally or more demanding. Our new products could take a significantly longer time than we expect to gain regulatory approval and may never gain approval. If a regulatory authority delays approval of a potentially significant product, the potential sales of the product and its value to us can be substantially reduced. Even if the FDA or another regulatory agency approves a product, the approval may limit the indicated uses of the product, or may otherwise limit our ability to promote, sell and distribute the product, or may require post- marketing studies. If we cannot obtain regulatory approval of our new products, or if the approval is too narrow, we will not be able to market these products, which would eliminate or reduce our potential sales and earnings.

Regulatory investigations and allegations, whether or not they lead to enforcement action, can materially harm our business and its reputation.

Failure to comply with the requirements of the FDA or other regulators can result in civil and criminal fines, the recall of products, the total or partial suspension of manufacture or distribution, seizure of products, injunctions, whistleblower lawsuits, failure to obtain approval of pending product applications, withdrawal of existing product approvals, exclusion from participation in government healthcare programs and other sanctions. Any threatened or actual government enforcement action can also generate adverse publicity and require us to divert substantial resources from more productive uses in our business. Enforcement actions could affect our ability to commercially distribute our products and could materially harm our business

From time to time STAAR is subject to formal and informal inquiries by regulatory agencies, which may or may not lead to investigations or enforcement actions. Even when an inquiry results in no evidence of wrongdoing or is inconclusive, the agency generally is not required to notify STAAR of its findings and may not inform STAAR that the inquiry has been terminated.

STAAR maintains a hotline for employees to anonymously report any violation of laws, regulations or company policies, and investigates any allegation of improper conduct. Nevertheless, present or former employees may elect to bring complaints to regulators and enforcement agencies. The relevant agency will generally be obligated to investigate such complaints to assess their validity and obtain evidence of any violation that may have occurred. Even without a finding of misconduct, negative publicity about investigations or allegations of misconduct could harm our reputation with customers and the market for our common stock.

We depend on proprietary technologies, but may not be able to protect our intellectual property rights adequately.

We have numerous patents and pending patent applications. We rely on a combination of contractual provisions, confidentiality procedures and patent, trademark, copyright and trade secrecy laws to protect the proprietary aspects of our technology. These legal measures afford limited protection and may not prevent our competitors from gaining access to our intellectual property and proprietary information. Any of our patents may be challenged, invalidated, circumvented or rendered unenforceable. Furthermore, we cannot be certain that any pending patent application held by us will result in an issued patent or that if patents are issued to us, the patents will provide meaningful protection against competitors or competitive technologies. Litigation may be necessary to enforce our intellectual property rights, to protect our trade secrets and to determine the validity and scope of our proprietary rights. Any litigation could result in substantial expense, may reduce our profits and may not adequately protect our intellectual property rights. In addition, we may be exposed to future litigation by third parties based on claims that our products infringe their intellectual property rights. This risk is exacerbated by the fact that the validity and breadth of claims covered by patents in our industry may involve complex legal issues that are not fully resolved.

Any litigation or claims against us, whether or not successful, could result in substantial costs and harm our reputation. In addition, intellectual property litigation or claims could force us to do one or more of the following: to cease selling or using any of our products that incorporate the challenged intellectual property, which would adversely affect our sales; to negotiate a license from the holder of the intellectual property right alleged to have been infringed, which license may not be available on reasonable terms, if at all; or to redesign our products to avoid

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infringing the intellectual property rights of a third party, which may be costly and time-consuming or impossible to accomplish.

We may not successfully develop and launch replacements for our products that lose patent protection.

Most of our products are covered by patents that give us a degree of market exclusivity during the term of the patent. We have also earned revenue in the past by licensing some of our patented technology to other ophthalmic companies. The legal life of a patent in the U.S. is 20 years from application. Patents covering our products will expire from this year through the next 20 years. Upon patent expiration, our competitors may introduce products using the same technology. As a result of this possible increase in competition, we may need to charge a lower price in order to maintain sales of our products, which could make these products less profitable. If we fail to develop and successfully launch new products prior to the expiration of patents for our existing products, our sales and profits with respect to those products could decline significantly. We may not be able to develop and successfully launch more advanced replacement products before these and other patents expire.

Risks Related to Ownership of Our Common Stock

Our Certificate of Incorporation could delay or prevent an acquisition or sale of our company.

Our Certificate of Incorporation empowers the Board of Directors to establish and issue a class of preferred stock, and to determine the rights, preferences and privileges of the preferred stock. These provisions give the Board of Directors the ability to deter, discourage or make more difficult a change in control of our company, even if such a change in control would be in the interest of a significant number of our stockholders or if such a change in control would provide our stockholders with a substantial premium for their shares over the then-prevailing market price for the common stock.

Our bylaws contain other provisions that could have an anti-takeover effect, including the following:

stockholders have limited ability to remove directors;

stockholders cannot act by written consent;

stockholders cannot call a special meeting of stockholders; and

stockholders must give advance notice to nominate directors.

Anti-takeover provisions of Delaware law could delay or prevent an acquisition of our company.

We are subject to the anti-takeover provisions of Section 203 of the Delaware General Corporation Law, which regulates corporate acquisitions. These provisions could discourage potential acquisition proposals and could delay or prevent a change in control transaction. They could also have the effect of discouraging others from making tender offers for our common stock or preventing changes in our management.

Future sales of our common stock could reduce our stock price.

Our Board of Directors could issue additional shares of common or preferred stock to raise additional capital or for other corporate purposes without stockholder approval. In addition, the Board of Directors could designate and sell a class of preferred stock with preferential rights over the common stock with respect to dividends or other distributions. Sales of common or preferred stock could dilute the interest of existing stockholders and reduce the market price of

our common stock. Even in the absence of such sales, the perception among investors that additional sales of equity securities may take place could reduce the market price of our common stock.

The market price of our common stock is likely to be volatile.

Our stock price has fluctuated widely, ranging from $6.31 to $9.53 during the year ended December 29, 2006. Our stock price could continue to experience significant fluctuations in response to factors such as quarterly variations in operating results, operating results that vary from the expectations of securities analysts and investors, changes in financial estimates, changes in market valuations of competitors, announcements by us or our competitors of a material nature, additions or departures of key personnel, future sales of Common Stock and stock volume fluctuations. Also, general political and economic conditions such as recession or interest rate fluctuations may adversely affect the market price of our stock.

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Item 1B. ***Unresolved Staff Comments***

None.

Item 2. ***Properties***

Our operations are conducted in leased facilities throughout the world. Our executive offices, manufacturing, warehouse and distribution, and primary research facilities are located in Monrovia, California. STAAR Surgical AG maintains office, manufacturing, and warehouse and distribution facilities in Nidau, Switzerland. The Company has one additional facility in Aliso Viejo, California for raw material production and research and development activities. The Company leases additional sales and distribution facilities in Germany and Australia. We believe our manufacturing facilities in the U.S. and Switzerland are suitable and adequate for our current and future planned requirements. The Company could increase capacity by adding additional shifts at our existing facilities. However, the Company is at capacity in the U.S. and Switzerland in the area of administration. The Company would require additional space to support growth in those areas, although this is not anticipated for 2007.

Item 3. ***Legal Proceedings***

From time to time the Company is subject to various claims and legal proceedings arising out of the normal course of our business. These claims and legal proceedings relate to contractual rights and obligations, employment matters, and claims of product liability. We do not believe that any of the claims known to us is likely to have a material adverse effect on our financial condition or results of operations.

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

There were no matters submitted to a vote of security holders during the quarter ended December 29, 2006.

PART II

Item 5. ***Market for Registrant s Common Equity, Related Stockholder Matters, and Issuer Purchases of Equity Securities***

Our Common Stock is traded on the Nasdaq Global Market under the symbol STAA. The following table sets forth the reported high and low bid prices of the Common Stock as reported by Nasdaq for the calendar periods indicated:

Period	High	Low
2006		
Fourth Quarter	$ 8.640	$ 6.400
Third Quarter	7.800	6.310
Second Quarter	9.500	7.210
First Quarter	9.530	6.630
2005		
Fourth Quarter	$ 9.370	$ 4.870
Third Quarter	6.050	3.120
Second Quarter	5.170	3.580
First Quarter	7.300	3.500

On March 23, 2007, the closing price of the Company s Common Stock was $5.79. Stockholders are urged to obtain current market quotations for the Common Stock.

As of March 23, 2007, there were approximately 558 record holders of our Common Stock.

We have not paid any cash dividends on our Common Stock since our inception. We currently expect to retain any earnings for use to further develop our business and not to declare cash dividends on our Common Stock in the foreseeable future. The declaration and payment of any such dividends in the future depends upon the Company s earnings, financial condition, capital needs and other factors deemed relevant by the Board of Directors and may be restricted by future agreements with lenders.

As of March 23, 2007, options to purchase 2,569,248 shares of Common Stock were exercisable.

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Stock Performance Graph

The following graph compares the yearly and cumulative return on an investment in STAAR s common stock over the last five fiscal years to the yearly and cumulative return of the following over the same time period: (1) the composite of all United States and foreign companies listed on the Nasdaq Stock Market (the Nasdaq Index); and (2) the composite of all United States and foreign companies listed on the Nasdaq Stock Market that operate in the surgical, medical and dental instrument and supply industries (the Peer Index), based on Standard Industrial Classification (SIC) codes in the range of 3840 through 3849. The Company s SIC code is 3845. The comparison assumes $100 was invested on December 28, 2001 in STAAR s common stock and in each of those indices, and that dividends were reinvested. The Center for Research in Security Prices of the University of Chicago s Graduate School of Business compiled the Peer Index and produced the graph. The stock price performance on the following graph is not necessarily indicative of future stock price performance.

In any of our filings under the Securities Act or Exchange Act that incorporate this Proxy Statement by reference, this graph will be considered excluded from the incorporation by reference and it will not be deemed a part of any such other filing unless we expressly state that the graph is so incorporated.

Comparison of Five-Year Cumulative Total Returns

CRSP Total Returns Index for:	**12/2001**	**01/2003**	**01/2004**	**12/2004**	**12/2005**	**12/2006**
STAAR SURGICAL CO	100.0	111.1	294.2	165.9	209.0	185.4
Nasdaq Stock Market (US & Foreign)	100.0	70.1	102.1	110.8	113.4	125.0
NASDAQ Stocks (SIC 3840 3849 US + Foreign) Surgical, Medical, and Dental Instruments and Supplies	100.0	81.3	119.2	139.4	153.0	161.4

Notes:
A. The lines represent monthly index levels derived from compounded daily returns that include all dividends.
B. The indexes are reweighted daily, using the market capitalization on the previous trading day.
C. If the monthly interval, based on the fiscal year-end, is not a trading day, the preceding trading day is used.
D. The index level for all series was set to $100.0 on 12/28/2001.

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Item 6. ***Selected Financial Data***

The following table sets forth selected consolidated financial data with respect to the five most recent fiscal years ended December 29, 2006, December 30, 2005, December 31, 2004, January 2, 2004 and January 3, 2003. The selected consolidated statement of operations data set forth below for each of the three most recent fiscal years, and the selected consolidated balance sheet data set forth below at December 29, 2006 and December 30, 2005, are derived from the consolidated financial statements which have been audited by BDO Seidman, LLP, independent registered public accounting firm, as indicated in their report which is included in this Annual Report. The selected consolidated statement of operations data set forth below for each of the two fiscal years in the periods ended January 2, 2004, and January 3, 2003, and the consolidated balance sheet data set forth below at December 31, 2004, January 2, 2004, and January 3, 2003 are derived from the Company s audited consolidated financial statements not included in this Annual Report. The selected consolidated financial data should be read in conjunction with the consolidated financial statements of the Company, and the Notes thereto, included in this Annual Report, and Management s Discussion and Analysis of Financial Condition and Results of Operations in Item 7.

	Fiscal Year Ended				
	December 29, 2006	December 30, 2005	December 31, 2004	January 2, 2004	January 3, 2003
	(In thousands except per share data)				
Statement of Operations					
Sales	$ 56,282	$ 51,303	$ 51,685	$ 50,409	$ 47,880
Royalty and other income				49	368
Total revenues	56,282	51,303	51,685	50,458	48,248
Cost of sales	29,849	27,517	25,542	22,621	24,099
Gross profit	26,433	23,786	26,143	27,837	24,149
Selling, general and administrative expenses					
General and administrative	10,891	9,727	9,253	9,343	8,959
Marketing and selling	22,395	18,552	20,302	19,509	16,833
Research and development	7,080	5,573	6,246	5,120	4,016
Notes receivable reserves (reversals)/other charges	(331)	746	500	390	1,454
Total selling, general and administrative expenses	40,035	34,598	36,301	34,362	31,262
Operating loss	(13,602)	(10,812)	(10,158)	(6,525)	(7,113)
Total other income (expense), net	95	854	(88)	(637)	(785)
Loss before income taxes and minority interest	(13,507)	(9,958)	(10,246)	(7,162)	(7,898)
Income tax provision	1,537	1,239	1,057	1,127	8,805

Minority interest	(22)	29	68		75
Net loss	$ (15,044)	$ (11,175)	$ (11,332)	$ (8,357)	$ (16,778)
Basic and diluted net loss per share	$ (0.60)	$ (0.47)	$ (0.58)	$ (0.47)	$ (0.98)
Weighted average number of basic and diluted shares	25,227	23,704	19,602	17,704	17,142
Balance Sheet Data					
Working capital	$ 14,363	$ 22,735	$ 19,103	$ 15,883	$ 7,095
Total assets	47,770	52,755	51,973	47,376	45,220
Notes payable and current portion of long-term debt	1,802	1,676	3,004	2,950	5,845
Stockholders equity	31,760	40,366	37,840	35,219	30,551

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Item 7. ***Management s Discussion and Analysis of Financial Condition and Results of Operations***

The matters addressed in Management s Discussion and Analysis of Financial Condition and Results of Operations that are not historical information constitute forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. Readers can recognize forward-looking statements by the use of words like anticipate, estimate, expect, project, intend, plan, believe, will, target , forecast and similar expressions in connection with any discussion of future operating or financial performance. In particular, these include statements relating to future actions, prospective products or product approvals, future performance or results of current and anticipated products, sales efforts, expenses, interest rates, foreign exchange rates, the outcome of contingencies, such as legal proceedings, and financial results.

Although the Company believes that the expectations reflected in these forward-looking statements are reasonable, such statements are inherently subject to risks and the Company can give no assurance that its expectations will prove to be correct. Actual results could differ from those described in this report because of numerous factors, many of which are beyond the control of the Company. These factors include, without limitation, those described in this Annual Report in Item 1 Risk Factors. The Company undertakes no obligation to update these forward-looking statements after the date of this report to reflect future events or circumstances or to reflect actual outcomes.

The following discussion should be read in conjunction with the audited consolidated financial statements of STAAR, including the related notes, provided in this report.

Overview

Strategy

STAAR is currently focusing on the following four strategic goals:

- building the U.S. market for the ICL and securing U.S. approval of the TICL;
- generating further growth of the ICL and TICL in international markets;
- reversing the decline in U.S. market share for our core cataract product lines by renewing and refining our product offering through enhanced R&D; and
- maintaining our focus on regulatory compliance and continuous quality improvement.

Building the U.S. market for the ICL and securing U.S. approval of the TICL. Because the ICL s design has advantages over other refractive procedures for many patients and its proprietary nature permits STAAR to maintain its profit margin, STAAR s management believes that increased sales of the ICL are the key to the company s return to profitability. U.S. market penetration is considered essential because of the size of the U.S. refractive surgery market and the perceived leadership of the U.S. in adopting innovative medical technologies.

STAAR s strategy for the U.S. market is to educate eye care professionals on the high quality of visual outcomes of the ICL for a significant portion of patients seeking refractive surgery, and to make the ICL available to selected surgeons only after completion of a training program that includes proctoring of selected supervised surgeries. STAAR believes that this carefully guided method of product release is essential to help ensure the consistent quality of patient outcomes and the high levels of patient satisfaction needed to establish wide acceptance of the ICL as a choice for refractive surgery.

To develop specialized resources to meet the challenge of penetrating the refractive market, and to take advantage of opportunities to improve cataract product sales, STAAR split its Sales and Marketing Department into two separate groups in the first quarter of 2007. Among other advantages, the split will enable the Sales Department to focus on the development of STAAR s direct sales model in regions where STAAR will sell directly, and to better coordinate sales initiatives with the independent Regional Marketing Representatives in those regions where STAAR will continue to rely on independent representatives.

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STAAR has relied on a largely independent sales force to sell its cataract products, and over the last several months has worked to re-orient this sales force to deal with the very different practice environment for refractive products. While STAAR expects to continue to rely on its independent sales force in some regions, it has moved to a direct sales structure in other regions. Because the refractive surgery market has been dominated by corneal laser-based techniques, STAAR faces special challenges in introducing an intraocular refractive implant. STAAR has developed a number of marketing tools and practice support programs to increase the use of the ICL and awareness of its advantages at laser-oriented surgery centers.

The Visian ICL was approved by the FDA for treatment of myopia on December 22, 2005. The U.S. rollout of the product began in the first quarter of 2006. As of December 29, 2006, 306 surgeons had completed training and 350 had completed training by March 26, 2007. STAAR recognized $4,172,000 of U.S. sales revenue from ICLs in 2006. It is too early to determine whether STAAR s strategy will be successful or to estimate the ultimate size of the U.S. market for ICLs.

STAAR believes that the Visian TICL, a variant of the ICL that corrects both astigmatism and myopia in a single lens, also has a significant potential market in the U.S. When measured six months after surgery, approximately 75% of the patients receiving the TICL have shown better visual acuity than the best they previously achieved with glasses or contact lenses. Securing FDA approval of the TICL is therefore an integral part of STAAR s strategy to develop its U.S. refractive market. STAAR submitted a Pre-Market Approval (PMA) application for the TICL to the FDA on April 28, 2006, and received comments from the Office of Device Evaluation (ODE) on November 20, 2006 requesting that STAAR submit an amended application. In subsequent discussion the ODE indicated that it expects to submit the amended application to review by the FDA Ophthalmic Devices Panel. As of the date of this Report, STAAR is preparing an amendment to the TICL application addressing the ODE comments.

Generating further growth of the ICL and TICL in international markets. The ICL and TICL are sold in more than 40 countries. International sales of refractive implants have continued a steady rate of growth, increasing approximately 50% in 2006 over the preceding year. STAAR believes that the international market for its refractive products has the potential for further growth, both through the introduction of the ICL and TICL in new territories and expanded market share in existing territories. In recent periods STAAR has received the majority of its revenue from international markets, and sales of ICLs have represented an increasing share of that revenue. STAAR received approval for the ICL in China on July 31, 2006 and we are awaiting approval of the TICL there as well. We also continue to seek new approvals for the ICL and TICL in other countries, but these approvals are at the discretion of the local authorities.

Reversing the decline in U.S. market share for our core cataract product lines by intensifying selling efforts and renewing and refining our product offering through enhanced R&D. During the last several years STAAR has experienced a decline in U.S. sales of IOLs. STAAR s management believes the decline principally resulted from the slow pace of cataract product improvement and enhancement during a period when we had to devote most of our research and development resources to introducing the ICL and to resolving the regulatory and compliance issues raised by the FDA, and the harm to our reputation from warning letters and other correspondence with the FDA during 2004 and 2005.

STAAR seeks to reverse the decline in its domestic cataract market share by the introduction of enhanced design IOLs and improved delivery systems in 2007 and 2008. The completion in 2005 of initiatives to revamp STAAR s systems of regulatory compliance and quality management permitted STAAR to shift resources back to product development. In particular, STAAR has focused on the following projects intended to expand and improve our cataract product offering:

A Collamer Toric IOL;

New Collamer IOL models featuring an aspheric optic design, in a three-piece configuration;

New silicone IOL models featuring aspheric optics and a squared edge configuration;

Enhancements to the injector system for our three-piece Collamer IOL to improve delivery;

An all new injector system for the three-piece Collamer IOL;

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A micro-incision injector for the one-piece Collamer IOL; and

Development of a preloaded injector system for our new silicone aspheric IOLs.

STAAR cautions that the successful development and introduction of new products is subject to risks and uncertainties, including the risk of unexpected delays.

STAAR also believes that expanding the U.S. market for the ICL should also improve the selling environment for STAAR s cataract products, especially cataract lenses made of the same biocompatible Collamer material used in the ICL. STAAR intends that the split of its Sales and Marketing Department will help it take advantage of the opportunities presented by the introduction of new cataract products and the improved selling environment for STAAR s products created by the ICL.

