

ADVANCED MEDICAL OPTICS INC  
Form 10-Q  
November 05, 2008  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**  
WASHINGTON, D.C. 20549

**FORM 10-Q**

(Mark One)

**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934.**

For the quarterly period ended September 26, 2008

or

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934.**

For the transition period from \_\_\_\_\_ to \_\_\_\_\_.

COMMISSION FILE NUMBER 001-31257

**ADVANCED MEDICAL OPTICS, INC.**

(Exact name of registrant as specified in its charter)

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|   |  |
|---|--|
| <b>DELAWARE</b><br>(State or other jurisdiction<br>of incorporation or organization)                            | <b>33-0986820</b><br>(I.R.S. Employer<br>Identification No.) |
| <b>1700 E. St. Andrew Place</b><br><br><b>Santa Ana, California</b><br>(Address of principal executive offices) | <b>92705</b><br>(Zip Code)                                   |
| <b>Registrant's telephone number, including area code: 714/247-8200</b>   |  |

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

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

|  |  |
|--|--|
| Large Accelerated Filer <input checked="" type="checkbox"/>                                  | Accelerated filer <input type="checkbox"/>         |
| Non-accelerated filer <input type="checkbox"/> (Do not check if a smaller reporting company) | Smaller reporting company <input type="checkbox"/> |

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

As of October 31, 2008, there were 61,281,853 shares of common stock outstanding.

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**ADVANCED MEDICAL OPTICS, INC.**

**FORM 10-Q FOR THE QUARTER ENDED SEPTEMBER 26, 2008**

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**Table of Contents****PART I FINANCIAL INFORMATION****Item 1. Financial Statements**

Advanced Medical Optics, Inc.

Unaudited Consolidated Statements of Operations

(In thousands, except per share data)

|   | Three Months Ended    |                       | Nine Months Ended     |                       |
|---|-----------------------|-----------------------|-----------------------|-----------------------|
|   | September 26,<br>2008 | September 28,<br>2007 | September 26,<br>2008 | September 28,<br>2007 |
| Net sales   | \$ 275,635            | \$ 273,194            | \$ 899,863            | \$ 786,264            |
| Cost of sales   | 110,570               | 121,030               | 349,438               | 348,683               |
| Gross profit  | 165,065               | 152,164               | 550,425               | 437,581               |
| Selling, general and administrative                   | 118,099               | 137,916               | 376,068               | 397,136               |
| Research and development                              | 16,876                | 20,975                | 56,194                | 60,819                |
| Restructuring charges (Note 2)                        | 3,447                 |                       | 24,532                |                       |
| Net gain on legal contingencies                       |                       |                       | (20,492)              |                       |
| In-process research and development                   |                       |                       |                       | 86,980                |
| Operating income (loss)                               | 26,643                | (6,727)               | 114,123               | (107,354)             |
| Non-operating expense (income):                       |                       |                       |                       |                       |
| Interest expense                                      | 17,566                | 20,588                | 56,592                | 48,792                |
| Unrealized (gain) loss on derivative instruments, net | (5,802)               | 2,433                 | (6,407)               | 2,738                 |
| Gain on investments                                   | (1,099)               |                       | (3,167)               |                       |
| Other, net  | 4,570                 | 1,517                 | 9,105                 | 4,254                 |
|   | 15,235                | 24,538                | 56,123                | 55,784                |
| Earnings (loss) before income taxes                   | 11,408                | (31,265)              | 58,000                | (163,138)             |
| Provision (benefit) for income taxes                  | 4,335                 | (5,328)               | 22,040                | 17,484                |
| Net earnings (loss)                                   | \$ 7,073              | \$ (25,937)           | \$ 35,960             | \$ (180,622)          |
| Net earnings (loss) per share:                        |                       |                       |                       |                       |
| Basic   | \$ 0.12               | \$ (0.43)             | \$ 0.59               | \$ (3.02)             |
| Diluted   | \$ 0.11               | \$ (0.43)             | \$ 0.57               | \$ (3.02)             |
| Weighted average number of shares outstanding:        |                       |                       |                       |                       |
| Basic   | 61,042                | 60,242                | 60,759                | 59,856                |
| Diluted   | 63,114                | 60,242                | 62,663                | 59,856                |

See accompanying notes to unaudited consolidated financial statements.