On January 22, 2007, the Centers for Medicare and Medicaid Services (CMS) issued a ruling that allows cataract patients receiving reimbursement by Medicare to choose a lens that also corrects astigmatism. Under the ruling, patients may elect to pay a premium for the correction of pre-existing astigmatism, while Medicare provides the customary reimbursement for cataract surgery. STAAR expects its silicone Toric IOL, currently one of two IOLs approved for sale in the U.S. for treatment of cataracts and astigmatism, to be covered by the CMS ruling. STAAR believes that the CMS ruling will increase the profitability of its sales of Toric IOLs and generate greater interest in implanting the product. In addition, STAAR expects to introduce a Toric IOL made of its proprietary Collamer material, which would also likely fall under the CMS ruling and compete with our competitor s acrylic model. STAAR cannot estimate the increased revenue that may result from the CMS ruling at this time.

While STAAR s U.S. cataract product sales, which include accessory products such as surgery packs and phacoemulsification equipment, declined 5% during 2006, U.S. cataract product sales for the fourth quarter of 2006 increased 6% compared with the same period in 2005. Despite the decline in total U.S. cataract sales for the full year, the fourth quarter sales in 2006 is a marked improvement compared with the first three quarters of 2006, which have improved from 13% down in the first quarter of 2006 when compared to their respective periods in 2005.

To reverse the decline in U.S. IOL sales, STAAR must overcome several short and long-term challenges, including overcoming reputational harm from the FDA s past findings of compliance deficiencies, successfully completing planned development projects, and organizing and managing a combined direct and independent sales force. We cannot ensure that this strategy will ultimately be successful.

Maintaining our focus on regulatory compliance and continuous quality improvement. As a manufacturer of medical devices, STAAR s manufacturing processes and facilities are regulated by the FDA. We also must satisfy the requirements of the International Standards Organization (ISO) to maintain approval to sell products in the European Community and other regions. Failure to demonstrate substantial compliance with FDA regulations can result in enforcement actions that terminate, suspend or severely restrict the ability to continue manufacturing and selling medical devices. Between December 29, 2003 and July 5, 2005, STAAR received Warning Letters, Form 483 Inspectional Observations and other correspondence from the FDA indicating deficiencies in STAAR s compliance with the FDA s Quality System Regulations and Medical Device Reporting regulations and warning of possible enforcement action. In response, STAAR implemented numerous improvements to its quality system. Among other things, STAAR developed a Global Quality Systems Action Plan, which has been continuously updated since its adoption in April, 2004, and took steps to emphasize a focus on compliance throughout the organization.

The FDA s most recent general quality inspections of STAAR s facilities were a post-market inspection of the Monrovia, California and Aliso Viejo, California facilities between August 2, 2006 and August 7, 2006, and a

post-market inspection of the Nidau, Switzerland facilities between September 26 and September 28, 2006. These inspections resulted in no observations of noncompliance. Based in part on these inspections and the FDA inspections conducted in 2005, STAAR believes that it is substantially in compliance with the FDA s Quality System Regulations and Medical Device Reporting regulations. Nevertheless, the FDA s past findings of compliance deficiencies have harmed our reputation in the ophthalmic industry and affected our product sales.

STAAR s ability to continue its U.S. business depends on the continuous improvement of its quality systems and its ability to demonstrate compliance with FDA regulations. Accordingly, for the foreseeable future STAAR s

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management expects its strategy to include devoting significant resources and attention to strict regulatory compliance and continuous improvement in quality.

In keeping with its compliance strategy, STAAR hired Rob Lally to serve as Vice President, Quality Assurance and Regulatory affairs on October 23, 2006. Prior to joining STAAR, Mr. Lally was most recently the Director of International Regulatory Affairs at Johnson & Johnson Vision Care in Florida. Mr. Lally previously served as Head of the Medical Devices Sector of the British Standards Institution, the National Standards Body of the United Kingdom responsible for independent certification of a variety of systems and products. Prior to this, he was a senior consultant at Quintiles, a global quality and regulatory consulting firm. Mr. Lally also served as General Manager, Quality and Certification at AMTAC Laboratories, a leading European Union notified body where he managed the medical device and drug sector.

On March 14, 2007, the Bioresearch Monitoring Program of the FDA Office of Regulatory Affairs (BIMO) concluded a routine audit of the Company s clinical trial records as a sponsor of biomedical research in connection with the Company s Supplemental Pre-Market Approval application for the TICL. At the conclusion of the audit the Company received eight Inspectional Observations on FDA Form 483 noting noncompliance with regulations. The Company is preparing its response to the Inspectional Observations and expects to address the concerns raised by BIMO through voluntary corrective actions. Most of the observed instances of non-compliance took place during the 2000-2004 period and the Company expects to show that some of these have already been addressed by corrective actions made in response to BIMO s observations of December 11, 2003 in connection with the Company s application for the ICL. The Company does not believe that the Inspectional Observations affect the integrity of the Toric clinical study. However, the determination of whether the Inspectional Observations affect the use of the Toric clinical study in STAAR s pending Toric application will be at the discretion of the ODE. Obtaining FDA approval of medical devices is never certain.

Financing Strategy

While STAAR s international business generates positive cash flow and 60% of STAAR s revenue, STAAR has reported losses on a consolidated basis over the last several years due to a number of factors, including eroding sales of cataract products in the U.S. and FDA compliance issues that consumed additional resources while delaying the introduction of new products in the U.S. market. During the last three years STAAR has secured additional capital to sustain operations through private sales of equity securities, exercise of options, the repayment of directors notes and debt financing.

STAAR s management believes that in the near term its best prospect for returning its U.S. and consolidated operations to profitability is achieving significant U.S. sales of the ICL. In the longer term STAAR seeks to develop and introduce products in the U.S. cataract market to stop further erosion of its market share and resume growth in that sector. Nevertheless, success of these strategies is not assured and, even if successful, STAAR is not likely to achieve positive cash flow on a consolidated basis during fiscal 2007.

To provide additional sources of available working capital, STAAR entered into two debt financing arrangements in 2006 and 2007.

On March 21, 2007, STAAR entered into a loan arrangement with Broadwood Partners, L.P. (Broadwood). Pursuant to a Promissory Note (the Note) between STAAR and Broadwood, Broadwood loaned $4 million to STAAR. The Note has a term of three years and bears interest at a rate of 10% per annum, payable quarterly. The Note is not secured by any collateral, may be pre-paid by STAAR at any time without penalty, and is not subject to covenants based on financial performance or financial condition (except for insolvency). As additional consideration for the loan STAAR also entered into a Warrant Agreement (the Warrant Agreement) with Broadwood granting the right to

purchase up to 70,000 shares of Common Stock at an exercise price of $6, exercisable for a period of six years. The Note also provides that so long as a principal balance remains outstanding on the Note STAAR will grant additional warrants each quarter on the same terms as the Warrant Agreement. The warrant agreement provides that STAAR will register the stock for resale with the SEC. Based on publicly available information filed with the Securities and Exchange Commission (the SEC), on the date of the transaction Broadwood Partners L.P. beneficially owned 2,492,788 shares of the Company s common stock, comprising 9.7% of the Company s common stock as of March 21, 2007, and Neal Bradsher, President of Broadwood Partners, L.P.,

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may have been deemed to beneficially own 2,518,688 shares of the Company s common stock, comprising 9.8% of the Company s common stock as of that date.

On June 8, 2006 STAAR signed a Credit and Security agreement with Wells Fargo Bank for a revolving credit facility. The credit facility provides for borrowings of 85% of eligible accounts receivable with a maximum of $3.0 million, carries an interest rate of prime plus 1.5%, and is secured by substantially all of the assets of STAAR s U.S. operations. The term of the agreement is three years and it contains certain financial covenants relating to minimum calculated net worth, net loss, liquidity and restrictions on Company investments or loans to affiliates and investments in capital expenditures, which only apply if the Company borrows and/or maintains an outstanding advance. No borrowings were outstanding as of December 29, 2006. However, as STAAR does not satisfy minimum financial covenants in its U.S. operations that are a condition to borrowing, no borrowings are available.

In addition, STAAR s Swiss subsidiary has $653,000 in borrowing availability under its $2.5 million line of credit for use in Swiss operations.

STAAR may seek additional debt or equity financing to provide working capital, finance new business initiatives, expand its business or make acquisitions. Because of our history of losses, our ability to obtain adequate financing on satisfactory terms is limited. STAAR s cash resources are discussed in further detail under the caption *Liquidity and Capital Resources* below.

Investigation of Fraud at Domilens GmbH

Domilens GmbH is a wholly owned indirect subsidiary of STAAR Surgical Company based in Hamburg, Germany. It distributes ophthalmic products made by both STAAR and other manufacturers. During fiscal year 2006 Domilens reported sales of $21.1 million.

On January 18, 2007, Guenther Roepstorff, president of Domilens, notified STAAR he had admitted to the German Federal Ministry of Finance that without STAAR s knowledge he had diverted property of Domilens to a company under his control over a four-year period between 2001 and 2004. Mr. Roepstorff made this admission in connection with an audit conducted by the Ministry in 2006, which examined the financial records of Mr. Roepstorff, Domilens and the company to which he owned and diverted the property, Equimed GmbH (currently known as eyemaxx GmbH), covering the four-year period.

Immediately after learning these facts STAAR commenced an internal investigation of Domilens. On January 20, 2007, the Audit Committee of STAAR s Board of Directors engaged PricewaterhouseCoopers LLP (PwC) to conduct a forensic audit in connection with the investigation by legal counsel. The Committee subsequently engaged the law firm of Taylor Wessing, through its Hamburg office, as independent German legal counsel. The investigation included a comprehensive forensic review of the accounting records, documents and electronic records of Domilens and interviews of current employees and Mr. Roepstorff. On March 6, 2007, the Audit Committee of the Board of Directors of STAAR Surgical Company received PwC s final report.

Key findings. PwC investigated instances of misappropriation of corporate assets by Mr. Roepstorff between 2001 and 2006. Areas of fraudulent activity investigated by PwC included diversions of sales of IOLs and equipment to Equimed GmbH, payments to Mr. Roepstorff disguised as prepayments to suppliers and unauthorized borrowing. It is estimated that from 2001 through 2006 these activities diverted assets having a book value of approximately $400,000 and resulted in unreported proceeds to Equimed and Mr. Roepstorff of approximately $1,000,000.

PwC identified Mr. Roepstorff s ability to override the internal controls implemented by STAAR as a key factor in his ability to accomplish fraudulent transactions and avoid detection. In particular, they found that even after STAAR had

acquired full control of Domilens and implemented further oversight he continued to run the company as his own and had a dominant presence with employees. PwC found evidence that, notwithstanding the requirements of STAAR s Code of Ethics, some Domilens employees had been aware of improper activities by Mr. Roepstorff and in some instances cooperated in documenting the activities in a manner that aided concealment. However, there is no evidence that other employees received any portion of the diverted assets or other payment for cooperation.

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PwC also identified inadequate oversight of Domilens by STAAR AG and inadequate management oversight by STAAR as significant factors enabling Mr. Roepstorff to accomplish his actions. PwC has determined that a greater degree of scrutiny would have likely led to earlier detection of irregularities at Domilens.

Impact on financial statements. Domilens financial results are consolidated into the audited financial statements of STAAR. STAAR has reviewed its historical financial statements, and has determined that properly accounting for past transactions in Domilens in light of the information provided by PwC s investigation did not result in a material change in STAAR s reported results of operations or reported financial condition for historical periods.

STAAR has determined that the events at Domilens revealed a material weakness in its internal controls over financial reporting. See *Item 9A. Controls and Procedures Management Report on Internal Control Over Financial Reporting.*

Expenses related to Domilens irregularities. It is currently estimated that the fees and reimbursable expenses of advisors incurred by STAAR in connection with the investigation will total approximately $750,000, which will be recorded in fiscal year 2007. In addition, STAAR has reserved approximately $700,000 against additional taxes that may be assessed for unreported sales, but will seek to reduce that amount in discussions with the German Ministry of Finance. The estimated tax liability was recorded in the fourth quarter of fiscal year 2006.

Other Actions. STAAR suspended all of Mr. Roespstorff s duties as president on January 19, 2007. He voluntarily resigned from his employment with Domilens on January 23, 2007. STAAR will provide all of Domilens employees further training in their duties as employees and in STAAR s Code of Ethics. In addition, based on the advice of German counsel, the degree of individual culpability and other factors, STAAR may take other disciplinary actions, including possible termination of employees or monitoring of selected employees during a probationary period.

Other Recent Highlights

Growth in International Sales of Visian ICLs and Preloaded Silicone IOLs. The decline in the U.S. cataract business during 2006 was offset in part by a 50% increase in international sales of the ICL and TICL. In addition, the preloaded silicone IOL injector system developed with our joint venture partner Canon Staar experienced strong sales in international markets, growing 21% for the year. This growth in the business contributed to an increase in international sales of 4% for fiscal 2006 compared with 2005.

Job Actions by Doctors in Germany. STAAR receives significant revenue from its German subsidiary, Domilens GmbH, a distributor of ophthalmic products manufactured by STAAR and other manufacturers. As is the case in most countries, purchases of Domilens cataract-related products in Germany depend on government reimbursement of cataract surgery. Germany has recently made a number of cost-cutting changes in its medical reimbursement policies, including a requirement that government-employed surgeons reduce the number of cataract surgeries performed to 20% below 2004 rates. In response to these changes in reimbursement policies, many medical doctors throughout Germany initiated job actions during the first and second quarters of 2006 such as strikes or slow-downs in which doctors provided only the most essential services to patients. While doctors and state-run and university clinics reached a settlement in June, strikes continue at city-run hospitals throughout Germany during the third quarter, but were ultimately resolved. These job actions, and the mandatory reduction in the number of cataract procedures, caused a significant reduction in ophthalmic surgeries and reduced sales of distributed products by Domilens, which during 2006 declined 6% compared to 2005, significantly impacting international and global sales of cataract product for the year. However, fourth quarter sales in Germany of 2006 improved over the fourth quarter of 2005 by 5% indicating we may have seen the worst in this market.

Competition with Multifocal IOLs. The U.S. IOL market continues to be affected by sales of multifocal and accommodating lenses resulting from a ruling of the Centers for Medicare and Medicaid Services (CMS). The ruling permits Medicare-covered cataract patients to receive more highly priced multifocal or accommodating IOLs (sometimes referred to as presbyopic lenses) by paying only the additional cost of the lens and surgical procedure while still receiving reimbursement for the basic cost of cataract surgery and a monofocal IOL. This has increased the number of patients to whom surgeons offer the alternative of the higher-priced lenses. While STAAR s

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U.S. cataract product sales increased in the first, second, and fourth quarters of 2006 over the preceding quarter, remained flat in the third quarter of 2006 compared to the same period in 2005, sales volume might have been greater were it not for increased sales of multifocal and accommodative lenses.

In January 2007, the CMS made a similar ruling, that allows a Medicare patient to pay a premium for a lens that also corrects astigmatism. STAAR expects this ruling will result in increased sales revenue from its silicone Toric IOLs, currently one of only two lenses of this type in the U.S. market, and will enhance the market for a Collamer Toric IOL currently in development. Nevertheless, with the help of the CMS ruling, presbyopic lenses are expected to claim a share of the cataract market in the future, and STAAR does not offer a lens of this type.

Seasonality. We generally experience lower sales during the third quarter due to the effect of summer vacations on elective procedures. In particular, because sales activity in Europe drops dramatically in the summer months, and European sales have recently accounted for a greater proportion of our total sales, this seasonal variation in our results has become even more pronounced.

Foreign Currency Fluctuations. Our products are sold in approximately 50 countries. During fiscal year 2006, sales from international operations represented 60% of total sales. The results of operations and the financial position of certain of our offshore operations are reported in the relevant local currencies and then translated into U.S. dollars at the applicable exchange rates for inclusion in our consolidated financial statements, exposing us to currency translation risk. For fiscal year 2006, changes in currency exchange rates did not have a material impact on net sales and marketing and selling expenses.

Gross Profit. Our gross profit margin increased to 47.0% for fiscal year 2006, compared with 46.4% in 2005. The improvement in gross profit from 2005 generally resulted from increased volume of higher margin ICLs in the U.S., partially offset by an obsolescence charge $807,000 against certain IOL inventory in anticipation of new product launches in 2007 and higher IOL and ICL unit costs due to lower manufacturing volumes.

Research and Development. We spent approximately 13% of our sales on research and development (which includes regulatory and quality assurance expenses) during fiscal 2006, and we expect to spend approximately 10% of our sales on an annual basis in the future.

Cash Flow. We exited the year with approximately $7.9 million in cash, cash equivalents and restricted short-term investments compared with $12.7 million at December 30, 2005. We used approximately $8.1 million for operating activities during fiscal 2006, which is 8% above the $7.5 million used during fiscal 2005. However, cash used in operating activities in 2006, which was at its highest level for the year in the first quarter of 2006 when the ICL was first introduced in the U.S. market, declined in each of the three subsequent quarters. Purchases of property and equipment were approximately $786,000. During the year we received approximately $2.9 million in proceeds from stock options and $1.2 million in payments on notes from a former director. During 2006 we obtained additional sources of financing such as the $3.0 million Wells Fargo LOC and $1.8 million in lease financing and we expect to continue to identify alternative sources of liquidity to support operations. The Company expects to reduce and ultimately reverse its operating losses and negative cash flows as ICL sales reach targeted levels and the TICL is approved in the U.S. In addition, we will continue to pursue cost savings opportunities, wherever possible, to conserve cash.

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Results of Operations

The following table sets forth the percentage of total revenues represented by certain items reflected in the Company s income statement for the period indicated and the percentage increase or decrease in such items over the prior period.

	Percentage of Total Sales			Percentage Change	
	December 29, 2006	December 30, 2005	December 31, 2004	2006 vs. 2005	2005 vs. 2004
Net Sales	100.0%	100.0%	100.0%	9.7%	(0.7)%
Cost of sales	53.0%	53.6%	49.4%	8.5%	7.7%
Gross profit	47.0%	46.4%	50.6%	11.1%	(9.0)%
General and administrative	19.4%	19.0%	17.9%	12.0%	5.1%
Marketing and selling	39.8%	36.2%	39.3%	20.7%	(8.6)%
Research and development	12.6%	10.9%	12.1%	27.1%	(10.8)%
Note Reserve (reversals)	(0.6)%	1.4%	1.0%		49.3%
Operating loss	(24.2)%	(21.1)%	(19.7)%	25.8%	6.4%
Total other income (expense), net	0.2%	1.7%	(0.1)%	(88.9)%	
Loss before income taxes and minority interest	(24.0)%	(19.4)%	(19.8)%	35.6%	(2.8)%
Provision for income taxes	2.7%	2.4%	2.0%	24.4%	17.4%
Minority interest			0.1%		
Net loss	(26.7)%	(21.8)%	(21.9)%	34.6%	(1.4)%

2006 Fiscal Year Compared to 2005 Fiscal Year

Net sales

Net sales for the year ended December 29, 2006 (fiscal 2006) were $56,282,000, an increase of 9.7% compared with net sales for the year ended December 30, 2005 (fiscal 2005) of $51,303,000. Changes in currency exchange rates did not have a material impact on net sales for fiscal 2006.

U.S. net sales for fiscal 2006 increased 19.1% to $22,293,000 compared with fiscal 2005. The increase in U.S. sales reflects both the recent approval of the Visian ICL for the treatment of myopia, and were partially offset by a 5% decrease in U.S. cataract product sales. The Company has lost increasing market share in the U.S. over the last several years as it has not kept pace with the competition in introducing new and enhanced cataracts products due to the Company s focus on bringing the Visian ICL to the U.S. market. U.S. sales of the Visian ICL, which was launched in the U.S. in February 2006, were $4,172,000 for fiscal 2006. The Company expects to grow ICL sales and reverse declining cataract sales trends and regain market share as it continues the process of training ICL surgeons and

introduces enhanced cataract products to the market in 2007 and beyond.

International net sales for fiscal were $33,990,000, an increase of 4% compared with fiscal 2005 and were impacted by a 50% increase in refractive product sales but partially offset by a decline of 5% in cataract product sales. The decline in international cataract sales is primarily due to the impact in 2006 of doctor strikes in Germany, one of STAAR s largest cataract sales markets. The labor disputes were settled in 2006 and the Company believes the declining cataract sales trends in Germany will reverse in 2007.

During fiscal 2006, global sales of ICLs and TICLs grew 129% to $12,093,000 compared with $5,287,000 in fiscal 2005. Total refractive sales during fiscal 2006 grew 134% to $12,514,000 compared with $5,347,000 in fiscal 2005 due to the launch of the ICL in the U.S. and increased international ICL sales in 2006.

The Company expects continued growth in sales, both in the U.S. and internationally, as the ICL and TICL gain broader acceptance and new cataract products are introduced.

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Gross profit margin

Gross profit margin for the full year 2006 was 47.0% compared with 46.4% for 2005. The increase in gross profit margin is due to increased sales of higher margin ICLs internationally and in the U.S. where the product was first launched in 2006. This increase in gross margin was partially offset due to decreased IOL margins due to lower average selling prices and higher costs. Additionally, gross profit for 2006 was impacted by obsolescence charges of $807,000 for certain IOL inventory in anticipation of new product launches in 2007 and to a lesser degree slower moving diopters of other lenses. Management intends to mitigate the risk of write-off of this and other product but felt it prudent to take this action as cannibalization of existing product is likely as new products roll out. This charge reduced gross profit margin by approximately 1.4%.

The Company expects gross profit margin to increase as sales of ICLs become a larger percentage of overall revenue, U.S. cataract sales continue to grow and as enhanced cataract products are delivered to the market.

General and administrative

General and administrative expenses for fiscal 2006 increased 12% or $1,165,000 over fiscal 2005. The increase in general and administrative expenses for fiscal 2006 was principally due to the $952,000 impact of FAS 123R which was adopted in fiscal 2006 and other general cost increases. The Company does not expect significant increases in general and administrative expenses in 2007.

Marketing and selling

Marketing and selling expenses for fiscal 2006 increased 21% or $3,842,000 compared with fiscal 2005. The increase in marketing and selling expenses for fiscal 2006 primarily resulted from the $419,000 impact of FAS 123R, which was adopted in fiscal 2006, increased costs to support the roll-out of the Company s refractive products in new territories, including the U.S., and increased commissions. The Company expects sales and marketing expense to decrease slightly as a percentage of sales over 2006 but increase in dollars due to increased commissions in the U.S. on higher sales.

Research and development

Research and development expenses, including regulatory and clinical expenses, for fiscal 2006 increased 27% or $1,507,000 compared with fiscal 2005. The increase in research and development expenses is due to the $262,000 impact of FAS 123R which was adopted in fiscal 2006, costs associated with new product development and TICL regulatory and FDA submission costs. The Company expects to spend approximately 10% of revenues in 2007 on its research and development activities.

Note reserves (reversals)

During 2006, the Company settled the last of its notes receivable from former directors and officers totaling $1,961,000 (including accrued interest) for a cash payment of $175,000 and proceeds from the sale of 120,000 shares of pledged Company stock of $870,000. The deficiency on the notes was applied against reserves recorded against the notes in 2005 and 2004 and $331,000 of excess reserves was reversed during fiscal 2006.

Other income (expense), net

Other income, net for fiscal 2006 was $95,000, compared to fiscal 2005 when it was $854,000. The principal reasons for the decrease in other income are due to 1) $65,000 of exchange losses recorded during the year versus $334,000 of exchange gains recorded during fiscal 2005; 2) decreased interest income due to decreased cash balances; 3) increased interest expense due to lease financing obtained in 2006; and 4) a decrease in earnings from the Company s joint venture and other miscellaneous income decreases.

Income taxes

The Company recorded income taxes of $1.5 million for fiscal 2006 and $1.2 million for fiscal 2005, based on the income of the Company s German subsidiary including taxes of approximately $700,000 that were accrued

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based on the results of a tax audit of the German subsidiary by the German tax authorities, see *Overview Investigation of Fraud at Domilens GmbH.*

2005 Fiscal Year Compared to 2004 Fiscal Year

Revenues

Net sales for the years ended fiscal 2005 and December 31, 2004 (fiscal 2004) were $51.3 million and $51.7 million, respectively. Changes in currency exchange rates did not have a material impact on net sales for fiscal 2005. The primary reason for the decrease in product sales was a decrease in U.S. cataract product sales, both in average selling prices and volumes, due to (i) increasing concerns in the marketplace regarding the Company s long unresolved compliance issues with the FDA, (ii) the Company s failure to match competitors improvements to IOL technology, (iii) although subsequently withdrawn, the receipt of a going concern qualification from the Company s auditors; (iv) our sales representatives loss of effective selling time as a result of the foregoing; (v) a supplier recall of viscoelastic which is often bundled with IOLs; and (vi) the CMS ruling that permits Medicare-covered cataract patients to receive higher-cost multifocal IOLs by paying only the additional cost of the lens and surgical procedure while still receiving reimbursement for the basic cost of cataract surgery and a monofocal IOL. The decreases in U.S. cataract product sales were partially offset by a 30% increase in sales of the Company s Visian™ ICL (ICL) and Visian™ Toric ICL (TICL) in international markets, and an 85% increase in sales of preloaded IOLs in international markets.

Gross profit

Gross profit margin decreased to 46.4% of revenues for fiscal 2005, from 50.6% of revenues for fiscal 2004. The primary reasons for the decrease in gross profit margin were higher unit costs due to the allocation of fixed overhead across fewer units produced, lower overall average selling prices of IOLs, and a continued shift in geographical and product mix.

General and administrative expenses

General and administrative expenses for fiscal 2005 increased $474,000, or 5%, over fiscal 2004 primarily due to increased insurance premiums and increased professional fees, particularly legal and settlement fees associated with the class action lawsuit.

Marketing and selling expenses

Marketing and selling expenses for fiscal 2005 decreased $1.8 million, or 8.6%, over fiscal 2004 primarily as a result of cost reduction measures taken during 2005 and a decrease in U.S. commissions due to decreased cataract product sales.

Research and development expenses

Research and development expenses for the fiscal 2005, decreased $673,000, or 10.8%, compared to fiscal 2004, as anticipated, because significant consulting costs were incurred in the previous year in preparation for FDA audits in the Company s Nidau, Switzerland and Monrovia, California facilities.

Note reserves (reversals)

Other charges for fiscal 2005 were $746,000 compared to $500,000 in fiscal 2004. During fiscal 2005, the Company recorded additional reserves totaling $746,000 against promissory notes of a former director of the Company. Aggregate principal and accrued interest owed to the Company under the notes was $1.9 million as of December 30, 2005, against which the Company has reserved a total of $1.2 million. The former Director is in default under the notes and a related Forbearance Agreement with the Company, but has recently affirmed his obligation to pay the full principal and interest under the notes.

On these events, the Company re-evaluated its likelihood of collecting on the notes and re-examined the collateral for the notes, which consists of a pledge of 120,000 shares of the Company s Common Stock (the

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Pledged Shares) and a second mortgage on a home in Florida. During the third quarter of 2005, the Company was advised that its collateral may be compromised with respect to the second mortgage. Accordingly, the Company increased its reserve on the notes to reflect the status of the collateral.

Other income (expense), net

Other income, net for fiscal 2005 was $854,000, compared to fiscal 2004 when it was expense of $88,000. The principal reasons for the increase in other income are due to 1) $334,000 of exchange gains recorded during the year versus $190,000 of exchange losses recorded during fiscal 2004; 2) increased interest income due to higher cash balances and interest rates; and 3) $158,000 in earnings from the Company s joint venture versus $191,000 of losses recorded during fiscal 2004.

Income taxes

The Company recorded income taxes of $1.2 million for fiscal 2005 and $1.1 million for fiscal 2004, primarily based on the income of the Company s German subsidiary.

Liquidity and Capital Resources

The Company has funded its activities over the past several years principally from cash flow generated from operations, credit facilities provided by institutional domestic and foreign lenders, the private placement of Common Stock, the repayment of former directors notes, and the exercise of stock options.

As of December 29, 2006 and December 30, 2005, the Company had $7.9 million and $12.7 million, respectively, of cash, cash equivalents and restricted short-term investments.

Net cash used in operating activities was $8.1 million, $7.5 million, and $8.6 million for fiscal 2006, 2005, and 2004, respectively. For fiscal 2006, cash used in operations was the result of increased net losses, adjusted for depreciation, amortization, expense related to the implementation of FAS 123R, and other miscellaneous non-cash items, and further offset by increases in working capital. For fiscal 2005, cash used in operations was the result of the net loss, adjusted for depreciation, amortization, notes receivable reserves and other non-cash charges, and net increases in working capital. For fiscal 2004, cash used in operations was the result of the net loss, adjusted for depreciation, amortization, notes receivable reserves and other non-cash charges, and net decreases in working capital.

Accounts receivable was $6.5 million in 2006, $5.1 million in 2005, and $6.2 million in 2004. The increase in accounts receivable is due to increased sales in the U.S. during fiscal 2006 and in international markets. Days Sales Outstanding (DSO) decreased slightly from 41 days in 2004 to 38 days in 2005, and increased to 39 days in 2006. The Company expects DSO to improve in 2007 assuming increased sales of the ICL in the U.S. which generally have shorter payment terms than U.S. cataract sales or all other products sold internationally.

Inventories at the end of fiscal 2006, 2005, and 2004 was $13.0 million, $14.7 million, and $15.1 million, respectively. Day s inventory on hand decreased from 186 days in 2004 and 235 days in 2005 to 162 days in 2006.

Net cash provided by (used in) investing activities was approximately $140,000, $4,067,000, and ($7,168,000), for fiscal 2006, 2005, and 2004, respectively. The decrease from 2005 to 2006 is due primarily to changes related to the purchase and sale of short term investments as the Company no longer holds the investments. During 2006, the Company s principal investments were in property and equipment. Investments in property and equipment were $786,000, $1.2 million, and $1.7 million for fiscal 2006, 2005, and 2004, respectively. The investments are generally made to upgrade and improve existing production equipment and processes. Investments in property and equipment

for 2006 were more than offset by proceeds of approximately $1.2 million from the settlement of notes receivable of a former director.

During 2005, the Company invested $13.4 million of the proceeds of a private placement and additional $1.9 million in cash in taxable auction-rate securities which were classified as available for sales investments and sold $7.8 million of the investment during the year to provide cash for operations. During the third quarter of 2005, the Company sold all of its remaining auction-rate securities totaling $12.6 million and purchased high-quality

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commercial paper, which is classified as a cash equivalent. During 2004, the Company invested $8.0 million of the proceeds of a private placement in taxable auction-rate securities which are classified as available for sale investments and sold $2.9 million of the investment during the year to provide cash for operations. Also during 2004, the Company purchased the 20% minority interest in an 80% owned subsidiary in exchange for cash of $768,000 and a long-term note in the amount of $542,000 due on November 1, 2007. The transaction resulted in the recording of goodwill of $1.1 million.

Net cash provided by financing activities was approximately $2,795,000, $12,239,000, and $12,547,000 for fiscal 2006, 2005, and 2004, respectively. Cash provided by financing activities in 2006 resulted from the receipt of $2.9 million of proceeds from stock option exercises. In 2005, cash provided by financing activities resulted from the receipt of net proceeds of $13.4 million from a private placement of 4.1 million shares of the Company s Common Stock and $130,000 received from the exercise of the stock options. During 2005, the Company used $1.2 million in cash generated from international operations to pay down (while retaining availability) the Company s Swiss credit facility. In 2004, cash provided by financing activities resulted from the receipt of net proceeds of $11.6 million from a private placement of 2.0 million shares of the Company s Common Stock and $829,000 received from the exercise of stock options.

Credit Facilities

The Company and its subsidiaries have credit facilities with different lenders to support operations in the U.S., Switzerland and Germany, respectively.

On June 8, 2006 the Company signed a Credit and Security agreement with Wells Fargo Bank for a revolving credit facility. The credit facility provides for borrowings of 85% of eligible accounts receivable with a maximum of $3.0 million, carries an interest rate of prime plus 1.5%, and is secured by substantially all of the assets of the Company s U.S. operations. The term of the agreement is three years and it contains certain financial covenants relating to minimum calculated net worth, net loss, liquidity and restrictions on Company investments or loans to affiliates and investments in capital expenditures, which only apply if the Company borrows and/or maintains an outstanding advance. No borrowings were outstanding as of December 29, 2006. As the Company does not satisfy minimum financial covenants in its U.S. operations that are a condition to borrowing, no borrowings are available. The Company intends to seek to renegotiate the conditions to borrowing under the agreement based on its most recent financial projections.

On March 21, 2007, STAAR entered into a loan arrangement with Broadwood Partners, L.P. (Broadwood). Pursuant to a Promissory Note (the Note) between STAAR and Broadwood, Broadwood loaned $4 million to STAAR. The Note has a term of three years and bears interest at a rate of 10% per annum, payable quarterly. The Note is not secured by any collateral, may be pre-paid by STAAR at any time without penalty, and is not subject to covenants based on financial performance or financial condition (except for insolvency). Based on publicly available information filed with the Securities and Exchange Commission (the SEC), on the date of the transaction Broadwood Partners L.P. beneficially owned 2,492,788 shares of the Company s common stock, comprising 9.7% of the Company s common stock as of March 21, 2007, and Neal Bradsher, President of Broadwood Partners, L.P., may have been deemed to beneficially own 2,518,688 shares of the Company s common stock, comprising 9.8% of the Company s common stock as of that date.

The Company s lease agreement with Farnam Street Financial, Inc., as amended on October 9, 2006, provides for purchases of up to $1,500,000 of property, plant and equipment. In accordance with the requirements of SFAS 13 Accounting for Leases, purchases under this facility are accounted for as capital leases and have a three-year term. Under the agreement, the Company has the option to purchase any item of the leased property, at the end of the respective items lease terms, at a mutually agreed fair value. Approximately $573,000 in borrowings were available

under this facility as of December 29, 2006.

The Company s lease agreement with Mazuma Capital Corporation, as amended on August 16, 2006, provides for purchases of up to $301,000 of property, plant and equipment. In accordance with the requirements of SFAS 13 Accounting for Leases, purchases under this facility are accounted for as capital leases and have a two-year term. The Company is required to open a certificate of deposit as collateral in STAAR Surgical Company s name at the underwriting bank for 50% of the assets funded by Mazuma. As of December 29, 2006, the Company had a

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certificate of deposit for approximately $150,000 recorded as short-term investment restricted with a 12-month term at a fixed interest rate of 4.5%. The agreement also provides that the Company may elect to purchase any item of the leased property at the end of its lease term for $1. No borrowings were available under this facility as of December 29, 2006.

The Company s Swiss credit agreement, as amended on August 2, 2004, provides for borrowings of up to 3.0 million Swiss Francs CHF (approximately $2.4 million based on the rate of exchange on December 29, 2006) for use in the Company s Swiss operations, permits either fixed-term or current advances, and does not have a termination date. The interest rate on current advances is 6.25% and 6.0% per annum, respectively, at December 29, 2006 and December 30, 2005, plus a commission rate of 0.25% payable quarterly. There were no current advances outstanding at December 29, 2006. The base interest rate for fixed-term advances follows Euromarket conditions for loans of a corresponding term and currency plus an individual margin (5.0% at December 29, 2006 and 4.25% at December 30, 2005, respectively). Fixed-term borrowings outstanding under the note at December 29, 2006 and December 30, 2005, respectively, were CHF 2.2 million (approximately $1.8 million based on the rate of exchange at December 29, 2006) and CHF 2.2 million (approximately $1.7 million based on the rate of exchange on December 30, 2005). The credit facility is secured by a general assignment of claims and includes positive and negative covenants which, among other things, require the maintenance of a minimum level of equity of at least $12.0 million and prevents the Swiss subsidiary from entering into other secured obligations or guaranteeing the obligations of others. The agreement also prohibits the sale or transfer of patents or licenses without the prior consent of the lender and the terms of inter-company receivables may not exceed 90 days.

The German subsidiary entered into a credit agreement on August 30, 2005. The renewed credit agreement provides for borrowings of up to 100,000 EUR ($131,000 at the rate of exchange on December 29, 2006), at a rate of 8.5% per annum and does not have a termination date. The credit facility is not secured. There were no borrowings outstanding as of December 29, 2006 and December 30, 2005.

The Company was in compliance with the covenants of its foreign credit facilities as of December 29, 2006.

The following table represents the Company s known contractual obligations as of December 29, 2006 (in thousands):

		Payments Due by Period			
Contractual Obligations	**Total**	**Less Than 1 Year**	**1-3 Years**	**3-5 Years**	**More Than 5 Years**
Notes payable	$ 1,802	$ 1,802	$	$	$
Capital lease obligations	1,720	647	1,073		
Operating lease obligations	4,254	1,344	2,637	273	
Purchase obligations	1,289	600	689		
Other current-term liabilities	927	927			
Open purchase orders	1,278	1,278			
Total	$ 11,270	$ 6,598	$ 4,399	$ 273	$

The table presented above excludes employment agreements for two employees of our Australian subsidiary.

On March 23, 2007 the Company executed a $4.0 million note with Broadwood Partners, LP. The obligation has been excluded from the table because it was not outstanding at December 29, 2006.

While the Company s international business generates positive cash flow and represents approximately 60% of consolidated net sales, the Company has reported losses on a consolidated basis for several years due to a number of factors, including eroding sales of cataract products in the U.S. and FDA compliance issues that consumed additional resources while delaying the introduction of new products in the U.S. market. During these years the Company has secured additional capital to sustain operations through private sales of equity securities.

The Company believes that in the near term its best prospect for returning its U.S. and consolidated operations to profitability is through the growth in sales of the ICL in the U.S. combined with continued growth in international

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markets. In the longer term the Company seeks to develop and introduce products in the U.S. cataract market to stop further erosion of its market share and resume growth in that sector. Nevertheless, success of these strategies is not assured and, even if successful, the company is not likely to achieve positive cash flow on a consolidated basis during fiscal 2007.

The Company believes that as a result of its debt financings, along with expected cash from operations, it currently has sufficient cash to meet its funding requirements at least through the first quarter of 2008. However, given its history of losses and negative cash flows, it is possible that the Company will find it necessary to supplement these sources of capital with additional financing to sustain operations until the Company returns to profitability.

The credit facilities are subject to various financial covenants and if our losses continue, we risk defaulting on the terms of our credit facilities. Our limited borrowing capacity could cause a shortfall in working capital or prevent us from making expenditures to expand or enhance our business. A default on any of our loan agreements could cause our long term obligations to be accelerated, make further borrowing difficult and jeopardize our ability to continue operations.

If the Company is unable to rely solely on existing debt financing and is unable to obtain additional debt financing, the Company may find it necessary to raise additional capital in the future through the sale of equity or debt securities.

The Company has filed a shelf registration statement with the Securities and Exchange Commission, which provides for the public offering and sale of up to $15 million in debt or equity securities pursuant to the Securities Act of 1933, as amended. The registration statement became effective on August 8, 2006. The Company is not obligated to sell any amount of securities under the registration statement, and as of the date of this report it has not entered into any commitment to do so. Notwithstanding the availability of shelf registration, the Company s ability to raise financing through sales of securities depends on general market conditions and the demand for STAAR s common stock or debt securities. The conditions prevailing at the time the Company seeks to raise capital may prevent it from selling securities under the shelf registration on favorable terms, or at all. If our common stock has a low market price at a time when we sell equity securities, our existing shareholders could experience substantial dilution. An inability to secure additional financing could limit our ability to expand our business. If we fail to achieve profitability and cannot secure adequate funding, our ability to continue operations would be in jeopardy.

The Company s liquidity requirements arise from the funding of its working capital needs, primarily inventory, work-in-process and accounts receivable. The Company s primary sources for working capital and capital expenditures are cash flow from operations, which will largely depend on the success of the ICL, proceeds from option exercises, borrowings under the Company s bank credit facilities and proceeds from the private placement of common stock. Any withdrawal of support from its banks could have serious consequences on the Company s liquidity. The Company s liquidity also depends, in part, on customers paying within credit terms, and any extended delays in payments or changes in credit terms given to major customers may have an impact on the Company s cash flow. In addition, any abnormal product returns or pricing adjustments may also affect the Company s short-term funding. Changes in the market price of our common stock affect the value of our outstanding options, and lower market prices could reduce our expected revenue from option exercises.

The business of the Company is subject to numerous risks and uncertainties that are beyond its control, including, but not limited to, those set forth above and in the other reports filed by the Company with the Securities and Exchange Commission. Such risks and uncertainties could have a material adverse effect on the Company s business, financial condition, operating results and cash flows.

Critical Accounting Policies

The preparation of financial statements in accordance 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 sales and expenses during the reporting period. On an on-going basis, we evaluate our estimates, including those related to revenue recognition, allowance for doubtful accounts, inventory reserves and

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income taxes, among others. Our estimates are based on historical experiences, market trends and financial forecasts and projections, and on various other assumptions that management believes are reasonable under the circumstances and at that certain point in time. Actual results may differ, significantly at times, from these if actual conditions differ from our assumptions.

The Company believes the following represent its critical accounting policies.

Revenue Recognition and Accounts Receivable. The Company recognizes revenue when realized or realizable and earned, which is when the following criteria are met: persuasive evidence of an arrangement exists; delivery has occurred; the sale price is fixed and determinable; and collectibility is reasonably assured. We record revenue from product sales when title and risk of ownership has been transferred to the customer, which is typically upon delivery to the customer. The Company s products are marketed to ophthalmic surgeons, hospitals, ambulatory surgery centers or vision centers, and distributors. IOLs may be offered to surgeons and hospitals on a consignment basis. In accordance with SAB 104, the Company recognizes revenue for consignment inventory when the IOL is implanted during surgery and not upon shipment to the surgeon. The Company believes its revenue recognition policies are appropriate in all circumstances. See Note 1 *Accounting Policies* for a further discussion of the Company s revenue recognition policy.