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Advanced Medical Optics, Inc.

Unaudited Consolidated Balance Sheets

(In thousands, except share data)

|   | September 26,<br>2008 | December 31,<br>2007 |
|---|-----------------------|----------------------|
| <b>ASSETS</b>   |                       |                      |
| Current assets:   |                       |                      |
| Cash and equivalents  | \$ 34,954             | \$ 34,525            |
| Trade receivables, net  | 251,564               | 250,018              |
| Inventories   | 192,623               | 160,267              |
| Deferred income taxes   | 42,187                | 42,227               |
| Income tax receivable   |                       | 10,569               |
| Other current assets  | 23,268                | 25,505               |
| <b>Total current assets</b>   | <b>544,596</b>        | <b>523,111</b>       |
| Property, plant and equipment, net  | 172,431               | 177,675              |
| Deferred income taxes   | 14,073                | 14,111               |
| Other assets  | 87,508                | 94,949               |
| Intangible assets, net  | 597,773               | 649,369              |
| Goodwill  | 1,289,153             | 1,289,121            |
| <b>Total assets</b>   | <b>\$ 2,705,534</b>   | <b>\$ 2,748,336</b>  |
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>   |                       |                      |
| Current liabilities:  |                       |                      |
| Current portion of long-term debt and short-term borrowings   | \$ 4,500              | \$ 64,500            |
| Accounts payable  | 64,197                | 88,432               |
| Accrued compensation  | 50,490                | 54,410               |
| Other accrued expenses  | 114,162               | 128,833              |
| Income tax payable  | 12,149                |                      |
| Deferred income taxes   | 6,425                 | 6,419                |
| <b>Total current liabilities</b>  | <b>251,923</b>        | <b>342,594</b>       |
| Long-term debt  | 1,540,980             | 1,543,230            |
| Deferred income taxes   | 192,243               | 198,333              |
| Other liabilities   | 69,777                | 65,443               |
| Commitments and contingencies (Note 10)   |                       |                      |
| Stockholders' equity:   |                       |                      |
| Preferred stock, \$.01 par value; 5,000,000 shares authorized; none issued                            |                       |                      |
| Common stock, \$.01 par value; 240,000,000 shares authorized; 61,298,622 and 60,647,394 shares issued | 613                   | 606                  |
| Additional paid-in capital  | 1,480,379             | 1,451,961            |
| Accumulated deficit   | (887,509)             | (923,469)            |
| Accumulated other comprehensive income  | 57,552                | 69,726               |
| Treasury stock, at cost (18,199 and 3,186 shares)   | (424)                 | (88)                 |
| <b>Total stockholders' equity</b>   | <b>650,611</b>        | <b>598,736</b>       |
| <b>Total liabilities and stockholders' equity</b>   | <b>\$ 2,705,534</b>   | <b>\$ 2,748,336</b>  |

See accompanying notes to unaudited consolidated financial statements.



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Advanced Medical Optics, Inc.

Unaudited Consolidated Statements of Cash Flows

(In thousands)