The Company generally permits returns of product if the product is returned within the time allowed by the Company, and in good condition. The Company provides allowances for returns based on an analysis of our historical patterns of returns matched against the sales from which they originated. While such allowances have historically been within the Company s expectations, the Company cannot guarantee that it will continue to experience the same return rates that it has in the past. Measurement of such returns requires consideration of historical return experience, including the need to adjust for current conditions and product lines, and judgments about the probable effects of relevant observable data. The Company considers all available information in its quarterly assessments of the adequacy of the allowance for returns.

The Company maintains provisions for uncollectible accounts based on estimated losses resulting from the inability of its customers to remit payments. If the financial condition of customers were to deteriorate, thereby resulting in an inability to make payments, additional allowances could be required. The Company performs ongoing credit evaluations of its customers and adjusts credit limits based upon customer payment history and current creditworthiness, as determined by the Company s review of its customers current credit information. The Company continuously monitors collections and payments from its customers and maintains a provision for estimated credit losses based upon its historical experience and any specific customer collection issues that have been identified. While such credit losses have historically been within the Company s expectations and the provisions established, the Company cannot guarantee that it will continue to experience the same credit loss rates that it has in the past. Measurement of such losses requires consideration of historical loss experience, including the need to adjust for current conditions, and judgments about the probable effects of relevant observable data, including present economic conditions such as delinquency rates and financial health of specific customers. The Company considers all available information in its assessments of the adequacy of the reserves for uncollectible accounts.

Stock-Based Compensation. We account for the issuance of stock options to employees and directors in accordance with SFAS 123R and the issuance of stock options and warrants for services from non-employees in accordance with SFAS 123, Accounting for Stock-Based Compensation, and the Financial Accounting Standards Board (FASB) Emerging Issues Task Force Issue (EITF) No. 96-18, Accounting For Equity Instruments That Are Issued To Other Than Employees For Acquiring Or In Conjunction With Selling Goods Or Services, by estimating the fair value of options and warrants issued using the Black-Scholes pricing model. This model s calculations include the exercise price, the market price of shares on grant date, risk-free interest rates, expected life of the option or warrant, expected volatility of our stock and expected dividend yield. The

amounts recorded in the financial statements for share-based expense could vary significantly if we were to use different assumptions.

Income Taxes. We account for income taxes under the asset and liability method, whereby deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the

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financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. We evaluate the need to establish a valuation allowance for deferred tax assets based on the amount of existing temporary differences, the period in which they are expected to be recovered and expected levels of taxable income. A valuation allowance to reduce deferred tax assets is established when it is more likely than not that some or all of the deferred tax assets will not be realized. As of December 29, 2006, the valuation allowance fully offsets the value of deferred tax assets on the Company s balance sheet. Net increases to the valuation allowance were $6,774,000, $5,490,000 and $6,097,000 in 2006, 2005 and 2004, respectively.

We expect to continue to maintain a full valuation allowance on future tax benefits until an appropriate level of profitability is sustained, or we are able to develop tax strategies that would enable us to conclude that it is more likely than not that a portion of our deferred tax assets would be realizable.

In the normal course of business, the Company is regularly audited by federal, state and foreign tax authorities, and is periodically challenged regarding the amount of taxes due. These challenges include questions regarding the timing and amount of deductions and the allocation of income among various tax jurisdictions. Management believes the Company s tax positions comply with applicable tax law and intends to defend its positions. The Company s effective tax rate in a given financial statement period could be impacted if the Company prevailed in matters for which reserves have been established, or was required to pay amounts in excess of established reserves.

Inventories. The Company provides estimated inventory allowances for excess, slow moving and obsolete inventory as well as inventory whose carrying value is in excess of net realizable value. These reserves are based on current assessments about future demands, market conditions and related management initiatives. If market conditions and actual demands are less favorable than those projected by management, additional inventory write-downs may be required. The Company values its inventory at the lower of cost or net realizable market values. The Company regularly reviews inventory quantities on hand and records a provision for excess and obsolete inventory based primarily on the expiration of products with a shelf life of less than four months, estimated forecasts of product demand and production requirements for the next twelve months. Several factors may influence the realizability of its inventories, including decisions to exit a product line, technological change and new product development. These factors could result in an increase in the amount of obsolete inventory quantities on hand. Additionally, estimates of future product demand may prove to be inaccurate, in which case the provision required for excess and obsolete inventory may be understated or overstated. If in the future, the Company determined that its inventory was overvalued, it would be required to recognize such costs in cost of sales at the time of such determination. Likewise, if the Company determined that its inventory was undervalued, cost of sales in previous periods could have been overstated and the Company would be required to recognize such additional operating income at the time of sale. While such inventory losses have historically been within the Company s expectations and the provisions established, the Company cannot guarantee that it will continue to experience the same loss rates that it has in the past. Therefore, although the Company makes every effort to ensure the accuracy of forecasts of future product demand, including the impact of planned future product launches, any significant unanticipated changes in demand or technological developments could have a significant impact on the value of its inventory and its reported operating results.

Impairment of Long-Lived Assets. Intangible and other long lived-assets are reviewed for impairment whenever events such as product discontinuance, plant closures, product dispositions or other changes in circumstances indicate that the carrying amount may not be recoverable. Certain factors which may occur and indicate that an impairment exists include, but are not limited to the following: significant underperformance

relative to expected historical or projected future operating results; significant changes in the manner of the Company s use of the underlying assets; and significant adverse industry or market economic trends. In reviewing for impairment, the Company compares the carrying value of such assets to the estimated undiscounted future cash flows expected from the use of the assets and their eventual disposition. In the event that the carrying value of assets is determined to be unrecoverable, the Company would estimate

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the fair value of the assets and record an impairment charge for the excess of the carrying value over the fair value. The estimate of fair value requires management to make a number of assumptions and projections, which could include, but would not be limited to, future revenues, earnings and the probability of certain outcomes and scenarios. The Company s policy is consistent with current accounting guidance as prescribed by SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets.* An assessment was completed under the guidance of SFAS No. 144 for the year ended December 29, 2006, and no impairment was identified. See Note 1 *Accounting Policies* for a further discussion of SFAS No. 144.

Goodwill. Goodwill, which has an indefinite life and was previously amortized on a straight-line basis over the periods benefited, is no longer amortized to earnings, but instead is subject to periodic testing for impairment. Intangible assets determined to have definite lives are amortized over their remaining useful lives. Goodwill of a reporting unit is tested for impairment on an annual basis or between annual tests if an event occurs or circumstances change that would reduce the fair value of a reporting unit below its carrying amount. Certain factors which may occur and indicate that an impairment exists include, but are not limited to the following: significant underperformance relative to expected historical or projected future operating results; significant changes in the manner of the Company s use of the underlying assets; and significant adverse industry or market economic trends. In the event that the carrying value of assets is determined to be unrecoverable, the Company would estimate the fair value of the reporting unit and record an impairment charge for the excess of the carrying value over the fair value. The estimate of fair value requires management to make a number of assumptions and projections, which could include, but would not be limited to, future revenues, earnings and the probability of certain outcomes and scenarios. The Company s policy is consistent with current accounting guidance as prescribed by SFAS No. 142, Goodwill and Intangible Assets. As provided under SFAS No. 142, an annual assessment was completed for the year ended December 29, 2006, and no impairment was identified. As of December 29, 2006, the carrying value of goodwill was $7.5 million. See Note 1 *Accounting Policies* for a further discussion of SFAS No. 142.

Patents and Licenses. The Company also has other intangible assets consisting of patents and licenses, with a gross book value of $11.5 million and accumulated amortization of $7.0 million as of December 29, 2006. Amortization is computed on the straight-line basis over the estimated useful lives, which are based on legal and contractual provisions, and range from 10 to 20 years. The Company reviews patents and licenses for impairment in the same assessment discussed above in the discussion above regarding *Impairment of Long-Lived Assets.* No impairment was identified during the review completed in the fourth quarter of 2006.

Foreign Exchange

Management does not believe that the fluctuation in the value of the dollar in relation to the currencies of its suppliers or customers in the last three fiscal years had adversely affected the Company s ability to purchase or sell products at agreed upon prices. No assurance can be given, however, that adverse currency exchange rate fluctuations will not occur in the future, which would affect the Company s operating results. The Company does not engage in hedging transactions to offset changes in currency.

Inflation

Management believes inflation has not had a significant impact on the Company s operations during the past three years.

Recent Accounting Pronouncements

In June 2006, the FASB issued FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes, (FIN 48) which clarifies the accounting for uncertainty in income taxes. FIN 48 requires that companies recognize in the consolidated financial statements the impact of a tax position, if that position is more likely than not of being sustained on audit, based on the technical merits of the position. FIN 48 also provides guidance on de-recognition, classification, interest and penalties, accounting in interim periods and disclosure. The provisions of FIN 48 are effective for fiscal years beginning after December 15, 2006. We will adopt FIN 48 effective January 1, 2007. We are currently evaluating the effect of this new pronouncement.

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In September 2006, the FASB issued SFAS No. 157 *Fair Value Measurements* (SFAS 157). SFAS 157 provides a new single authoritative definition of fair value and provides enhanced guidance for measuring the fair value of assets and liabilities and requires additional disclosures related to the extent to which companies measure assets and liabilities at fair value, the information used to measure fair value, and the effect of fair value measurements on earnings. SFAS 157 is effective for the Company as of December 29, 2007. The Company is currently assessing the impact, if any, of SFAS 157 on its consolidated financial statements.

In November 2006, the FASB issued FASB Staff Position No. EITF 00-19-2, Accounting for Registration Payment Arrangements , which specifies that the contingent obligation to make future payments or otherwise transfer consideration under a registration payment arrangement, whether issued as a separate agreement or included as a provision of a financial instrument or other agreement, should be separately recognized and measured. Additionally, this guidance further clarifies that a financial instrument subject to a registration payment arrangement should be accounted for in accordance with other applicable GAAP without regard to the contingent obligation to transfer consideration pursuant to the registration payment arrangement. This guidance is effective for financial statements issued for fiscal years beginning after December 15, 2006, and interim periods within those fiscal years. We are assessing the impact of adopting EITF 00-19-2 and currently do not believe the adoption will have a material impact on our consolidated financial statements.

In February 2007, the FASB issued Statement No. 159, The Fair Value Option for Financial Assets and Financial Liabilities (SFAS 159). SFAS 159 provides that companies may elect to measure specified financial instruments and warranty and insurance contracts at fair value on a contract-by-contract basis, with changes in fair value recognized in earnings each reporting period. The election, called the fair value option, will enable some companies to reduce the variability in reported earnings caused by measuring related assets and liabilities differently. Companies may elect fair-value measurement when an eligible asset or liability is initially recognized or when an event, such as a business combination, triggers a new basis of accounting for that asset or liability. The election is irrevocable for every contract chosen to be measured at fair value and must be applied to an entire contract, not to only specified risks, specific cash flows, or portions of that contract. SFAS 159 is effective as of the beginning of a company s first fiscal year that begins after November 15, 2007. Retrospective application is not allowed. Companies may adopt SFAS 159 as of the beginning of a fiscal year that begins on or before November 15, 2007 if the choice to adopt early is made after SFAS 159 has been issued and within 120 days of the beginning of the fiscal year of adoption and the entity has not issued GAAP financial statements for any interim period of the fiscal year that includes the early adoption date. Companies are permitted to elect fair-value measurement for any eligible item within SFAS 159 s scope at the date they initially adopt SFAS 159. The adjustment to reflect the difference between the fair value and the current carrying amount of the assets and liabilities for which a company elects fair-value measurement is reported as a cumulative-effect adjustment to the opening balance of retained earnings upon adoption. Companies that adopt SFAS 159 early must also adopt all of SFAS 157 s requirements at the early adoption date. We are assessing the impact of adopting SFAS 159 and currently do not believe the adoption will have a material impact on our consolidated financial statements.

Item 7A. ***Quantitative and Qualitative Disclosures About Market Risk***

In the normal course of business, our operations are exposed to risks associated with fluctuations in interest rates and foreign currency exchange rates. The Company manages its risks based on management s judgment of the appropriate trade-off between risk, opportunity and costs. Management does not believe that these market risks are material to the results of operations or cash flows of the Company, and, accordingly, does not generally enter into interest rate or foreign exchange rate hedge instruments.

Interest rate risk. Our $1.8 million of debt is based on the borrowings of our international subsidiaries. The majority of our international borrowings bear an interest rate that is linked to Swiss market conditions and, thus, our interest rate expense will fluctuate with changes in those conditions. If interest rates were to increase or decrease by 1% for the year, our annual interest rate expense would increase or decrease by approximately $18,000.

Foreign currency risk. Our international subsidiaries operate in and are net recipients of currencies other than the U.S. dollar and, as such, our revenues benefit from a weaker dollar and are adversely affected by a stronger dollar relative to major currencies worldwide (primarily, the Euro and Australian dollar). Accordingly, changes in

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exchange rates, and particularly the strengthening of the US dollar, may negatively affect our consolidated sales and gross profit as expressed in U.S. dollars. Additionally, as of December 29, 2006, all of our debt is denominated in Swiss Francs and as such, we are subject to fluctuations of the Swiss Franc as compared to the U.S. dollar in converting the value of the debt to U.S. dollars. The U.S. dollar value of the debt is increased by a weaker dollar and decreased by a stronger dollar relative to the Swiss Franc.

In the normal course of business, we also face risks that are either non-financial or non-quantifiable. Such risks include those set forth in Item 1A. Risk Factors.

Item 8. ***Financial Statements and Supplementary Data***

Financial Statements and the Report of Independent Registered Public Accounting Firm are filed with this Annual Report on Form 10-K/A in a separate section following Part IV, as shown on the index under Item 15 of this Annual Report.

Item 9. ***Changes in and Disagreements with Accountants on Accounting and Financial Disclosure***

Not applicable.

Item 9A. ***Controls and Procedures***

Attached as exhibits to this Annual Report on Form 10-K/A are certifications of STAAR s Chief Executive Officer (CEO) and Chief Financial Officer (CFO), which are required in accordance with Rule 13a-14 of the Securities Exchange Act of 1934, as amended (the Exchange Act). This Controls and Procedures section includes information concerning the controls and controls evaluation referred to in the certifications. Page F-3 of this Annual Report on Form 10-K/A sets forth the report of BDO Seidman, LLP, our independent registered public accounting firm, regarding its audit of STAAR s internal control over financial reporting and of management s assessment of internal control over financial reporting set forth below in this section. This section should be read in conjunction with the certifications and the BDO Seidman, LLP report for a more complete understanding of the topics presented.

Evaluation of Disclosure Controls and Procedures

The Company s management, with the participation of the CEO and CFO, conducted an evaluation of the effectiveness of the Company s disclosure controls and procedures, as defined in Exchange Act Rule 13a-15(e), as of the end of the period covered by this Form 10-K/A. Based on that evaluation and the identification of the material weakness in internal controls over financial reporting described below, the CEO and the CFO concluded that, as of the end of the period covered by this Form 10-K/A, the Company s disclosure controls and procedures were not effective.

As previously reported in Form 8-Ks filed on January 23, 2007 and March 14, 2007, the Audit Committee of the Company s Board of Directors commenced in January 2007, an independent investigation into reports to the Company s management by Guenther Roepstorff, president of Domilens GmbH, a subsidiary of STAAR located in Germany, that he admitted to the German Federal Ministry of Finance that without STAAR s knowledge he had diverted property of Domilens with a book value of approximately $400,000 to a company under his control over a four-year period between 2001 and 2004. Mr. Roepstorff made this admission in connection with an audit conducted by the Ministry in 2006, which examined the financial records of Mr. Roepstorff, Domilens and the company to which he diverted the property, Equimed GmbH (currently known as eyemaxx GmbH), covering the four-year period. During the course of the investigation, the Company found that in addition to the diversions of property admitted by Mr. Roepstorff, payments were made to Mr. Roepstorff disguised as prepayments to suppliers and unauthorized borrowing occurred.

Management Report on Internal Control Over Financial Reporting

The Company s management is responsible for establishing and maintaining adequate internal control over financial reporting as defined in Exchange Act Rule 13a-15(f) and for assessing the effectiveness of its internal

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control over financial reporting. Our internal control system is designed to provide reasonable assurance to our management and Board of Directors regarding the preparation and fair presentation of published financial statements in accordance with United States generally accepted accounting principles.

Our management, including the CEO, does not expect that our disclosure controls and procedures or our internal control over financial reporting will necessarily prevent all fraud and material errors. An internal control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations on all internal control systems, our internal control system can provide only reasonable assurance of achieving its objectives and no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within our Company have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of simple error or mistake. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the control. The design of any system of internal control is also based in part upon certain assumptions about the likelihood of future events, and can provide only reasonable, not absolute, assurance that any design will succeed in achieving its stated goals under all potential future conditions. Over time, controls may become inadequate because of changes in circumstances, or the degree of compliance with the policies and procedures may deteriorate.

The Company s management, with the participation of the CEO and CFO, conducted an evaluation of the effectiveness of the Company s internal control over financial reporting as of December 29, 2006, the end of our fiscal year. Management based its assessment on criteria established in *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission.

A material weakness is a control deficiency, or a combination of control deficiencies that results in more than a remote likelihood that a material misstatement of annual or interim financial statements will not be prevented or detected. In connection with the assessment described above, management has identified the following material weakness as of December 29, 2006:

Failure to design and maintain controls over and in its German subsidiary sufficient to detect and prevent management override and fraud

> *Control Environment* The Company did not maintain an effective control environment because of the following: (a) the Company did not adequately and consistently reinforce the importance of adherence to controls and the Company s code of conduct; (b) the Company failed to institute all elements of an effective program to help prevent and detect fraud by Company employees; and (c) the Company did not maintain effective corporate and regional management oversight and monitoring of operations to detect managements override of established financial controls and accounting policies, execution of improper transactions and accounting entries to impact revenue and earnings, and reporting of these transactions to the appropriate finance personnel or the Company s independent registered public accounting firm.

As a result of the material weakness described above, management has concluded that our internal control over financial reporting was not effective as of the end of the fiscal year ended December 29, 2006.

BDO Seidman LLP, the independent registered public accounting firm that audited and reported on the consolidated financial statements of the Company contained in this report, has issued an attestation report on management s assessment of our internal control over financial reporting, which appears on Page F-3 of this Annual Report on Form 10-K/A.

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Remediation of Material Weakness in Internal Control Over Financial Reporting

The Company has engaged in, and will continue to engage in remediation efforts to address the material weakness in its internal control over financial reporting. Specific actions which have been or will be taken are outlined below:

The Company has:

- obtained the immediate resignation of the president of Domilens GmbH
- appointed the V.P. Sales and Marketing International, as interim president of Domilens
- enhanced monitoring and oversight from STAAR s Swiss and U.S. operations
- held meetings to discuss the Company s Code of Ethics and whistleblower policies with subsidiary employees as a bridge to more formal training

The Company will assess the need to take additional actions including but not limited to the following:

- assign oversight of corporate compliance programs and training to its corporate legal counsel
- evaluate accounting and inventory systems to identify opportunities for enhanced controls
- recruit a local controller who will have enhanced authority in Domilens and direct reporting to corporate headquarters
- evaluate the need for other employee changes
- re-educate employees in STAAR s Code of Ethics
- enhance whistleblower program
- expand executive management s ongoing communications regarding the importance of adherence to internal controls and company policies
- reinforce the certification process to emphasize senior manager s accountability for maintaining an ethical environment
- take steps to fully integrate Domilens into the controls environment of STAAR and STAAR AG
- implement an internal auditing function at STAAR and its subsidiaries, including Domilens
- standardize accounting policies and procedures globally
- evaluate and standardize SOX testing and controls
- institute global fraud prevention programs
- evaluate such other actions as its advisors may recommend

Changes in Internal Control over Financial Reporting

There was no change during the fiscal quarter ended December 29, 2006 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

Item 9B. ***Other Information***

Not applicable.

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PART III

Item 10. ***Directors and Executive Officers of the Registrant***

The information in Item 10 is incorporated herein by reference to the section entitled Proposal One Election of Directors contained in the proxy statement (the Proxy Statement) for the 2006 annual meeting of stockholders to be filed with the Securities and Exchange Commission within 120 days of the close of the fiscal year ended December 29, 2006.

Item 11. ***Executive Compensation***

The information in Item 11 is incorporated herein by reference to the section entitled Proposal One Election of Directors contained in the Proxy Statement.

Item 12. ***Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters***

The information in Item 12 is incorporated herein by reference to the section entitled General Information Security Ownership of Certain Beneficial Owners and Management and Proposal One Election of Directors contained in the Proxy Statement.

Item 13. ***Certain Relationships and Related Transactions***

The information in Item 13 is incorporated herein by reference to the section entitled Proposal One Election of Directors contained in the Proxy Statement.

Item 14. ***Principal Accountant Fees and Services***

The information in Item 14 is incorporated herein by reference to the section entitled Proposal Two Ratification of the Appointment of Independent Registered Public Accounting Firm contained in the Proxy Statement.

PART IV

Item 15. ***Exhibits and Financial Statement Schedules***

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Schedules not listed above have been omitted because the information required to be set forth therein is not applicable or is shown in the financial statements and the notes thereto.

(3) *Exhibits*

3.1	Certificate of Incorporation, as amended to date(1)
3.2	By-laws, as amended to date(1)
4.1	1991 Stock Option Plan of STAAR Surgical Company(2)
4.2	1996 STAAR Surgical Company Non-Qualified Stock Plan(3)
4.3	1998 STAAR Surgical Company Stock Plan, adopted April 17, 1998(4)
4.4	Form of Certificate for Common Stock, par value $0.01 per share(11)
4.5	2003 Omnibus Equity Incentive Plan and form of Option Grant and Stock Option Agreement(10)
4.6	Registration Rights Agreement, dated June 4, 2004(15)
4.7	Registration Rights Agreement, dated March 31, 2005(18)
10.1	Joint Venture Agreement, dated May 23, 1988, among the Company, Canon Marketing Japan Inc. and Canon, Inc., and Exhibit B, Technical Assistance and License Agreement, dated September 6, 1988, between the Company and Canon Staar Co., Inc.(6)
10.2	Settlement Agreement among the Company, Canon, Inc., Canon Marketing Japan Inc., and Canon Staar Company, Inc. dated September 28, 2001(8)
10.3	Indenture of Lease dated September 1, 1993, between the Company and FKT Associates and First through Third Additions Thereto(7)
10.4	Second Amendment to Indenture of Lease dated September 21, 1998, between the Company and FKT Associates(7)
10.5	Third Amendment to Indenture of Lease dated October 13, 2003, by and between the Company and FKT Associates(13)
10.6	Indenture of Lease dated October 20, 1983, between the Company and Dale E. Turner and Francis R. Turner and First through Fifth Additions Thereto(5)
10.7	Sixth Lease Addition to Indenture of Lease dated October 13, 2003, by and between the Company and Turner Trust UTD Dale E. Turner March 28, 1984(13)
10.9	Amendment No. 1 to Standard Industrial/Commercial Multi-Tenant Lease dated January 3, 2003, by and between the Company and California Rosen(13)
10.10	Lease Agreement dated July 12, 1994, between STAAR Surgical AG and Calderari and Schwab AG/SA(17)
10.11	Supplement #1 dated July 10, 1995, to the Lease Agreement of July 12, 1994, between STAAR Surgical AG and Calderari and Schwab AG/SA(17)
10.12	Supplement #2 dated August 2, 1999, to the Lease Agreement of July 12, 1994, between STAAR Surgical AG and Calderari and Schwab AG/SA(17)
10.13	Commercial Lease Agreement dated November 29, 2000, between Domilens GmbH and DePfa Deutsche Pfandbriefbank AG(17)
10.14	Patent License Agreement, dated May 24, 1995, with Eye Microsurgery Intersectoral Research and Technology Complex(12)
10.15	Patent License Agreement, dated January 1, 1996, with Eye Microsurgery Intersectoral Research and Technology Complex(7)
10.22	Employment Agreement dated December 19, 2000, between the Company and David Bailey(8)
10.23	Stock Option Plan and Agreement for Chief Executive Officer dated November 13, 2001, between the Company and David Bailey(9)
10.24	Stock Option Certificate dated August 9, 2001, between the Company and David Bailey(20)
10.25	Stock Option Certificate dated January 2, 2002, between the Company and David Bailey(20)

10.26 Stock Option Certificate dated February 14, 2003, between the Company and David Bailey(20)

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10.27	Amended and Restated Stock Option Certificate dated February 12, 2003, between the Company and David Bailey(20)
10.28	Stock Option Certificate dated May 9, 2000, between the Company and Volker Anhaeusser(20)
10.29	Stock Option Certificate dated May 31 2000, between the Company and Volker Anhaeusser(17)
10.30	Stock Option Certificate dated May 30, 2002, between the Company and Volker Anhaeusser(17)
10.31	Stock Option Agreement dated November 13, 2001, between the Company and David R. Morrison(8)
10.32	Stock Option Certificate dated February 13, 2003, between the Company and Donald Duffy(17)
10.36	Offer of Employment dated July 12, 2002, from the Company to Nick Curtis(17)
10.37	Amendment to Offer of Employment dated February 14, 2003 from the Company to Nick Curtis(17)
10.38	Stock Option Certificate dated February 14, 2003, between the Company and Nicholas Curtis(17)
10.39	Amended and Restated Stock Option Certificate dated February 12, 2003, between the Company and Nicholas Curtis(17)
10.40	Employment Agreement dated March 18, 2005, between the Company and Tom Paul(17)
10.42	Form of Indemnification Agreement between the Company and certain officers and directors(17)
10.43	Managing Director s Contract of Employment, dated June 22, 1993, between Domilens and Guenther Roepstorff(17)
10.44	Supplementary Agreement #1 to the Managing Director s Contract of Employment, dated November 25, 1997, between STAAR Surgical AG and Guenther Roepstorff(17)
10.45	Supplementary Agreement #2 to the Managing Director s Contract of Employment dated January 1, 1998, between Domilens and Guenther Roepstorff(17)
10.46	Supplementary Agreement #3 to the Managing Director s Contract of Employment dated January 1, 2003, between Domilens and Guenther Roepstorff(17)
10.47	Employment Agreement dated May 5, 2004, between the ConceptVision Australia Pty Limited CAN 006 391 928 and Philip Butler Stoney(14)
10.48	Employment Agreement dated May 5, 2004, between the ConceptVision Australia Pty Limited CAN 006 391 928 and Robert William Mitchell(14)
#10.49	Assignment Agreement of the Share Capital of Domilens Vertrieb fuer medizinische Produkte GmbH dated January 3, 2003, between STAAR Surgical AG and Guenther Roepstorff(9)
10.50	Assignment Agreement of the Share Capital of ConceptVision Australia Pty Limited ACN 006 391 928, dated May 5, 2004, between the Company and Philip Butler Stoney and Robert William Mitchell(14)
10.51	Addendum to the Assignment Agreement of the Share Capital of ConceptVision Australia Pty Limited ACN 006 391 928, dated May 5, 2004, between the Company and Philip Butler Stoney and Robert William Mitchell(14)
10.53	Stock Purchase Agreement dated June 4, 2004(15)
10.54	Master Credit Agreement dated August 2, 2004, between STAAR Surgical AG and UBS AG(16)
10.58	Loan Agreement between Deutsche Postbank AG and Domilens GmbH dated August 30, 2005(19)
10.59	Standard Industrial/Commercial Multi Tenant Lease Gross dated October 6, 2005, entered into between the Company and Z & M LLC(19)
10.60	Stock Purchase Agreement dated March 31, 2005(18)
10.61	Amendment No. 1 to Commercial Leases between Domilens GmbH and DePfa Deutsche Pfandbriefbank AG related to Domilens headquarters facilities, dated as of December 13, 2005. (23)
#10.62	Credit and Security Agreement by and between STAAR Surgical Company and Wells Fargo Bank, National Association acting through its Wells Fargo Business Credit Operating Division, dated June 8, 2006. (24)
10.63	Promissory Note between STAAR Surgical Company and Broadwood Partners, L.P., dated March 21, 2007. (25)
10.64	

Warrant Agreement between STAAR Surgical Company and Broadwood Partners, L.P., dated March 21, 2007. (25)

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14.1	Code of Ethics(17)
21.1	List of Significant Subsidiaries(17)
23.1	Consent of BDO Seidman, LLP*
31.1	Certification Pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934, Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002*
31.2	Certification Pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934, Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002*
32.1	Certification Pursuant to 18 U.S.C. Section 1350, Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002*

* Filed herewith

Management contract or compensatory plan or arrangement

\# All schedules and or exhibits have been omitted. Any omitted schedule or exhibit will be furnished supplementally to the Securities and Exchange Commission upon request

(1) Incorporated by reference from the Company s Current Report on Form 8-K, as filed on May 23, 2006.

(2) Incorporated by reference from the Company s Registration Statement on Form S-8, File No. 033-76404, as filed on March 11, 1994.

(3) Incorporated by reference from the Company s Annual Report on Form 10-K, for the year ended January 3, 1997, as filed on April 2, 1997.

(4) Incorporated by reference from the Company s Proxy Statement, for its Annual Meeting of Stockholders held on May 29, 1998, as filed on May 1, 1998.

(5) Incorporated by reference from the Company s Annual Report on Form 10-K, for the year ended January 2, 1998, as filed on April 1, 1998.

(6) Incorporated by reference from the Company s Annual Report on Form 10-K, for the year ended January 1, 1999, as filed on April 1, 1999.

(7) Incorporated by reference from the Company s Annual Report on Form 10-K, for the year ended December 29, 2000, as filed on March 29, 2001.

(8) Incorporated by reference to the Company s Annual Report on Form 10-K, for the year ended December 28, 2001, as filed on March 28, 2002.

(9) Incorporated by reference to the Company s Annual Report on Form 10-K, for the year ended January 3, 2003, as filed on April 3, 2003.

(10) Incorporated by reference from the Company s Proxy Statement, for its Annual Meeting of Stockholders held on June 18, 2003, as filed on May 19, 2003.

(11)

Incorporated by reference to Exhibit 4.1 to Amendment No. 1 to the Company s Registration Statement on Form 8-A/A, as filed on April 18, 2003.

(12) Incorporated by reference from the Company s Annual Report on Form 10-K/A, for the year ended December 29, 2000, as filed on May 9, 2001.

(13) Incorporated by reference to the Company s Annual Report on Form 10-K, for the year ended January 2, 2004, as filed on March 17, 2004.

(14) Incorporated by reference to the Company s Quarterly Report, for the period ended April 2, 2004, as filed on May 12, 2004.

(15) Incorporated by reference to the Company s Current Report on Form 8-K filed on June 9, 2004.

(16) Incorporated by reference to the Company s Quarterly Report, for the period ended October 1, 2004, as filed on November 10, 2004.

(17) Incorporated by reference to the Company s Annual Report on Form 10-K, for the year ended December 30, 2005, as filed on March 30, 2005.

(18) Incorporated by reference to the Company s Current Report on Form 8-K filed on April 5, 2005.

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(19) Incorporated by reference to the Company s Quarterly Report for the period ended September 30, 2005, as filed on November 9, 2005.

(20) Incorporated by reference to the Company s Quarterly Report for the period ended March 31, 2006, as filed on May 10, 2006.

(20) Incorporated by reference to the Company s Current Report on Form 8-K filed on June 14, 2006.

(21) Incorporated by reference to the Company s Current Report on Form 8-K filed on March 21, 2007.

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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this Amendment No. 1 to Annual Report on Form 10-K/A to be signed on its behalf by the undersigned, thereunto duly authorized.

STAAR SURGICAL COMPANY

By: /s/ Barry G. Caldwell
Barry G. Caldwell
President and Chief Executive Officer
(principal executive officer)

Date: February 6, 2008

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STAAR SURGICAL COMPANY AND SUBSIDIARIES

CONSOLIDATED FINANCIAL STATEMENTS

Years Ended December 29, 2006,
December 30, 2005 and December 31, 2004

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STAAR SURGICAL COMPANY AND SUBSIDIARIES
REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Board of Directors and Stockholders
STAAR Surgical Company
Monrovia, CA

We have audited the accompanying consolidated balance sheets of STAAR Surgical Company and Subsidiaries (the Company) as of December 29, 2006 and December 30, 2005, and the related consolidated statements of operations, changes in stockholders equity and comprehensive loss, and cash flows (restated) for each of the three years in the period ended December 29, 2006. 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 audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, 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 consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of STAAR Surgical Company and subsidiaries as of December 29, 2006 and December 30, 2005, and the consolidated results of their operations and their cash flows (restated) for each of the three years in the period ended December 29, 2006, in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 19 to the consolidated financial statements, the accompanying consolidated statements of cash flows for each of the three years in the period ended December 29, 2006 have been restated for an error made in the Company s method of translating foreign currency cash flows.

As more fully disclosed in Note 10 to the consolidated financial statements, effective December 31, 2005, the Company adopted the provisions of Statement of Financial Accounting Standards No. 123(R), Share-Based Payment.

We also have audited, in accordance with standards of the Public Company Accounting Oversight Board (United States), the effectiveness of the Company s internal control over financial reporting as of December 29, 2006, based on criteria established in *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) and our report dated March 29, 2007, except for Note 19 which is as of February 6, 2008 expressed an unqualified opinion on management s assessment of the effectiveness of internal control over financial reporting and an adverse opinion on the effectiveness of internal control over financial reporting.

/s/ BDO Seidman, LLP

Los Angeles, California
March 29, 2007, except for Note 19
which is as of February 6, 2008

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STAAR SURGICAL COMPANY AND SUBSIDIARIES

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Board of Directors and Stockholders
STAAR Surgical Company
Monrovia, CA

We have audited management s assessment, included in the accompanying Item 9A, *Management s Report on Internal Control over Financial Reporting*, that STAAR Surgical Company and Subsidiaries (the Company) did not maintain effective internal control over financial reporting as of December 29, 2006, because of the effect of management s failure to design and maintain controls over and in its German subsidiary sufficient to detect and prevent management override and fraud, based on criteria established in *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria). The Company s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management s assessment and an opinion on the effectiveness of the company s internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, evaluating management s assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company s internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company s internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company s assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

A material weakness is a control deficiency, or a combination of control deficiencies, that results in more than a remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected. The following material weakness has been identified and included in management s assessment. Management did not design and maintain controls over and in its German subsidiary sufficient to detect and prevent management override and fraud. This material weakness was considered in determining the nature, timing, and extent of audit tests applied in our audit of the 2006 financial statements, and this report does not affect our report dated March 29, 2007, except for Note 19 which is as of February 6, 2008 on those consolidated financial statements.

In our opinion, management s assessment that STAAR Surgical Company and Subsidiaries did not maintain effective internal control over financial reporting as of December 29, 2006, is fairly stated, in all material respects, based on the COSO criteria. Also in our opinion, because of the effect of the material weakness described above on the achievement of the objectives of the control criteria, the Company has not maintained effective internal control over financial reporting as of December 29, 2006, based on the COSO criteria.

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We do not express an opinion or any form of assurance on management s statements referring to corrective actions taken by the Company after the date of management s assessment.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of STAAR Surgical Company as of December 29, 2006 and December 30, 2005 and the related consolidated statements of operations, changes in stockholders equity and comprehensive loss, and cash flows for each of the three years in the period ended December 29, 2006, and our report dated March 29, 2007, except for Note 19 which is as of February 6, 2008 expressed an unqualified opinion thereon.

/s/ BDO Seidman, LLP

Los Angeles, California
March 29, 2007, except for Note 19
which is as of February 6, 2008

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STAAR SURGICAL COMPANY AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS
December 29, 2006 and December 30, 2005

	2006	2005
	(In thousands, except par value amounts)	
ASSETS		
Current assets:		
Cash and cash equivalents	$ 7,758	$ 12,708
Short-term investments restricted	150	
Accounts receivable trade, net	6,524	5,100
Inventories	12,939	14,699
Prepaids, deposits and other current assets	1,923	1,763
Total current assets	29,294	34,270
Investment in joint venture	397	283
Property, plant and equipment, net	5,846	5,595
Patents and licenses, net	4,439	4,920
Goodwill	7,534	7,534
Other assets	260	153
Total assets	$ 47,770	$ 52,755
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Notes payable	$ 1,802	$ 1,676
Accounts payable	5,055	4,014
Obligations under capital leases current	500	36
Other current liabilities	7,574	5,809
Total current liabilities	14,931	11,535
Obligations under capital leases long-term	957	116
Other long-term liabilities	122	738
Total liabilities	16,010	12,389
Commitments and contingencies (Note 11)		
Stockholders equity:		
Preferred stock, $.01 par value, 10,000 shares authorized, none issued or outstanding		
Common stock, $.01 par value; 60,000 and 30,000 shares authorized; issued and outstanding 25,618 and 24,819 shares	256	248
Additional paid-in capital	117,312	112,434
Accumulated other comprehensive income	889	146

Accumulated deficit	(86,697)	(71,653)
	31,760	41,175
Notes receivable from former director, net		(809)
Total stockholders equity	31,760	40,366
Total liabilities and stockholders equity	$ 47,770	$ 52,755

See accompanying summary of accounting policies and notes to consolidated financial statements.

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STAAR SURGICAL COMPANY AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS
Years Ended December 29, 2006, December 30, 2005 and December 31, 2004

	2006	2005	2004
	(In thousands, except per share amounts)		
Net sales	$ 56,282	$ 51,303	$ 51,685
Cost of sales	29,849	27,517	25,542
Gross profit	26,433	23,786	26,143
Selling, general and administrative expenses:			
General and administrative	10,891	9,727	9,253
Marketing and selling	22,395	18,552	20,302
Research and development	7,080	5,573	6,246
Note reserves (reversals)	(331)	746	500
Total selling, general and administrative expenses	40,035	34,598	36,301
Operating loss	(13,602)	(10,812)	(10,158)
Other income (expense):			
Equity in operations of joint venture	114	158	(191)
Interest income	293	453	219
Interest expense	(261)	(170)	(215)
Other income (expense), net	(51)	413	99
Total other income (expense), net	95	854	(88)
Loss before income taxes and minority interest	(13,507)	(9,958)	(10,246)
Provision for income taxes	1,537	1,239	1,057
Minority interest		(22)	29
Net loss	$ (15,044)	$ (11,175)	$ (11,332)
Loss per share:			
Basic and diluted	$ (0.60)	$ (0.47)	$ (0.58)
Weighted average shares outstanding			
Basic and diluted	25,227	23,704	19,602

See accompanying summary of accounting policies and notes to consolidated financial statements.

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STAAR SURGICAL COMPANY AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS EQUITY AND COMPREHENSIVE LOSS
Years Ended December 29, 2006, December 30, 2005 and December 31, 2004

	Common Stock Shares	Common Stock Par Value	Additional Paid-In Capital	Accumulated Other Comprehensive Income (Loss)	Accumulated Deficit	Notes Receivable	Total
				(In thousands)			
Balance, at January 2, 2004	18,403	$ 184	$ 85,948	$ 572	$ (49,146)	$ (2,339)	$ 35,219
Comprehensive loss:							
Net loss					(11,332)		(11,332)
Foreign currency translation adjustment				452			452
Total comprehensive loss							(10,880)
Common stock issued upon exercise of warrants	250	3	826				829
Common stock issued as payment for services	11		60				60
Stock-based consultant expense			231				231
Net proceeds from private placement	2,000	20	11,626				11,646
Proceeds from notes receivable						330	330
Accrued interest on notes receivable						(95)	(95)
Notes receivable reserve						500	500
Balance, at December 31, 2004	20,664	207	98,691	1,024	(60,478)	(1,604)	37,840
Comprehensive loss:							
Net loss					(11,175)		(11,175)
Foreign currency translation adjustment				(878)			(878)
Total comprehensive loss							(12,053)
Common stock issued upon exercise of options	36		130				130
Common stock issued as payment for services	13		77				77
			203				203

Stock-based consultant expense							
Net proceeds from private placement	4,100	41	13,333				13,374
Restricted stock grants	6		37				37
Deferred compensation			(37)				(37)
Proceeds from notes receivable, net						130	130
Accrued interest on notes receivable						(81)	(81)
Notes receivable reserve						746	746
Balance, at December 30, 2005	24,819	248	112,434	146	(71,653)	(809)	40,366
Net loss					(15,044)		(15,044)
Foreign currency translation adjustment				743			743
Total comprehensive loss							(14,301)
Common stock issued upon exercise of options	753	8	2,882				2,890
Stock-based compensation			1,996				1,996
Restricted stock grants	46						
Proceeds from notes receivable, net						1,181	1,181
Accrued interest on notes receivable						(41)	(41)
Notes receivable reserve reversal						(331)	(331)
Balance, at December 29, 2006	25,618	$ 256	$ 117,312	$ 889	$ (86,697)	$	$ 31,760

See accompanying summary of accounting policies and notes to consolidated financial statements.