|  | Nine Months Ended     |                       |
|--|-----------------------|-----------------------|
|  | September 26,<br>2008 | September 28,<br>2007 |
| Cash flows from operating activities:  |                       |                       |
| Net earnings (loss)  | \$ 35,960             | \$ (180,622)          |
| Adjustments to reconcile net earnings (loss) to net cash provided by operating activities: |                       |                       |
| Amortization of debt issuance costs  | 4,263                 | 4,941                 |
| Depreciation and amortization  | 86,528                | 70,821                |
| Deferred income taxes  | (6,103)               | (4,958)               |
| In-process research and development  |                       | 86,980                |
| (Gain) loss on investments and long-lived assets   | (2,734)               | 1,558                 |
| Unrealized (gain) loss on derivatives  | (6,407)               | 2,738                 |
| Share-based compensation   | 18,314                | 15,504                |
| Changes in assets and liabilities (net of effect of businesses acquired):                  |                       |                       |
| Trade receivables, net   | (1,717)               | 30,828                |
| Inventories  | (32,949)              | 3,326                 |
| Other current assets   | (871)                 | 1,558                 |
| Accounts payable   | (18,932)              | 4,325                 |
| Accrued expenses and other liabilities   | (14,218)              | (6,628)               |
| Income taxes   | 22,486                | 8,469                 |
| Other non-current assets and liabilities   | 5,201                 | (7,133)               |
| <b>Net cash provided by operating activities</b>   | <b>88,821</b>         | <b>31,707</b>         |
| Cash flows from investing activities:  |                       |                       |
| Acquisition of businesses, net of cash acquired  | (77)                  | (737,773)             |
| Additions to property, plant and equipment   | (16,978)              | (24,241)              |
| Proceeds from sale of property, plant and equipment  | 615                   | 751                   |
| Proceeds from sale of investments  | 4,417                 |                       |
| Additions to software and other long-lived assets  | (770)                 | (5,391)               |
| Additions to demonstration and bundled equipment   | (9,944)               | (6,328)               |
| <b>Net cash used in investing activities</b>   | <b>(22,737)</b>       | <b>(772,982)</b>      |
| Cash flows from financing activities:  |                       |                       |
| Repayments of short-term borrowings, net   | (60,000)              | 51,000                |
| Repayment of long-term debt  | (2,250)               | (2,250)               |
| Payment of financing-related costs   | (2,763)               | (15,386)              |
| Proceeds from issuance of long-term debt   |                       | 695,500               |
| Proceeds from issuance of common stock   | 5,111                 | 18,651                |
| Purchase of treasury stock   |                       | (64)                  |
| <b>Net cash (used in) provided by financing activities</b>                                 | <b>(59,902)</b>       | <b>747,451</b>        |
| Effect of exchange rates on cash and equivalents   | (5,753)               | (4,149)               |
| <b>Net increase in cash and equivalents</b>  | <b>429</b>            | <b>2,027</b>          |
| Cash and equivalents at beginning of period  | 34,525                | 34,522                |

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|                                       |           |           |
|---------------------------------------|-----------|-----------|
| Cash and equivalents at end of period | \$ 34,954 | \$ 36,549 |
|---------------------------------------|-----------|-----------|

See accompanying notes to unaudited consolidated financial statements.



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Advanced Medical Optics, Inc.

Notes to Unaudited Consolidated Financial Statements

### **Note 1: Basis of Presentation**

In the opinion of management, the accompanying unaudited consolidated financial statements contain all adjustments necessary (consisting only of normal, recurring adjustments) for a fair statement of the financial information contained therein. These statements do not include all disclosures required by accounting principles generally accepted in the United States of America for annual financial statements and should be read in conjunction with the audited consolidated financial statements of Advanced Medical Optics, Inc. (the Company or AMO) for the year ended December 31, 2007. The results of operations for the three and nine months ended September 26, 2008 are not necessarily indicative of the results to be expected for the year ending December 31, 2008.

All material intercompany balances have been eliminated.

#### *Use of Estimates*

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America (GAAP) 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, the reported amounts of revenues and expenses during the reporting period, and related disclosures. Actual results could differ materially from those estimates.

#### *Recently Issued Accounting Standards*

In September 2006, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No. 157, Fair Value Measurements (SFAS No. 157). SFAS No. 157 defines fair value, establishes a framework for measuring fair value within generally accepted accounting principles, and expands disclosure requirements regarding fair value measurements. Although SFAS No. 157 does not require any new fair value measurements, its application may, in certain instances, change current practice. Where applicable, SFAS No. 157 simplifies and codifies fair value related guidance previously issued within GAAP. The Company has adopted FASB Staff Position 157-2, Effective Date of FASB Statement No. 157 (FSP 157-2), issued February 2008, and as a result the Company has applied the provisions of SFAS No. 157 that are applicable as of January 1, 2008, which had no material effect on its consolidated financial statements. FSP 157-2 delays the effective date of SFAS No. 157 for certain non-financial assets and non-financial liabilities until January 1, 2009. See Note 5 for the interim disclosures required by SFAS No. 157.

In October 2008, the FASB issued Staff Position No. 157-3, Determining the Fair Value of a Financial Asset When the Market for That Asset Is Not Active (FSP No. 157-3). FSP No. 157-3 clarifies the application of SFAS No. 157 in a market that is not active and provides an example to illustrate key considerations in determining the fair value of a financial asset when the market for that financial asset is not active. FSP No. 157-3 was effective upon issuance on October 10, 2008, including prior periods for which financial statements had not been issued. The application of the provisions of FSP No. 157-3 did not materially affect the Company's results of operations or financial condition as of and for the three and nine months ended September 26, 2008.

In December 2007, the FASB issued SFAS No. 141(R), Business Combinations (SFAS No. 141R), and SFAS No. 160, Accounting and Reporting of Noncontrolling Interest in Consolidated Financial Statements, an amendment of ARB No. 51 (SFAS No. 160). These new standards will significantly change the financial accounting and reporting of business combination transactions and noncontrolling (or minority) interests in consolidated financial statements. The Company will be required to adopt SFAS No. 141R and SFAS No. 160 effective January 1, 2009. The Company has not yet determined the effect, if any, that the adoption of SFAS No. 141R and SFAS No. 160 will have on its consolidated financial statements.

In March 2008, the FASB issued SFAS No. 161, Disclosures about Derivative Instruments and Hedging Activities - an Amendment of FASB Statement No. 133 (SFAS No. 161). SFAS No. 161 is intended to improve financial reporting of derivative instruments and hedging activities by requiring enhanced disclosures to enable investors to better understand their effects on an entity's financial position, financial performance, and cash flows. SFAS No. 161 is effective for the Company January 1, 2009. The Company is evaluating the impact of this new standard but currently does not anticipate a material impact on its consolidated financial statements as a result of the implementation of SFAS No. 161.



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In April 2008, the FASB issued FASB Staff Position No. 142-3, *Determination of the Useful Life of Intangible Assets* ( FSP No. 142-3 ). FSP No. 142-3 amends the factors that should be considered in developing assumptions about renewal or extension used in estimating the useful life of a recognized intangible asset under SFAS No. 142, *Goodwill and Other Intangible Assets* ( SFAS No. 142 ). This standard is intended to improve the consistency between the useful life of a recognized intangible asset under SFAS No. 142 and the period of expected cash flows used to measure the fair value of the asset under SFAS No. 141R and other GAAP. FSP No. 142-3 is effective for financial statements issued for fiscal years beginning after December 15, 2008. The measurement provisions of this standard will apply only to intangible assets of the Company acquired after January 1, 2009.

In May 2008, the FASB issued SFAS No. 162, *The Hierarchy of Generally Accepted Accounting Principles* ( SFAS No. 162 ), which identifies the sources of accounting principles and the framework for selecting the principles to be used in the preparation of financial statements of non-governmental entities that are presented in conformity with GAAP in the United States. SFAS No. 162 is effective sixty days following the SEC's approval of The Public Company Accounting Oversight Board's related amendments to remove the GAAP hierarchy from auditing standards.

In May 2008, the FASB issued FASB Staff Position No. APB 14-1, *Accounting for Convertible Debt Instruments That May Be Settled in Cash Upon Conversion (Including Partial Cash Settlement)* ( FSP No. APB 14-1 ). FSP No. APB 14-1 applies to convertible debt instruments that, by their stated terms, may be settled in cash (or other assets) upon conversion, including partial cash settlement, unless the embedded conversion option is required to be separately accounted for as a derivative under SFAS 133. FSP No. APB 14-1 specifies that issuers of convertible debt instruments should separately account for the liability and equity components in a manner that will reflect the entity's nonconvertible debt borrowing rate when interest cost is recognized in subsequent periods. FSP No. APB 14-1 is effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those fiscal years. FSP No. APB 14-1 shall be applied retrospectively to all periods presented. The cumulative effect of the change in accounting principle on periods prior to those presented shall be recognized as of the beginning of the first period presented. An offsetting adjustment shall be made to the opening balance of retained earnings for that period, presented separately. The Company has not yet determined the effect that the adoption of FSP No. APB 14-1 will have on its consolidated financial statements.