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STAAR SURGICAL COMPANY AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS
Years Ended December 29, 2006, December 30, 2005 and December 31, 2004

	2006 As Restated Note 19	2005 As Restated Note 19	2004 As Restated Note 19
		(In thousands)	
Cash flows from operating activities:			
Net loss	$ (15,044)	$ (11,175)	$ (11,332)
Adjustments to reconcile net loss to net cash used in operating activities:			
Depreciation of property and equipment	1,889	2,010	2,003
Amortization of intangibles	481	480	688
Loss on disposal of fixed assets	190	90	174
Equity in earnings of joint venture	(114)	(158)	191
Stock-based compensation expense	1,856	203	231
Common stock issued for services		77	60
Notes receivable reserve (reversal)	(331)	746	500
Deferred income taxes	179		
Other	(44)	(81)	(95)
Minority interest		(22)	21
Changes in working capital:			
Accounts receivable	(1,233)	807	(497)
Inventories	2,502	(450)	(2,058)
Prepaids, deposits and other current assets	(7)	170	(79)
Accounts payable	926	(1,155)	402
Other current liabilities	681	910	1,143
Net cash used in operating activities	(8,069)	(7,548)	(8,648)
Cash flows from investing activities:			
Acquisition of property and equipment	(786)	(1,203)	(1,685)
Acquisition of patents and licenses			(16)
Purchase of short-term investments	(193)	(15,300)	(8,000)
Sale of short-term investments	43	20,425	2,875
Purchase of minority interest in subsidiary			(687)
Proceeds from notes receivable	1,181	130	330
Net change in other assets	(105)	15	(66)
Dividends received from joint venture			81
Net cash provided by (used in) investing activities	140	4,067	(7,168)
Cash flows from financing activities:			
Net borrowings (payments) under notes payable and long-term debt	(95)	(1,265)	72

Proceeds from the exercise of stock options and warrants	2,890	130	829
Net proceeds from private placement		13,374	11,646
Net cash provided by financing activities	2,795	12,239	12,547
Effect of exchange rate changes on cash and cash equivalents	184	(237)	170
Increase (decrease) in cash and cash equivalents	(4,950)	8,521	(3,099)
Cash and cash equivalents, at beginning of year	12,708	4,187	7,286
Cash and cash equivalents, at end of year	$ 7,758	$ 12,708	$ 4,187

See accompanying summary of accounting policies and notes to consolidated financial statements.

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STAAR SURGICAL COMPANY AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
Years Ended December 29, 2006 and December 30, 2005

Note 1 Significant Accounting Policies

Organization and Description of Business

STAAR Surgical Company and Subsidiaries (the Company), a Delaware corporation, was incorporated in 1982 for the purpose of developing, producing, and marketing intraocular lenses (IOLs) and other products for minimally invasive ophthalmic surgery. The Company has evolved to become a developer, manufacturer and global distributor of products used by ophthalmologists and other eye care professionals to improve or correct vision in patients with cataracts, refractive conditions and glaucoma. Products sold by the Company for use in restoring vision adversely affected by cataracts include its line of silicone and Collamer IOLs, the Preloaded Injector (a three-piece silicone IOL preloaded into a single-use disposable injector,), the SonicWAVE™ Phacoemulsification System, STAARVISC® II, a viscoelastic material, and Cruise Control, a disposable filter which allows for a faster, cleaner phacoemulsification procedure and is compatible with all phacoemulsification equipment utilizing Venturi and peristaltic pump technologies. Products sold by the Company for use in correcting refractive conditions such as myopia (near-sightedness), hyperopia (far-sightedness) and astigmatism include the Visian™ ICL (ICL) and the Visian™ TICL (TICL). The Company s AquaFlow™ Collagen Glaucoma Drainage Device is surgically implanted in the outer tissues of the eye to maintain a space that allows increased drainage of intraocular fluid thereby reducing intraocular pressure, which otherwise may lead to deterioration of vision in patients with glaucoma. The Company also sells other instruments, devices and equipment that are manufactured either by the Company or by others in the ophthalmic products industry.

The Company s only significant subsidiary is STAAR Surgical AG, a wholly owned subsidiary formed in Switzerland to develop, manufacture and distribute certain of the Company s products worldwide, including Collamer IOLs, the ICL and the AquaFlow device. STAAR Surgical AG also controls 100% of Domilens GmbH, a German sales subsidiary, which distributes both STAAR products and products from other ophthalmic manufacturers.

Canon Staar Joint Venture

In 1988, the Company entered into a Joint Venture Agreement with Canon Inc. and Canon Marketing Japan Inc., creating a company for the principal purpose of designing, manufacturing, and selling in Japan intraocular lenses and other ophthalmic products. The joint venture company, Canon Staar Co., Inc., markets its products worldwide through Canon, Canon Marketing, their subsidiaries and/or STAAR or such other distributors as the Board of Directors of the joint venture may approve. The terms of any such distribution arrangements require the unanimous approval of the Board of Directors of the joint venture. Of the five members of the Board of Directors of the joint venture, STAAR and Canon Marketing are each entitled to appoint two directors and Canon may appoint one. The president of the joint venture is to be appointed by STAAR. Several matters in addition to the approval of distribution arrangements require the unanimous approval of the directors, including appointment of officers, acquiring or disposing of assets exceeding 20% of the joint venture s total book value, and borrowing money or granting a lien exceeding 20% of the joint venture s total book value. Upon the occurrence of certain events, including the merger, sale of substantially all of the assets or change in the management of one of the parties, any of the other parties may have the right to acquire the first party s interest in the joint venture at book-value.

In 1988, the Company also entered into a Technical Assistance and License Agreement with the joint venture to further its purposes, granting to the joint venture a perpetual, exclusive license to use STAAR technology to make and

sell products in Japan, and a perpetual, non-exclusive license to use STAAR technology to sell products in the rest of the world, subject to the requirements of the Joint Venture Agreement that all sales take place through a distribution agreement unanimously approved by the directors of the joint venture. STAAR also granted to the joint venture a right of first refusal on the distribution of STAAR s products in Japan.

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STAAR SURGICAL COMPANY AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

In 2001, the parties entered into a settlement agreement whereby (i) they reconfirmed the Joint Venture Agreement and the Technical Assistance and License Agreement, (ii) they agreed that the Company would promptly commence the transfer of STAAR s technology to the joint venture, (iii) the Company granted the joint venture an exclusive license to make any products in China and sell such products in Japan and China (subject to STAAR s existing licenses and the existing rights of third parties), (iv) the Company agreed to provide the joint venture with raw materials under a supply agreement to be entered into with the joint venture, (v) Canon Marketing is to enter into a distribution agreement with the joint venture providing a minimum 50-70% share of sales revenue to the joint venture and having such other terms as unanimously approved by the directors of the joint venture, and (iv) the parties settled certain patent disputes.

The joint venture has a single class of capital stock, of which STAAR owns 50%. Accordingly, STAAR is entitled to 50% of any dividends or distributions by the joint venture and 50% of the proceeds of any liquidation.

Basis of Presentation

The accompanying consolidated financial statements include the accounts of the Company and its wholly owned and majority owned subsidiaries. All significant intercompany balances and transactions have been eliminated in consolidation.

Investment in the Company s joint venture, Canon Staar Co., Inc., is accounted for using the equity method of accounting (see Note 7).

The Company s fiscal year ends on the Friday nearest December 31 and each of the Company s quarterly reporting periods generally consists of 13 weeks.

Foreign Currency

In accordance with SFAS No 52, *Foreign Currency Translation*, assets and liabilities of foreign subsidiaries are translated at rates of exchange in effect at the close of the period. Sales and expenses are translated at the weighted average of exchange rates in effect during the period. The resulting translation gains and losses are deferred and are shown as a separate component of stockholders equity as accumulated other comprehensive income. During 2006, 2005 and 2004, the net foreign translation gain (loss) was $743,000, ($878,000) and $452,000, respectively, and net foreign currency transaction gain (loss), included in the statement of operations in other income (expense), net, was ($65,000), $334,000 and ($190,000), respectively.

Revenue Recognition

The Company recognizes revenue when realized or realizable and earned, which is when the following criteria are met: persuasive evidence of an arrangement exists; delivery has occurred; the sale price is fixed and determinable; and collectibility is reasonably assured. We record revenue from product sales when title and risk of ownership has been transferred to the customer, which is typically upon delivery to the customer.

The Company s products are marketed to ophthalmic surgeons, hospitals, ambulatory surgery centers or vision centers, and distributors. IOLs may be offered to surgeons and hospitals on a consignment basis. In accordance with SAB 104, the Company recognizes revenue for consignment inventory when the IOL is implanted during surgery and not upon shipment to the surgeon.

The Company has ongoing programs that, under specified conditions, allow customers to return products and, in accordance with SFAS No. 48, *Revenue Recognition When Right of Return Exists*, records liabilities for estimated returns and allowances at the time revenue is recognized. The Company s liability for estimated returns considers historical trends, the impact of new product launches, the entry of a competitor, product rationalization and the various terms and arrangements offered, including sales with extended credit terms.

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STAAR SURGICAL COMPANY AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The Company maintains provisions for uncollectible accounts for estimated losses resulting from the inability of its customers to remit payments. The Company continuously monitors collections and payments from customers and maintains a provision for estimated credit losses based upon its historical experience and any specific customer collection issues that have been identified.

Use of Estimates

The consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America and, as such, include amounts based on informed estimates and judgments of management with consideration given to materiality. For example, estimates are used in determining valuation allowances for uncollectible trade receivables, obsolete inventory, deferred income taxes and tax reserves. Estimates are also used in the evaluation of asset impairment, in determining the useful life of depreciable assets, and in calculating stock-based compensation. Actual results could differ from those estimates.

Segment Reporting

The Company reports segment information in accordance with SFAS No. 131, Disclosures about Segments of an Enterprise and Related Information (SFAS 131). Under SFAS 131 all publicly traded companies are required to report certain information about the operating segments, products, services and geographical areas in which they operate and their major customers. Although the Company has expanded its marketing focus beyond the cataract market to include the refractive and glaucoma markets, the ophthalmic surgery market remains its primary source of revenues and, accordingly, the Company operates as one business segment (see Note 16).

Cash and Cash Equivalents

The Company considers all highly liquid investments purchased with a maturity of three months or less to be cash equivalents. The Company maintains cash deposits with major banks which from time to time may exceed federally insured limits. The Company periodically assesses the financial condition of the institutions and believes that the risk of any loss is minimal.

Concentration of Credit Risk

Financial instruments that potentially subject the Company to credit risk principally consist of trade receivables. This risk is limited due to the large number of customers comprising the Company s customer base, and their geographic dispersion. Ongoing credit evaluations of customers financial condition are performed and, generally, no collateral is required. The Company maintains reserves for potential credit losses and such losses, in the aggregate, have not exceeded management s expectations.

Fair Value of Financial Instruments

The carrying values reflected in the consolidated balance sheets for cash and cash equivalents, trade accounts receivable, accounts payable, capital leases, and notes payable approximate their fair values because of the short maturity of these instruments.

Inventories

Inventories are valued at the lower of cost, determined on a first-in, first-out basis, or market. Inventories include the costs of raw material, labor, and manufacturing overhead. The Company provides estimated inventory allowances for excess, slow moving and obsolete inventory as well as inventory whose carrying value is in excess of net realizable value to properly reflect inventory at the lower of cost or market.

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STAAR SURGICAL COMPANY AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Property, Plant and Equipment

Property, plant and equipment are recorded at cost. Depreciation on property, plant, and equipment is computed using the straight-line method over the estimated useful lives of the assets. Leasehold improvements are amortized over the lesser of the estimated useful lives of the assets or the related lease term. Major improvements are capitalized and minor replacements, maintenance and repairs are charged to expense as incurred.

Demonstration Equipment

In the normal course of business, the Company maintains demonstration and bundled equipment, primarily phacoemulsification surgical equipment, for the purpose and intent of selling similar equipment or related products to the customer in the future. Demonstration equipment is not held for sale and is recorded as property, plant and equipment. The assets are amortized utilizing the straight-line method over their estimated economic life not to exceed three years.

Goodwill and Other Intangible Assets

Goodwill represents the excess of the purchase price over the fair value of identifiable net assets acquired in business combinations accounted for as purchases. The Company accounts for goodwill in accordance with Statement of Financial Accounting Standards (SFAS) No. 141, Business Combinations, and No. 142, Goodwill and Other Intangible Assets.

Goodwill, which has an indefinite life and was previously amortized on a straight-line basis over the periods benefited, is no longer amortized to earnings but instead is subject to periodic testing for impairment. Intangible assets determined to have definite lives are amortized over their remaining useful lives. Goodwill is tested for impairment on an annual basis or between annual tests if an event occurs or circumstances change that would indicate the carrying amount may be impaired. Impairment testing for goodwill is done at the reporting unit level. Reporting units are one level below the business segment level, but can be combined when reporting units within the same segment have similar economic characteristics. Under the criteria set forth by SFAS No. 142, the Company has determined that its reporting units have similar economic characteristics and therefore, can be combined into one reporting unit for the purposes of goodwill impairment testing. As provided under SFAS No. 142, an annual assessment was completed during fiscal year 2006 and no impairment was identified. As of December 29, 2006, the carrying value of goodwill was $7.5 million.

The Company also has other intangible assets consisting of patents and licenses, with a gross book value of $11.5 million and accumulated amortization of $7.0 million and $6.6 million as of December 29, 2006 and December 30, 2005, respectively. The Company capitalizes the costs of acquiring patents and licenses. Amortization is computed on the straight-line basis over the estimated useful lives, since the pattern in which the economic benefits realized cannot be precisely determined, which are based on legal and contractual provisions, and range from 10 to 20 years. Aggregate amortization expense for amortized other intangible assets was $481,000, $480,000 and $688,000 for the years ended December 29, 2006, December 30, 2005 and December 31, 2004, respectively.

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STAAR SURGICAL COMPANY AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The following table shows the estimated amortization expense for these assets for each of the five succeeding years (in thousands):

Fiscal Year	
2007	$ 481
2008	481
2009	481
2010	380
2011	380
Total	$ 2,203

Impairment of Long-Lived Assets

In accordance with SFAS No. 144, Accounting for the Impairment of Long-Lived Assets, intangible and other long lived-assets are reviewed for impairment whenever events such as product discontinuance, plant closures, product dispositions or other changes in circumstances indicate that the carrying amount may not be recoverable. In reviewing for impairment, the Company compares the carrying value of such assets to the estimated undiscounted future cash flows expected from the use of the assets and their eventual disposition. When the estimated undiscounted future cash flows are less than their carrying amount, an impairment loss is recognized equal to the difference between the assets fair value and their carrying value.

There were no impairments of long-lived assets identified during the years ended December 29, 2006, December 30, 2005, and December 31, 2004.

Research and Development Costs

Expenditures for research activities relating to product development and improvement are charged to expense as incurred.

Income Taxes

The Company recognizes deferred tax assets and liabilities for temporary differences between the financial reporting basis and the tax basis of the Company s assets and liabilities along with net operating loss and credit carryforwards. A valuation allowance is recognized if, based on the weight of available evidence, it is more likely than not that some portion or all of the deferred tax asset may not be realized. The impact on deferred taxes of changes in tax rates and laws, if any, are applied to the years during which temporary differences are expected to be settled and reflected in the financial statements in the period of enactment.

Basic and Diluted Loss Per Share

The consolidated financial statements include basic and diluted per share information. Basic per share information is calculated by dividing net loss by the weighted average number of shares outstanding. Diluted per share information is calculated by also considering the impact of potential common stock on both net income and the weighted number of shares outstanding. As the Company was in a loss position, potential common shares of 2.6 million, 3.9 million, and 3.1 million for the fiscal years ended December 29, 2006, December 30, 2005, and December 31, 2004, respectively, were excluded from the computation as the shares would have had an anti-dilutive effect.

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STAAR SURGICAL COMPANY AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Stock Based Compensation

Effective December 31, 2005, the Company adopted the fair value recognition provisions of Statement of Financial Accounting Standards (SFAS) No. 123 (revised 2004), Share-Based Payment (SFAS 123R), using the modified prospective transition method and therefore has not restated results for prior periods. Under this transition method, stock-based compensation expense for fiscal 2006 includes compensation expense for all stock-based compensation awards granted prior to, but not yet vested as of December 30, 2005, based on the grant date fair value estimated in accordance with the original provision of SFAS No. 123, Accounting for Stock-Based Compensation (SFAS 123). Stock-based compensation expense for all stock-based compensation awards granted after December 30, 2005 is based on the grant-date fair value estimated in accordance with the provisions of SFAS 123R. The Company recognizes these compensation costs on a straight-line basis over the requisite service period of the award, which is generally the option vesting term of three to four years. Prior to the adoption of SFAS 123R, the Company recognized stock-based compensation expense in accordance with Accounting Principles Board (APB) Opinion No. 25, Accounting for Stock Issued to Employees (APB 25). In March 2005, the Securities and Exchange Commission (the SEC) issued Staff Accounting Bulletin No. 107 (SAB 107) regarding the SEC s interpretation of SFAS 123R and the valuation of share-based payments for public companies. The Company has applied the provisions of SAB 107 in its adoption of SFAS 123R. See Note 10 to the Consolidated Financial Statements for a further discussion of stock-based compensation.

The Company accounts for options granted to persons other than employees and directors under SFAS 123 and EITF 98-16, *Accounting for Equity Investments That Are Issued to Other Than Employees for Acquiring or in Conjunction with Selling Goods and Services.* As such, the fair value of such options is periodically remeasured using the Black-Scholes option-pricing model and income or expense is recognized over the vesting period.

Comprehensive Loss

The Company presents comprehensive losses in its Consolidated Statement of Changes in Stockholders Equity in accordance with SFAS No. 130, Reporting Comprehensive Income (SFAS 130). Total comprehensive loss includes, in addition to net loss, changes in equity that are excluded from the consolidated statements of operations and are recorded directly into a separate section of stockholders equity on the consolidated balance sheets.

Comprehensive loss and its components consist of the following (in thousands):

	2006	2005	2004
Net loss	$ (15,044)	$ (11,175)	$ (11,332)
Foreign currency translation adjustment	743	(878)	452
Comprehensive loss	$ (14,301)	$ (12,053)	$ (10,880)

Recent Accounting Pronouncements

In June 2006, the FASB issued FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes, (FIN 48) which clarifies the accounting for uncertainty in income taxes. FIN 48 requires that companies recognize in the consolidated financial statements the impact of a tax position, if that position is more likely than not of being sustained on audit, based on the technical merits of the position. FIN 48 also provides guidance on de-recognition, classification, interest and penalties, accounting in interim periods and disclosure. The provisions of FIN 48 are effective for fiscal years beginning after December 15, 2006. We will adopt FIN 48 effective January 1, 2007. We are currently evaluating the effect of this new pronouncement.

In September 2006, the FASB issued SFAS No. 157 *Fair Value Measurements* (SFAS 157). SFAS 157 provides a new single authoritative definition of fair value and provides enhanced guidance for measuring the fair value of assets and liabilities and requires additional disclosures related to the extent to which companies measure

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STAAR SURGICAL COMPANY AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

assets and liabilities at fair value, the information used to measure fair value, and the effect of fair value measurements on earnings. SFAS 157 is effective for the Company as of December 29, 2007. The Company is currently assessing the impact, if any, of SFAS 157 on its consolidated financial statements.

In November 2006, the FASB issued FASB Staff Position No. EITF 00-19-2, Accounting for Registration Payment Arrangements , which specifies that the contingent obligation to make future payments or otherwise transfer consideration under a registration payment arrangement, whether issued as a separate agreement or included as a provision of a financial instrument or other agreement, should be separately recognized and measured. Additionally, this guidance further clarifies that a financial instrument subject to a registration payment arrangement should be accounted for in accordance with other applicable GAAP without regard to the contingent obligation to transfer consideration pursuant to the registration payment arrangement. This guidance is effective for financial statements issued for fiscal years beginning after December 15, 2006, and interim periods within those fiscal years. We are assessing the impact of adopting EITF 00-19-2 and currently do not believe the adoption will have a material impact on our consolidated financial statements.

In February 2007, the FASB issued Statement No. 159, The Fair Value Option for Financial Assets and Financial Liabilities (SFAS 159). SFAS 159 provides that companies may elect to measure specified financial instruments and warranty and insurance contracts at fair value on a contract-by-contract basis, with changes in fair value recognized in earnings each reporting period. The election, called the fair value option, will enable some companies to reduce the variability in reported earnings caused by measuring related assets and liabilities differently. Companies may elect fair-value measurement when an eligible asset or liability is initially recognized or when an event, such as a business combination, triggers a new basis of accounting for that asset or liability. The election is irrevocable for every contract chosen to be measured at fair value and must be applied to an entire contract, not to only specified risks, specific cash flows, or portions of that contract. SFAS 159 is effective as of the beginning of a company s first fiscal year that begins after November 15, 2007. Retrospective application is not allowed. Companies may adopt SFAS 159 as of the beginning of a fiscal year that begins on or before November 15, 2007 if the choice to adopt early is made after SFAS 159 has been issued and within 120 days of the beginning of the fiscal year of adoption and the entity has not issued GAAP financial statements for any interim period of the fiscal year that includes the early adoption date. Companies are permitted to elect fair-value measurement for any eligible item within SFAS 159 s scope at the date they initially adopt SFAS 159. The adjustment to reflect the difference between the fair value and the current carrying amount of the assets and liabilities for which a company elects fair-value measurement is reported as a cumulative-effect adjustment to the opening balance of retained earnings upon adoption. Companies that adopt SFAS 159 early must also adopt all of SFAS 157 s requirements at the early adoption date. We are assessing the impact of adopting SFAS 159 and currently do not believe the adoption will have a material impact on our consolidated financial statements.