## **Note 2: Restructuring Plan**

After its acquisition of IntraLase Corp. ( IntraLase ) in the second quarter of 2007, the Company continued femtosecond laser manufacturing operations in Irvine, California (the Irvine Plant ). As part of the overall integration of IntraLase, on December 13, 2007, AMO management committed to a plan to relocate the femtosecond laser manufacturing operations from the Irvine Plant to its excimer laser and phacoemulsification manufacturing facility in Milpitas, California (the Milpitas Plant ), in order to consolidate equipment manufacturing in one location and to maximize opportunities to leverage core strengths. Also included in the plan was the movement of the assembly of IntraLase disposable patient interfaces from the Irvine Plant to AMO's facility in Puerto Rico in order to obtain additional synergies.

As a continuation of AMO's commitment to further enhance its global competitiveness, operating leverage and cash flow, the Board of Directors of AMO on February 12, 2008 approved an additional plan to reduce the Company's fixed costs. The additional plan included a net workforce reduction of approximately 150 positions, or about 4% of the Company's global workforce. In addition, AMO consolidated certain operations, including the relocation of all remaining activities at the Irvine Plant, to improve its overall facility utilization.

These plans include workforce reductions and transfers, outplacement assistance, relocation of certain employees, facilities-related costs, and accelerated amortization of certain long-lived assets and termination of redundant supplier contracts. These plans will also result in start-up costs such as expenses for moving, incremental travel, recruiting and duplicate personnel associated with hiring staff during ramp-up, as well as incremental costs associated with capacity underutilization of the Milpitas Plant during the ramp-up period.

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AMO expects to complete these activities in 2008 and estimates the total pre-tax charges resulting from these plans to be in the range of \$36 million to \$43 million, substantially all of which are expected to be cash expenditures. The Company incurred severance and retention bonus charges of \$0.4 million under the plan in 2007. An estimated breakdown of the total charges is as follows:

|   |                             |
|---|-----------------------------|
| Severance, retention bonuses, employee relocation and other one-time termination benefits | \$20 million - \$24 million |
| Facilities related and other costs  | \$10 million - \$13 million |
| Termination of redundant supplier contracts and relocation of equipment and inventory     | \$2 million                 |
| Incremental costs for transition and start-up activities at the Milpitas Plant            | \$4 million                 |

The Company has recorded the following costs associated with the restructuring plans (in thousands):

|   | Three Months Ended<br>September 26, 2008 | Nine Months Ended<br>September 26, 2008 |
|---|--|---|
| <b>Costs included in cost of sales:</b>   |  |   |
| Facilities related and other costs  | \$ 4,721                                 | \$ 4,721                                |
| Termination of redundant supplier contracts   | 166                                      | 166                                     |
| Incremental costs for transition and start-up activities at the Milpitas Plant            | 803                                      | 803                                     |
|   | 5,690                                    | 5,690                                   |
| <b>Costs included in selling, general and administrative expenses:</b>                    |  |   |
| Accelerated depreciation relating to the restructuring                                    | 1,839                                    | 3,678                                   |
| <b>Costs included in restructuring charges:</b>   |  |   |
| Severance, retention bonuses, employee relocation and other one-time termination benefits | 1,991                                    | 22,463                                  |
| Facilities related and other costs  |  | 613                                     |
| Travel and relocation   | 1,456                                    | 1,456                                   |
|   | 3,447                                    | 24,532                                  |
| <b>Total</b>  | <b>\$ 10,976</b>                         | <b>\$ 33,900</b>                        |

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Activities in the restructuring charges accrual balances during the nine months ended September 26, 2008 were as follows (in thousands):

|   | Balance at<br>December 31,<br>2007 | Costs<br>Incurred | Cash<br>Payments | Non-Cash<br>Adjustments | Balance at<br>September 26,<br>2008 |
|---|------------------------------------|-------------------|------------------|-------------------------|-------------------------------------|
| Severance, retention bonuses, employee relocation and other one-time termination benefits | \$ 351                             | \$ 22,463         | \$ (15,944)      | \$ (1,090)              | \$ 5,780                            |
| Facilities related and other costs  |                                    | 5,334             | (3,537)          | (1,797)                 |                                     |
| Termination of redundant supplier contracts and relocation of equipment and inventory     |                                    | 1,622             | (1,622)          |                         |                                     |
| Incremental costs for transition and start-up activities at the Milpitas Plant            |                                    | 803               | (330)            | (473)                   |                                     |
| Accelerated depreciation relating to the restructuring                                    |                                    | 3,678             |                  | (3,678)                 |                                     |
|   | \$ 351                             | \$ 33,900         | \$ (21,433)      | \$ (7,038)              | \$ 5,780                            |

**Note 3: Composition of Certain Financial Statement Captions****Inventories:**

| (In thousands)  | September 26,<br>2008 | December 31,<br>2007 |
|---|-----------------------|----------------------|
| Finished goods, including consignment inventory of \$8,840 and \$7,712 in 2008 and 2007, respectively | \$ 127,809            | \$ 93,503            |
| Work in process   | 15,724                | 16,562               |
| Raw materials   | 49,090                | 50,202               |
|   | \$ 192,623            | \$ 160,267           |

**Intangible assets, net**

| (In thousands)                        | Useful<br>Life (Years) | September 26, 2008 |                             | December 31, 2007 |                             |
|---------------------------------------|------------------------|--------------------|-----------------------------|-------------------|-----------------------------|
|                                       |                        | Gross<br>Amount    | Accumulated<br>Amortization | Gross<br>Amount   | Accumulated<br>Amortization |
| <b>Amortizable Intangible Assets:</b> |                        |                    |                             |                   |                             |
| Patent                                | 17                     | \$ 431             | \$ (45)                     | \$ 431            | \$ (26)                     |
| Licensing                             | 3 - 5                  | 4,590              | (4,470)                     | 4,590             | (4,373)                     |
| Technology rights                     | 5 - 19                 | 548,251            | (162,183)                   | 549,737           | (117,699)                   |
| Trademarks                            | 13.5                   | 17,724             | (5,906)                     | 17,899            | (5,064)                     |
| Customer relationships                | 5 - 10                 | 33,093             | (18,012)                    | 32,680            | (13,106)                    |
|                                       |                        | 604,089            | (190,616)                   | 605,337           | (140,268)                   |
| Nonamortizable Tradename (VISX)       | Indefinite             | 140,400            |                             | 140,400           |                             |
| Nonamortizable Tradename (IntraLase)  | Indefinite             | 43,900             |                             | 43,900            |                             |
|                                       |                        | \$ 788,389         | \$ (190,616)                | \$ 789,637        | \$ (140,268)                |

The amortizable intangible assets balance decreased due to the impact of \$2.4 million in foreign currency fluctuation, partially offset by \$1.2 million of technology rights, trademarks and customer relationships related to an acquisition. Amortization expense was \$17.2 million and \$51.5 million for the three and nine months ended September 26, 2008, respectively, and \$17.4 million and \$44.3 million for the three and nine months ended September 28, 2007, respectively, and is recorded in selling, general and administrative in the accompanying unaudited consolidated

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statements of operations. Amortization expense is expected to be \$68.2 million in 2008, \$68.0 million in 2009, \$65.4 million in 2010, \$63.5 million in 2011 and \$58.6 million in 2012. Actual amortization expense may vary due to the impact of foreign currency fluctuations.