Note 2 Short-Term Investments Restricted

Short-term investments consist of a 12-month Certificate of Deposit with a 4.5% interest rate to collateralize capital leases funded under a lease line of credit with Mazuma Capital Corporation (see Note 8).

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 3 Accounts Receivable Trade

Accounts receivable consisted of the following at December 29, 2006 and December 30, 2005 (in thousands):

	2006	2005
Domestic	$ 2,880	$ 2,066
Foreign	4,334	3,514
	7,214	5,580
Less allowance for doubtful accounts and sales returns	690	480
	$ 6,524	$ 5,100

Note 4 Inventories

Inventories consisted of the following at December 29, 2006 and December 30, 2005 (in thousands):

	2006	2005
Raw materials and purchased parts	$ 690	$ 859
Work in process	1,669	2,259
Finished goods	10,580	11,581
	$ 12,939	$ 14,699

Note 5 Prepaids, Deposits, and Other Current Assets

Prepaids, deposits, and other current assets consisted of the following at December 29, 2006 and December 30, 2005 (in thousands):

	2006	2005
Prepaids and deposits	$ 1,455	$ 1,367
Other current assets	468	396
	$ 1,923	$ 1,763

Note 6 Property, Plant and Equipment

Property, plant and equipment consisted of the following at December 29, 2006 and December 30, 2005 (in thousands):

	2006	2005
Machinery and equipment	$ 13,053	$ 12,174
Furniture and fixtures	5,985	5,498
Leasehold improvements	4,952	4,832
	23,990	22,504
Less accumulated depreciation and amortization	18,144	16,909
	$ 5,846	$ 5,595

Depreciation expense for each of the years ended December 29, 2006, December 30, 2005, and December 31, 2004 was approximately $2.0 million.

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STAAR SURGICAL COMPANY AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 7 Investment in Joint Venture

The Company owns a 50% equity interest in a joint venture, the Canon Staar Co., Inc. (CSC), with Canon Inc. and Canon Marketing Japan Inc., together the Canon Companies (see Note 1). The investment in the Japanese joint venture is accounted for using the equity method of accounting. Dividends received are recorded under the equity method as a reduction to the investment. The principal difference between 50% of the equity balance recorded on CSC s financial statements and the Company s recorded investment in the joint venture relates to the fiscal year 2000 write down of the investment of approximately $3.6 million due to disputes between the Company and the Canon Companies. The disputes were subsequently resolved in late 2001.

The financial statements of CSC include the following information (in thousands):

	2006	2005
Current assets	$ 6,507	$ 5,679
Non-current assets	2,986	1,242
Current liabilities	1,143	1,025
Non-current liabilities	778	709
Net sales	10,368	9,656
Gross profit	5,461	5,171
Income from operations	483	460
Net Income loss	$ 228	$ 316

The Company s equity in earnings (loss) of the joint venture is calculated as follows (in thousands):

	2006	2005	2004
Joint venture net income (loss)	$ 228	$ 316	$ (382)
Equity interest	50%	50%	50%
Equity in operations of joint venture	$ 114	$ 158	$ (191)

The Company did not receive dividends during 2006 and 2005. Approximately $81,000 of dividends were received during 2004.

The Company recorded sales of certain IOL products to CSC of approximately $67,000, $180,000 and $185,000 in 2006, 2005 and 2004, respectively.

The Company purchased preloaded injectors from CSC in the amount of $2.2 million, $2.0 million, and $1.7 million in 2006, 2005, and 2004, respectively.

The Company owed CSC $702,000 and $566,000 as of December 29, 2006 and December 30, 2005, respectively, for purchases of preloaded injectors.

Note 8 Notes Payable

The Company and its subsidiaries have credit facilities with different lenders to support operations in the U.S., Switzerland and Germany, respectively.

On June 8, 2006 the Company signed a Credit and Security agreement with Wells Fargo Bank for a revolving credit facility. The credit facility provides for borrowings of 85% of eligible accounts receivable with a maximum of $3.0 million, carries an interest rate of prime plus 1.5%, and is secured by substantially all of the assets of the Company s U.S. operations. The term of the agreement is three years and it contains certain financial covenants relating to minimum calculated net worth, net loss, liquidity and restrictions on Company investments or loans to affiliates and investments in capital expenditures, which only apply if the Company borrows and/or maintains an outstanding advance. As of December 29, 2006, there were no borrowings outstanding. As the Company does not

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

satisfy minimum financial covenants in its U.S. operations that are a condition to borrowing, no borrowings are available.

The Company s lease agreement with Farnam Street Financial, Inc., as amended on October 9, 2006, provides for purchases of up to $1,500,000 of property, plant and equipment. In accordance with the requirements of SFAS 13 Accounting for Leases, purchases under this facility are accounted for as capital leases and have a three-year term. Under the agreement, the Company has the option to purchase any item of the leased property, at the end of the respective items lease terms, at a mutually agreed fair value. Approximately $573,000 in borrowings were available under this facility as of December 29, 2006.

The Company s lease agreement with Mazuma Capital Corporation, as amended on August 16, 2006, provides for purchases of up to $301,000 of property, plant and equipment. In accordance with the requirements of SFAS 13 Accounting for Leases, purchases under this facility are accounted for as capital leases and have a two-year term. The Company is required to open a certificate of deposit as collateral in STAAR Surgical Company s name at the underwriting bank for 50% of the assets funded by Mazuma. As of December 29, 2006, the Company had a certificate of deposit for approximately $150,000 recorded as short-term investment restricted with a 12-month term at a fixed interest rate of 4.5%. The agreement also provides that the Company may elect to purchase any item of the leased property at the end of its lease term for $1. No borrowings were available under this facility as of December 29, 2006.

The Company s Swiss credit agreement, as amended on August 2, 2004, provides for borrowings of up to 3.0 million Swiss Francs CHF (approximately $2.5 million based on the rate of exchange on December 29, 2006) for use in the Company s Swiss operations, permits either fixed-term or current advances, and does not have a termination date. The interest rate on current advances is 6.25% and 6.0% per annum, respectively, at December 29, 2006 and December 30, 2005, plus a commission rate of 0.25% payable quarterly. There were no current advances outstanding at December 29, 2006. The base interest rate for fixed-term advances follows Euromarket conditions for loans of a corresponding term and currency plus an individual margin (5.0% at December 29, 2006 and 4.25% at December 30, 2005, respectively). Fixed-term borrowings outstanding under the note at December 29, 2006 and December 30, 2005, respectively, were CHF 2.2 million (approximately $1.8 million based on the rate of exchange at December 29, 2006) and CHF 2.2 million (approximately $1.7 million based on the rate of exchange on December 30, 2005). The credit facility is secured by a general assignment of claims and includes positive and negative covenants which, among other things, require the maintenance of a minimum level of equity of at least $12.0 million and prevents the Swiss subsidiary from entering into other secured obligations or guaranteeing the obligations of others. The agreement also prohibits the sale or transfer of patents or licenses without the prior consent of the lender and the terms of inter-company receivables may not exceed 90 days.

The German subsidiary entered into a credit agreement on August 30, 2005. The renewed credit agreement provides for borrowings of up to 100,000 EUR ($131,000 at the rate of exchange on December 29, 2006), at a rate of 8.5% per annum and does not have a termination date. The credit facility is not secured. There were no borrowings outstanding as of December 29, 2006 and December 30, 2005.

The Company was in compliance with the covenants of these credit facilities as of December 29, 2006.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 9 Income Taxes

The provision for income taxes consists of the following (in thousands):

	2006	2005	2004
Current tax provision:			
U.S. federal	$	$	$
State	17	18	
Foreign	1,341	1,221	1,057
Total current provision	1,358	1,239	1,057
Deferred tax provision:			
U.S. federal and state			
Foreign	179		
Total deferred provision	179		
Provision for income taxes	$ 1,537	$ 1,239	$ 1,057

As of December 29, 2006, the Company had $89.4 million of federal net operating loss carryforwards available to reduce future income taxes. The net operating loss carryforwards expire in varying amounts between 2020 and 2026.

The Company has net income taxes payable at December 29, 2006 and December 30, 2005 of $830,000 and $923,000, respectively. Included in the Company s foreign tax provision is approximately $700,000 in additional taxes that may be assessed by the German Ministry of Finance pursuant the Domilens Investigation (see Note 12).

The provision (benefit) for income before taxes differs from the amount computed by applying the statutory federal income tax rate to loss before taxes as follows (in thousands):

	2006		2005		2004	
Computed benefit for taxes based on income at statutory rate	$ (4,592)	34.0%	$ (3,386)	34.0%	$ (3,484)	34.0%
Increase (decrease) in taxes resulting from:						
Permanent differences	210	(1.6)	19	(0.2)	36	(0.3)
State taxes, net of federal income tax benefit	11	(0.1)	12	(0.1)		(0.0)

Tax effect attributed to foreign operations	733	(5.4)	300	(3.0)	158	(1.5)
Other			29	(0.3)	7	(0.1)
Valuation allowance	5,175	(38.3)	4,265	(42.8)	4,340	(42.4)
Effective tax provision (benefit) rate	$ 1,537	(11.4)%	$ 1,239	(12.4)%	$ 1,057	(10.3)%

The state tax provision is composed of an increase to the state deferred tax asset and corresponding increase to the valuation allowance of $1,256,000, $945,000, and $1,010,000 for 2006, 2005 and 2004 respectively. This results in a total state tax provision of $17,000 for 2006, $18,000, for 2005 and zero state tax provision for 2004.

Undistributed earnings of the Company s foreign subsidiaries amounted to approximately $13.7 million at December 29, 2006. Undistributed earnings are considered to be indefinitely reinvested and, accordingly, no provision for United States federal and state income taxes has been provided thereon. Upon distribution of earnings in the form of dividends or otherwise, the Company would be subject to both United States income taxes (subject to

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

an adjustment for foreign tax credits) and withholding taxes payable to the various foreign countries. Determination of the amount of unrecognized deferred United States income tax liability is not practicable because of the complexities associated with its hypothetical calculation.

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Approximately $179,000 in deferred tax liabilities are classified in other current liabilities in the 2006 Consolidated Balance Sheet. Significant components of the Company s deferred tax assets (liabilities) as of December 29, 2006 and December 30, 2005 are as follows (in thousands):

	2006	2005
Current deferred tax assets (liabilities):		
Allowance for doubtful accounts and sales returns	$ 120	$ 133
Inventory	675	663
Accrued vacation	238	260
State taxes	3	3
Deferred revenue		46
Accrued expenses	99	
Valuation allowance	(1,314)	(1,105)
Total current deferred tax liabilities	$ (179)	$
Non-current deferred tax assets (liabilities):		
Net operating loss and capital loss carryforwards	36,515	30,157
Business, foreign and AMT credit carryforwards	879	880
Depreciation and amortization	75	28
Notes receivable		517
Reserve for restructuring costs	464	511
Capitalized R&D	409	420
Contributions	89	44
Stock-based payments	691	
Valuation allowance	(39,122)	(32,557)
Total non-current deferred tax assets (liabilities)	$	$

SFAS No. 109, Accounting for Income Taxes (SFAS 109) requires that a valuation allowance be established when it is more likely than not that all or a portion of a deferred tax asset may not be realized. Cumulative losses weigh heavily in the assessment of the need for a valuation allowance. Due to its history of losses, the Company records a valuation allowance to fully offset the value of its deferred tax assets. Further, under Federal Tax Law Internal Revenue Code Section 382, significant changes in ownership may restrict the future utilization of these tax loss carry forwards.

Income (loss) before income taxes are as follows (in thousands):

	2006	2005	2004
Domestic	$ (15,824)	$ (12,665)	$ (12,887)
Foreign	2,317	2,707	2,641
	$ (13,507)	$ (9,958)	$ (10,246)

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STAAR SURGICAL COMPANY AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 10 Stockholders Equity

Common Stock

During fiscal year 2006, the Company issued 46,000 shares of restricted stock to certain employees and a consultant in consideration for future services to the Company. As of December 29, 2006, none of the shares were vested.

During fiscal year 2005, the Company issued 13,000 shares to consultants for services rendered to the Company. Also during 2005, the Company completed a private placement with institutional investors of 4,100,000 shares of the Company s common stock, for net proceeds of $13.4 million. Also during 2005, the Company issued 6,117 shares of restricted stock to certain employees and a consultant in consideration for future services to the Company. During fiscal 2006, 2,039 of the shares vested.

During fiscal year 2004, the Company issued 11,000 shares to consultants for services rendered to the Company. Also during 2004, the Company completed a private placement with institutional investors of 2,000,000 shares of the Company s common stock, for net proceeds of $11.6 million.

Restricted shares are issued at fair market value on the date of grant, vest over a period of three or four years, and are subject to forfeiture until vested or the service period is terminated. Prior to 2006, the cost of the restricted stock was recorded as deferred equity compensation in Additional Paid-in Capital and amortized over the vesting period. Beginning in 2006, the amortization is included in stock-based compensation.

Stock Based Compensation

As of December 29, 2006, the Company has multiple share-based compensation plans, which are described below. The Company issues new shares upon option exercise once the optionee remits payment for the exercise price. The compensation cost that has been charged against income for the 2003 Omnibus Plan and the 1998 Stock Option Plan totaled $1,725,000 for the fiscal year ended December 29, 2006, which included $1,634,000, respectively, for the implementation of SFAS 123R, and $91,000 for restricted stock grants. In addition, for the fiscal year ended December 29, 2006, there was $116,000, of compensation cost charged against income for consultant stock options. There was no income tax benefit recognized in the income statement for share-based compensation arrangements as the Company fully offsets net deferred tax assets with a valuation allowance. In addition, the Company capitalized $155,000 of SFAS 123R compensation to inventory for the fiscal year ended December 29, 2006 and recognizes those amounts as expense under in Cost of Sales as the inventory is sold. See the table below for comparative purposes of prior year amounts (in thousands, except per share data):

	Fiscal Year Ended		
	December 29, 2006	December 30, 2005	December 31, 2004
Net loss as reported	$ (15,044)	$ (11,175)	$ (11,332)
Add: Stock-based compensation included in reported net loss	1,841		
	(1,841)	(1,038)	(739)

Less: Stock-based compensation expense determined under the fair-value method for all awards			
Pro forma net loss	$ (15,044)	$ (12,213)	$ (12,071)
Net loss per share, basic and diluted, as reported	$ (.60)	$ (.47)	$ (.58)
Pro forma net loss, basic and diluted, as reported	N/A	$ (.52)	$ (.62)

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STAAR SURGICAL COMPANY AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Stock Option Plans

In fiscal year 2003, the Board of Directors approved the 2003 Omnibus Equity Incentive Plan (the 2003 Plan) authorizing awards of equity compensation, including options to purchase common stock and restricted shares of common stock. The 2003 Plan amends, restates and replaces the 1991 Stock Option Plan, the 1995 Consultant Stock Plan, the 1996 Non-Qualified Stock Plan and the 1998 Stock Option Plan (the Restated Plans). Under provisions of the 2003 Plan, all of the unissued shares in the Restated Plans are reserved for issuance in the 2003 Plan. Each year the number of shares reserved for issuance under the 2003 Plan is increased if necessary to provide that 2% of the total shares of common stock outstanding on the immediately preceding December 31 will be reserved for issuance. The 2003 Plan provides for various forms of stock-based incentives. To date, of the available forms of awards under the 2003 Plan, the Company has granted only stock options and restricted stock. Options under the plan are granted at fair market value on the date of grant, become exercisable over a three- or four-year period, or as determined by the Board of Directors, and expire over periods not exceeding 10 years from the date of grant. Certain option and share awards provide for accelerated vesting if there is a change in control (as defined in the 2003 Plan). Restricted stock grants under the 2003 Plan generally vest over a period of three or four years. Pursuant to the plan, options for 1,817,000 shares were outstanding at December 29, 2006 with exercise prices ranging between $3.81 and $11.24 per share. There were 52,000 shares of restricted stock outstanding at December 29, 2006.

In fiscal year 2000, the Board of Directors approved the Stock Option Plan and Agreement for the Company s Chief Executive Officer authorizing the granting of options to purchase common stock or awards of common stock. The options under the plan were granted at fair market value on the date of grant, become exercisable over a three-year period, and expire 10 years from the date of grant. Pursuant to this plan, options for 500,000 were outstanding at December 29, 2006, with an exercise price of $11.125.

In fiscal year 1998, the Board of Directors approved the 1998 Stock Option Plan, authorizing the granting of options to purchase common stock or awards of common stock. Under the provisions of the plan, 1.0 million shares were reserved for issuance; however, the maximum number of shares authorized may be increased provided such action is in compliance with Article IV of the plan. During fiscal year 2001, pursuant to Article IV of the plan, the stockholders of the Company authorized an additional 1.5 million shares. Generally, options under the plan are granted at fair market value at the date of the grant, become exercisable over a three-year period, or as determined by the Board of Directors, and expire over periods not exceeding 10 years from the date of grant. Pursuant to the plan, options for 945,000 were outstanding at December 29, 2006 with exercise prices ranging between $2.96 and $13.625 per share. No further awards may be made under this plan.

In fiscal year 1995, the Company adopted the 1995 Consultant Stock Plan, authorizing the granting of options to purchase common stock or awards of common stock. Generally, options under the plan were granted at fair market value at the date of the grant, become exercisable on the date of grant and expire 10 years from the date of grant. Pursuant to this plan, options for 95,000 shares were outstanding at December 29, 2006 with exercise prices ranging from $1.70 to $3.00 per share. No further awards may be made under this plan.

Under provisions of the Company s 1991 Stock Option Plan, 2.0 million shares were reserved for issuance. Generally, options under this plan were granted at fair market value at the date of the grant, become exercisable over a three-year period, or as determined by the Board of Directors, and expire over periods not exceeding 10 years from the date of grant. Pursuant to this plan, options for 60,000 shares were outstanding at December 29, 2006 with exercise prices

ranging from $9.56 to $10.18 per share. No further awards may be made under this plan.

During fiscal years 1999 and 2000, the Company issued non-qualified options to purchase shares of its Common Stock to employees and consultants. Pursuant to these agreements, options for 55,000 shares were outstanding at December 29, 2006 with exercise prices ranging between $9.375 and $10.63.

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During the fiscal year ended December 29, 2006, officers, employees and others exercised 753,000 options from the 1995, 1996, 1998, non qualified and 2003 stock option plans at prices ranging from $1.91 to $7.00 resulting in net cash proceeds to the Company totaling $2,890,000.

In fiscal year 2005, officers, employees and others exercised 36,000 options from the 1998 and 2003 stock option plans at prices ranging from $2.00 to $4.62 resulting in cash proceeds totaling $130,000.

In fiscal year 2004, officers, employees and others exercised 250,000 options from the 1995, 1998 and 2003 stock option plans at prices ranging from $1.90 to $4.65 resulting in cash proceeds totaling $829,000.

Assumptions

The fair value of each option award is estimated on the date of grant using a Black-Scholes option valuation model that uses the assumptions noted in the following table. Expected volatilities are based on historical volatility of the Company s stock. The Company uses historical data to estimate option exercise and employee termination behavior. The expected term of options granted is derived from the historical exercise activity over the past 15 years, and represents the period of time that options granted are expected to be outstanding. The Company used the shortcut method to calculate the expected term of its options granted during the first quarter of 2006 that had a four year vesting life as it has no historical experience for the expected term of options with a four-year life. All other options granted with a three year vesting life during the fiscal year ended December 29, 2006 had an expected term of 5.2 years derived from historical exercise and termination activity. The Company has calculated a 10.5% estimated forfeiture rate used in the model for fiscal year 2006 option grants based on historical forfeiture experience. The risk-free rate for periods within the contractual life of the option is based on the U.S. Treasury yield curve in effect at the time of grant.

	Fiscal Year Ended	
	December 29, 2006	December 30, 2005
Expected dividend yield	0%	0%
Expected volatility	73%	70%
Risk-free interest rate	4.17%	4.35%
Expected term (in years)	5.2&7	4.3

A summary of option activity under the Plans as of December 29, 2006, December 30, 2005, and December 31, 2004, and changes during the years then ended are presented below:

	Shares	Weighted-Average Exercise	Weighted-Average Remaining Contractual	Aggregate Intrinsic Value

Options	(000 s)	Price	Term	(000 s)
Outstanding at December 30, 2005	3,870	$ 6.23		
Granted	401	7.35		
Exercised	(753)	3.84		
Forfeited or expired	(46)	4.15		
Outstanding at December 29, 2006	3,472	$ 5.62	5.6	$ 5,109
Exercisable at December 29, 2006	2,440	$ 7.29	4.3	$ 3,615

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The weighted-average grant-date fair value of options granted during the fiscal year ended December 29, 2006 was $4.96. The total fair value of options vested during fiscal year ended December 29, 2006 was $1,725,000. The total intrinsic value of options exercised during the year ended December 29, 2006 was $2,038,000.