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| (In thousands) | Balance at<br>December 31,<br>2007 | Foreign<br>Currency<br>Adjustments | Acquisition | Balance at<br>September 26,<br>2008 |
|----------------|------------------------------------|------------------------------------|-------------|-------------------------------------|
| Goodwill:      |                                    |                                    |             |                                     |
| Eye Care       | \$ 30,182                          | \$ 1,434                           | \$          | \$ 31,616                           |
| Cataract       | 365,785                            | (5,146)                            | 3,744       | 364,383                             |
| Refractive     | 893,154                            |                                    |             | 893,154                             |
|                | \$ 1,289,121                       | \$ (3,712)                         | \$ 3,744    | \$ 1,289,153                        |

The change in goodwill during the nine months ended September 26, 2008 included a decrease of \$3.7 million from foreign currency fluctuations in the Eye Care and Cataract segments. In addition, during the third quarter of 2008 the Company recorded \$3.7 million of goodwill from an acquisition, which was included in the Cataract segment. In July 2008, the Company acquired the assets of a company that provides proprietary on-demand task automation software to ambulatory surgical centers for approximately \$5.1 million. The business combination was not material to the consolidated financial position, results of operations or cash flows of the Company.

The Company performed its annual impairment test of goodwill and purchased intangible assets with indefinite lives during the second quarter of 2008 and determined there was no impairment. The valuation of goodwill and purchased intangible assets with indefinite lives requires assumptions and estimates of many critical factors, including revenue and market growth, operating cash flows, investments in capital equipment and working capital, and discount rates. As compared to its internal projections, the Company has experienced declines in its Refractive revenue during the third quarter as a result of the ongoing impact of deteriorating economic conditions on this business. Adverse changes in expected operating results and/or unfavorable changes in other economic factors used to estimate fair values could result in a non-cash impairment charge related to intangible assets and/or goodwill prior to the next annual review in the second quarter of 2009, which could be material to the Company's consolidated financial statements.

**Note 4: Debt**

| (In thousands)   | Average Rate<br>of Interest | September 26,<br>2008 | December 31,<br>2007 |
|--|-----------------------------|-----------------------|----------------------|
| Convertible Senior Subordinated Notes due 2024 ( 2 1/2% Notes ), with put dates of January 15, 2010, July 15, 2014 and July 15, 2019 | 2.500%                      | \$ 246,105            | \$ 246,105           |
| Convertible Senior Subordinated Notes due 2025 ( 1.375% Notes ), with put dates of July 1, 2011, July 1, 2016 and July 1, 2021       | 1.375%                      | 105,000               | 105,000              |
| Convertible Senior Subordinated Notes due 2026 ( 3.25% Notes ), with put dates of August 1, 2014, August 1, 2017 and August 1, 2021  | 3.250%                      | 500,000               | 500,000              |
| Senior Subordinated Notes due 2017 ( 7 1/2% Notes )  | 7.500%                      | 250,000               | 250,000              |
| Term Loan due 2014 ( Term Loan )   | 4.57%                       | 444,375               | 446,625              |
| Senior revolving credit facility   | 4.84%                       |                       | 60,000               |
|  |                             | 1,545,480             | 1,607,730            |
| Less current portion   |                             | 4,500                 | 64,500               |
| <b>Total long-term debt</b>  |                             | <b>\$ 1,540,980</b>   | <b>\$ 1,543,230</b>  |

All of the convertible notes issued by the Company may be converted, at the option of the holders, on or prior to the final maturity date under certain circumstances, none of which had occurred as of September 26, 2008. Upon conversion of the convertible notes, the Company will satisfy in cash the conversion obligation with respect to the principal amount of the convertible notes, with any remaining amount of the conversion obligation to be satisfied in shares of common stock. As a result of this election, the Company also is required to satisfy in cash its obligations to repurchase any convertible notes that holders may put to the Company on the respective dates noted in the table above.

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The Company has access to a credit facility (the Credit Facility ), which is comprised of a \$300 million revolving line of credit maturing in April 2013 (the Revolver ) and a \$450 million term loan maturing on April



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2014 (the Term Loan). As of September 26, 2008, the Revolver included commitments to support letters of credit totaling \$8.5 million issued on behalf of the Company for normal operating purposes, which resulted in an available balance of \$291.5 million. The outstanding balance of the Term Loan as of September 26, 2008 was \$444.4 million.