	Number of Shares	Weighted Average Exercise Price
Balance at January 2, 2004	3,219	$ 6.84
Options granted	531	$ 7.76
Options exercised	(250)	$ 3.32
Options forfeited/cancelled	(348)	$ 8.27
Balance at December 31, 2004	3,152	$ 7.12
Options granted	1,044	$ 4.40
Options exercised	(36)	$ 3.65
Options forfeited/cancelled	(290)	$ 9.55
Balance at December 30, 2005	3,870	$ 6.23
Options exercisable at December 31, 2004	2,535	$ 7.27
Options exercisable at December 30, 2005	2,728	$ 6.77

A summary of the status of the Company s non-vested shares as of December 29, 2006 and changes during the period is presented below:

Nonvested Shares	Shares (000 s)	Weighted-Average Grant Date Fair Value
Nonvested at December 30, 2005	1,142	$ 2.99
Granted	401	4.86
Vested	(484)	1.98
Forfeited	(27)	3.71
Nonvested at December 29, 2006	1,032	$ 3.30

As of December 29, 2006, there was $2.2 million of total unrecognized compensation cost related to non-vested share-based compensation arrangements granted under the Plans. That cost is expected to be recognized over a weighted-average period of 1.41 years.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The following table summarizes information about stock options outstanding and exercisable at December 29, 2006 (in thousands, except per share data):

Range of Exercise Prices	Options Outstanding Number Outstanding at 12/29/06	Options Outstanding Weighted-Average Remaining Contractual Life	Options Outstanding Weighted-Average Exercise Price	Options Exercisable Number Exercisable at 12/29/06	Options Exercisable Weighted-Average Exercise Price
$ 1.70 to $ 2.15	45	4.7 years	$ 1.70	45	$ 1.70
$ 2.96 to $ 4.30	1,319	5.6 years	$ 3.76	896	$ 3.68
$ 4.64 to $ 6.92	616	6.9 years	$ 6.06	291	$ 5.65
$ 7.00 to $10.19	664	6.9 years	$ 8.28	380	$ 8.64
$10.60 to $13.63	828	3.8 years	$ 11.47	828	$ 11.47
$ 1.70 to $13.63	3,472	5.6 years	$ 5.62	2,440	$ 7.29

Receivables from Former Directors

As of December 29, 2006 and December 30, 2005, notes receivable (excluding reserves) from a former director totaling $0 and $2.0 million, respectively, were outstanding. The notes were issued in connection with purchases of the Company s common stock and bear interest at rates ranging between 1.98% and 6.40% per annum, or at the lowest federal applicable rate allowed by the Internal Revenue Service. The notes were secured by stock pledge agreements and matured on various dates through July 1, 2006.

During 2006, the Company settled the last of its notes receivable from a former director totaling $1,961,000 (including accrued interest) for a cash payment of $175,000 and proceeds from the sale of 120,000 shares of pledged Company stock of $870,000, which was received on October 3, 2006. The deficiency on the notes was applied against reserves recorded against the notes in 2005 and 2004 and in 2006, $331,000 of excess reserves was reversed. Amounts are included in the Company s *Consolidated Statement of Operations Note reserves (reversals).*

Note 11 Commitments and Contingencies

Lease Obligations

The Company leases certain property, plant and equipment under capital and operating lease agreements. These leases vary in duration and many contain renewal options and/or escalation clauses. Current and long-term obligations under capital leases are classified in other current liabilities and other long-term debt in the Company s Consolidated Balance Sheets.

Estimated future minimum lease payments under leases having initial or remaining non-cancelable lease terms in excess of one year as of December 29, 2006 were approximately as follows (in thousands):

Fiscal Year	Operating Leases	Capital Leases
2007	$ 1,344	$ 647
2008	1,199	590
2009	762	418
2010	675	65
2011	274	
Total minimum lease payments	$ 4,254	$ 1,720
Less amounts representing interest		(263)
	$ 4,254	$ 1,457

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Rent expense was approximately $1.2 million for each of the years ended December 29, 2006, December 30, 2005, and December 31, 2004, respectively.

The Company had the following assets under capital lease at December 29, 2006 and December 30, 2005 (in thousands):

	2006	2005
Machinery and equipment	$ 1,290	$ 14
Furniture and fixtures	145	
Leasehold improvements	111	
	1,546	14
Less accumulated depreciation and amortization	109	7
	$ 1,437	$ 7

Depreciation expense for assets under capital lease for each of the years ended December 29, 2006, December 30, 2005, and December 31, 2004 was approximately $146,000, $4,000 and $4,000, respectively.

Supply Agreement

In December 2000, the Company entered into a minimum purchase agreement with another manufacturer for the purchase of viscoelastic solution. In January 2006, the Company extended this agreement through December 31, 2008 under the same purchasing terms as the original contract. In addition to the minimum purchase requirement, the Company is also obligated to pay an annual regulatory maintenance fee. The agreement contains provisions to increase the minimum annual purchases in the event that the seller gains regulatory approval of the product in other markets, excluding the U.S and Canada, as requested by the Company. Purchases under the agreement for fiscal 2006, 2005, and 2004 were approximately $502,000, $728,000, and $644,000, respectively.

As of December 29, 2006, estimated future annual purchase commitments under this contract are as follows (in thousands):

Fiscal Year	
2007	$ 600
2008	689
	$ 1,289

Indemnification Agreements

The Company has entered into indemnification agreements with its directors and officers that may require the Company: a) to indemnify them against liabilities that may arise by reason of their status or service as directors or officers, except as prohibited by applicable law; b) to advance their expenses incurred as a result of any proceeding against them as to which they could be indemnified; and c) to make a good faith determination whether or not it is practicable for the Company to obtain directors and officers insurance. The Company currently has directors and officers liability insurance through a third party carrier.

Tax Filings

The Company s tax filings are subject to audit by taxing authorities in jurisdictions where it conducts business. These audits may result in assessments of additional taxes that are subsequently resolved with the authorities or potentially through the courts. Management believes the Company has adequately provided for any ultimate

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STAAR SURGICAL COMPANY AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

amounts that are likely to result from these audits; however, final assessments, if any, could be different than the amounts recorded in the consolidated financial statements.

Employment Agreements

The Company s Chief Executive Officer and certain other officers have as provisions of their employment agreements certain rights, including continuance of cash compensation and benefits, upon a change in control, which may include an acquisition of substantially all of its assets.

Litigation and Claims

From time to time the Company is subject to various claims and legal proceedings arising out of the normal course of our business. These claims and legal proceedings relate to contractual rights and obligations, employment matters, and claims of product liability. While the Company does not believe that any of the claims known is likely to have a material adverse effect on its financial condition or results of operations, new claims or unexpected results of existing claims could lead to significant financial harm.

Note 12 Other Liabilities

Other Current Liabilities

Other current liabilities consisted of the following at December 29, 2006 and December 30, 2005 (in thousands):

	2006	2005
Accrued salaries & wages	$ 1,974	$ 1,934
Accrued income taxes	830	923
Commissions due to outside sales representatives	800	654
Payable related to acquisition of minority interest in Australia subsidiary	770	
Accrued audit expenses	517	287
Accrued insurance	484	484
Other	2,199	1,527
	$ 7,574	$ 5,809

No item in other above exceeds 5% of total other current liabilities.

Note 13 Related Party Transactions

The Company has had significant related party transactions as discussed in Notes 7, 10, 11 and 17.

In addition to secured notes (see Note 10), the Company holds other various promissory notes from employees of the Company. The notes, which provide for interest at the lowest applicable rate allowed by the Internal Revenue Code, are due on demand. Amounts due from employees and included in prepaids, deposits, and other current assets at December 29, 2006 and December 30, 2005 were $116,000 and $110,000, respectively.

The Company paid a Board member for consulting services related to strategic marketing in the ophthalmic sector. Amounts paid during the year ended December 29, 2006, December 30, 2005, and December 31, 2004, were $0, $2,000, and $13,000, respectively.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 14 Supplemental Disclosure of Cash Flow Information

Interest paid was $175,000, $181,000 and $159,000 for the years ended December 29, 2006, December 30, 2005, and December 31, 2004, respectively. Income taxes paid amounted to approximately $731,000, $1,047,000 and $1,602,000 for the years ended December 29, 2006, December 30, 2005, and December 31, 2004, respectively.

The Company s non-cash investing and financing activities were as follows (in thousands):

	2006	2005	2004
Non-cash investing activities:			
Purchase of fixed assets on terms	$ 1,228	$ 200	$
Non-cash financing activities:			
Notes receivable reserve	(331)	746	500
Other charges	331	(746)	(500)
Acquisition of business:			
Minority interest acquired	$	$	$ 203
Goodwill			1,107
Note payable			(542)
Cash paid			(768)

Note 15 Net Loss Per Share

The following is a reconciliation of the weighted average number of shares used to compute basic and diluted loss per share (in thousands):

	2006	2005	2004
Basic weighted average shares outstanding	25,227	23,704	19,602
Diluted effect of stock options and warrants			
Diluted weighted average shares outstanding	25,227	23,704	19,602

Potential common shares of 2.6 million, 3.9 million, and 3.1 million for the fiscal years ended December 29, 2006, December 30, 2005, and December 31, 2004, respectively, were excluded from the computation as the shares would have had an anti-dilutive effect.

Note 16 Geographic and Product Data

The Company markets and sells its products in approximately 50 countries and has manufacturing sites in the United States and Switzerland. Other than the United States, Germany and Australia, the Company does not conduct business in any country in which its sales in that country exceed 5% of consolidated sales. Sales are attributed to countries based on location of customers. The composition of the Company s sales to unaffiliated

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

customers between those in the United States, Germany, Australia, and other locations for each year, is set forth below (in thousands):

	2006	2005	2004
Sales to unaffiliated customers			
U.S.	$ 22,293	$ 18,715	$ 21,643
Germany	21,135	22,433	22,128
Australia	2,178	2,722	1,914
Other	10,676	7,433	6,000
Total	$ 56,282	$ 51,303	$ 51,685

100% of the Company s sales are generated from the ophthalmic surgical product segment and, therefore, the Company operates as one operating segment for financial reporting purposes. The Company s principal products are IOLs and ancillary products used in cataract and refractive surgery. The composition of the Company s net sales by surgical line are as follows (in thousands):

Net Sales by Surgical Line

	2006	2005	2004
Cataract	$ 43,099	$ 45,361	$ 46,772
Refractive	12,514	5,288	4,066
Glaucoma	669	654	847
Total	$ 56,282	$ 51,303	$ 51,685

The composition of the Company s long-lived assets, consisting of property and equipment, patents and licenses, and goodwill, between those in the United States, Germany, Switzerland, and other countries is set forth below (in thousands):

	2006	2005
Long-lived assets		
U.S.	$ 8,153	$ 8,072
Germany	7,208	6,952
Switzerland	1,140	1,646
Australia	1,318	1,379

Total	$ 17,819	$ 18,049

The Company sells its products internationally, which subjects the Company to several potential risks, including fluctuating exchange rates (to the extent the Company s transactions are not in U.S. dollars), regulation of fund transfers by foreign governments, United States and foreign export and import duties and tariffs, and political instability.

Note 17 Subsequent Event

On March 21, 2007, the Company executed a promissory note to Broadwood Partners, L.P. (Noteholder), in the amount of $4.0 million, the proceeds of which may be used for general corporate purposes. The note bears interest at a rate of 10% per annum, payable quarterly, is unsecured, may be prepaid without penalty, and matures on March 21, 2010. The note contains certain affirmative and negative covenants but no financial covenants (other than avoidance of insolvency). The note provides for the issuance of 70,000 warrants upon execution of the note and additional

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STAAR SURGICAL COMPANY AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

warrants quarterly so long as the note is outstanding. The warrant agreement provides that the Company will register the stock for resale with the SEC. Based on publicly available information filed with the Securities and Exchange Commission (the SEC), on the date of the transaction Broadwood Partners L.P. beneficially owned 2,492,788 shares of the Company s common stock, comprising 9.7% of the Company s common stock as of March 21, 2007, and Neal Bradsher, President of Broadwood Partners, L.P., may have been deemed to beneficially own 2,518,688 shares of the Company s common stock, comprising 9.8% of the Company s common stock as of that date.

STAAR s activities as a sponsor of biomedical research are subject to review by the Bioresearch Monitoring Program of the FDA Office of Regulatory Affairs (BIMO). On March 14, 2007, BIMO concluded a routine audit of the Company s clinical trial records as a sponsor of biomedical research in connection with the Company s Supplemental Pre-Market Approval application for the Toric ICL (TICL). At the conclusion of the audit the Company received eight Inspectional Observations on FDA Form 483 noting noncompliance with regulations. The Company is preparing its response to the Inspectional Observations and expects to address the concerns raised by BIMO through voluntary corrective actions. Most of the observed instances of non-compliance took place during the 2000-2004 period and the Company expects to show that some of these have already been addressed by corrective actions made in response to BIMO s observations of December 11, 2003 in connection with the Company s application for the ICL.

The Company does not believe that the Inspectional Observations affect the integrity of the Toric clinical study. However, the determination of whether the Inspectional Observations affect the use of the Toric clinical study in the Toric application will be at the discretion of the FDA Office of Device Evaluation (ODE). Obtaining FDA approval of medical devices is never certain. The Company cannot assure investors that the ODE will grant approval to the TICL, or that the scope of requested TICL approval could not be limited by the FDA or the Ophthalmic Devices Panel.

Note 18 Quarterly Financial Data (Unaudited)

Summary unaudited quarterly financial data from continuing operations for fiscal 2006 and 2005 is as follows (in thousands except per share data):

December 29, 2006	**1st Qtr.**	**2nd Qtr.**	**3rd Qtr.**	**4th Qtr.**
Revenues	$ 13,315	$ 14,561	$ 13,139	$ 15,267
Gross profit	6,399	7,040	6,401	6,593
Net loss	(3,362)	(3,218)	(2,789)	(5,675)
Basic and diluted loss per share	(.14)	(.13)	(.11)	(.22)

December 30, 2005	**1st Qtr.**	**2nd Qtr.**	**3rd Qtr.**	**4th Qtr.**
Revenues	$ 13,678	$ 13,910	$ 11,647	$ 12,068
Gross profit	6,450	6,610	5,197	5,529
Net loss	(2,338)	(2,110)	(3,302)	(3,425)
Basic and diluted loss per share	(.11)	(.09)	(.13)	(.14)

Quarterly and year-to-date computations of loss per share amounts are made independently. Therefore, the sum of the per share amounts for the quarters may not agree with the per share amounts for the year.

Significant Fourth Quarter Adjustments

During the fourth quarter of 2006, the Company recorded two significant adjustments. The Company took an obsolescence charge of $807,000 against certain IOL inventory in anticipation of new product launches that are expected to take place in 2007. The Company will continue to monitor the inventory reserve to ensure that the

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STAAR SURGICAL COMPANY AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

amount is appropriate. In addition to the inventory reserve the Company has reserved $700,000 for additional taxes in connection with the findings at the Company s German subsidiary. The Company will seek to reduce the amount in discussions with the German Ministry of Finance.

Note 19 Restatement

After the issuance of the Company s 2006 consolidated financial statements management determined that its method for translating foreign currency cash flows did not conform to paragraph 25 of Statement of Financial Accounting Standard No. 95, Statement of Cash Flows (SFAS 95). SFAS 95 requires an enterprise with foreign operations to translate foreign currency cash flows in the reporting currency using the exchange rates in effect at the time of the each transaction, or if the result will be substantially the same, to use a weighted average of the exchange rates during the period. Previously, the Company has primarily used the exchange rate in effect at the end of the reporting period. In prior periods, the difference between the method applied by the Company and the methods prescribed by paragraph 25 of SFAS 95 would not have a significant effect on the Company s reported cash flow. However, in recent periods foreign exchange has had a greater effect on the Company s cash flows because the portion of the Company s business represented by international operations has increased. As a result, management determined it was appropriate to restate the previously filed cash flow information.

In accordance with SFAS No. 154, Accounting Changes and Error Corrections (SFAS 154) the impact of the changes required by paragraph 25 of SFAS 95 has been applied retrospectively by adjusting all prior periods presented. The following tables summarize all consolidated statement of cash flow line items affected by the accounting change for the years ended December 29, 2006, December 30, 2005, and December 31, 2004:

For the year ended December 29, 2006 (in thousands):

	As Filed	Effect of SFAS 95	As Restated
Depreciation of property and equipment	$ 1,891	$ (2)	$ 1,889
Loss on disposal of fixed assets	169	21	190
Stock-based compensation expense	1,841	15	1,856
Accounts receivable	(1,400)	167	(1,233)
Inventories	1,896	606	2,502
Prepaids, deposits and other current assets	(160)	153	(7)
Accounts payable	1,042	(116)	926
Other current liabilities	947	(266)	681
Acquisition of property and equipment	(779)	(7)	(786)
Net change in other assets	(107)	2	(105)
Net borrowings (payments) under notes payable and long-term debt	(81)	(14)	(95)
Effect of exchange rate changes on cash and cash equivalents	743	(559)	184
Total cash used in operating activities	(8,647)	578	(8,069)
Total cash provided by investing activities	145	(5)	140

Total cash provided by financing activities	$ 2,809	$ (14)	$ 2,795

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STAAR SURGICAL COMPANY AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

For the year ended December 30, 2005 (in thousands):

	As Filed	Effect of SFAS 95	As Restated
Depreciation of property and equipment	$ 1,992	$ 18	$ 2,010
Loss on disposal of fixed assets	85	5	90
Accounts receivable	1,117	(310)	807
Inventories	270	(720)	(450)
Prepaids, deposits and other current assets	206	(36)	170
Accounts payable	(1,399)	244	(1,155)
Other current liabilities	683	227	910
Acquisition of property and equipment	(1,194)	(9)	(1,203)
Net change in other assets	16	(1)	15
Net borrowings (payments) under notes payable and long-term debt	(1,206)	(59)	(1,265)
Effect of exchange rate changes on cash and cash equivalents	(878)	641	(237)
Total cash used in operating activities	(6,976)	(572)	(7,548)
Total cash provided by investing activities	4,077	(10)	4,067
Total cash provided by financing activities	$ 12,298	$ (59)	$ 12,239

For the year ended December 31, 2004 (in thousands):

	As Filed	Effect of SFAS 95	As Restated
Depreciation of property and equipment	$ 2,005	$ (2)	$ 2,003
Loss on disposal of fixed assets	175	(1)	174
Accounts receivable	(542)	45	(497)
Inventories	(2,282)	224	(2,058)
Prepaids, deposits and other current assets	32	(111)	(79)
Accounts payable	769	(367)	402
Other current liabilities	775	368	1,143
Purchase of property and equipment	(1,705)	20	(1,685)
Purchase of minority interest in subsidiary	(768)	81	(687)
Net change in other assets	(91)	25	(66)
Effect of exchange rate changes on cash and cash equivalents	452	(282)	170
Total cash used in operating activities	(8,804)	156	(8,648)
Total cash used in investing activities	(7,294)	126	(7,168)
Total cash provided by financing activities	$ 12,547	$	$ 12,547

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INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

REPORT ON SCHEDULE

To the Board of Directors
STAAR Surgical Company
Monrovia, CA

The audits referred to in our report dated March 29, 2007, except for Note 19 which is as of February 6, 2008, relating to the consolidated financial statements of STAAR Surgical Company and Subsidiaries, which is contained in Item 8 of this Form 10-K/A included the audit of Schedule II, Valuation and Qualifying Accounts and Reserves as of December 29, 2006, and for each of the three years in the period ended December 29, 2006. This financial statement schedule is the responsibility of the Company s management. Our responsibility is to express an opinion on this financial statement schedule based on our audits.

In our opinion, such financial statement schedule presents fairly, in all material respects, the information set forth therein.

By: /s/ BDO Seidman, LLP

Los Angeles, California
March 29, 2007, except for Note 19
which is as of February 6, 2008

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STAAR SURGICAL COMPANY AND SUBSIDIARIES

SCHEDULE II VALUATION AND QUALIFYING ACCOUNTS AND RESERVES

Column A Description	Column B Balance at Beginning of Year	Column C Additions	Column D Deductions	Column E Balance at End of Year
		(In thousands)		
2006				
Allowance for doubtful accounts and sales returns deducted from accounts receivable in balance sheet	$ 480	$ 348	$ 138	$ 690
Deferred tax asset valuation allowance	33,662	6,774		40,436
Notes receivable reserve	1,246		1,246	
	$ 35,388	$ 7,122	$ 1,384	$ 41,126
2005				
Allowance for doubtful accounts and sales returns deducted from accounts receivable in balance sheet	$ 460	$ 191	$ 171	$ 480
Deferred tax asset valuation allowance	28,172	5,490		33,662
Notes receivable reserve	500	746		1,246
	$ 29,132	$ 6,427	$ 171	$ 35,388
2004				
Allowance for doubtful accounts and sales returns deducted from accounts receivable in balance sheet	$ 734	$ 236	$ 510	$ 460
Deferred tax asset valuation allowance	22,075	6,097		28,172
Notes receivable reserve		500		500
	$ 22,809	$ 6,833	$ 510	$ 29,132