Borrowings under the Credit Facility, if any, bear interest at current market rates plus a margin based upon the Company's ratio of debt to EBITDA, as defined. The incremental interest margin on borrowings under the Credit Facility decreases as the Company's ratio of debt to EBITDA decreases to specified levels. During the third quarter of 2008, this interest margin was 1.75% over the applicable LIBOR rate. Additionally, the Company can borrow at the prevailing prime rate of interest plus an interest margin of 0.75%. The average annual rate of interest during the third quarter of 2008, inclusive of incremental margin, was 4.84% and 4.57% for the Revolver and Term Loan, respectively. Under the Credit Facility, certain transactions may trigger mandatory prepayment of borrowings. Such transactions may include equity or debt offerings, certain asset sales and extraordinary receipts. The Company pays a quarterly fee (1.875% per annum at September 26, 2008) on the average balance of outstanding letters of credit and a quarterly commitment fee (0.50% per annum at September 26, 2008) on the average unused portion of the Revolver. In addition, the Company makes mandatory quarterly amortization payments (1.0% per annum) on the outstanding balance of the Term Loan. The Credit Facility requires that the Company will maintain certain financial and operating covenants which include, among other provisions, maintaining specific leverage and interest coverage ratios. The Company was in compliance with the financial covenants at September 26, 2008. Certain covenants under the Credit Facility may limit the incurrence of additional indebtedness. The Credit Facility prohibits dividend payments by the Company. On October 5, 2007, as a result of the product recall in May 2007 discussed in Note 10, the Company amended the Credit Facility. The amendment changed the Maximum Consolidated Total Leverage Ratio for certain quarterly periods. Additionally, for purposes of calculating this ratio as well as the Minimum Consolidated Interest Coverage Ratio, the Company was permitted to exclude certain recall-related costs and other related impacts. On July 30, 2008, in anticipation of the effects to the LASIK business of the slowing U.S. economy, the Company amended the Credit Facility. The amendment changed the Maximum Consolidated Total Leverage Ratio for certain quarterly periods.

The Credit Facility is collateralized by a first priority perfected lien on, and pledge of, all of the Company's present and future property and assets (subject to certain exclusions), 100% of the stock of the domestic subsidiaries, 66% of the stock of foreign subsidiaries and all present and future intercompany debts.

As of September 26, 2008, the aggregate maturities of total long-term debt of \$1.5 billion are due after 2012.

*Guarantor Subsidiaries*

In connection with the issuance of the 7 1/2% Notes, certain of the Company's 100%-owned subsidiaries (Guarantor Subsidiaries) jointly, fully, severally and unconditionally guaranteed such 7 1/2% Notes. Each subsidiary is 100%-owned by the parent company issuer. The following presents the condensed consolidating financial information separately for:

- i. Advanced Medical Optics, Inc. (the Parent Company), the issuer of the guaranteed obligations;
- ii. Guarantor Subsidiaries, on a combined basis, as specified in the Indenture;
- iii. Non-guarantor subsidiaries, on a combined basis, as specified in the Indenture;
- iv. Consolidating entries and eliminations representing adjustments to (a) eliminate intercompany transactions and balances between or among the Parent Company, the Guarantor Subsidiaries and the non-guarantor subsidiaries, (b) eliminate the Parent Company's investments in the subsidiaries and (c) record consolidating entries; and
- v. Advanced Medical Optics, Inc. and subsidiaries on a consolidated basis.

Each entity in the consolidating financial information follows the same accounting policies as described in the consolidated financial statements, except for the use by the Parent Company and Guarantor Subsidiaries of the equity method of accounting to reflect ownership interests in subsidiaries which are eliminated upon consolidation.



**Table of Contents****Condensed Consolidating Balance Sheet**

| September 26, 2008 (in thousands)                 | Parent<br>Company   | Guarantor<br>Subsidiaries | Non-<br>Guarantor<br>Subsidiaries | Consolidating<br>Entries and<br>Eliminations | Consolidated        |
|---|---------------------|---------------------------|-----------------------------------|--|---------------------|
| <b>Assets:</b>                                    |                     |                           |                                   |  |                     |
| Cash and equivalents                              | \$ 1,496            | \$ 3,423                  | \$ 30,035                         | \$   | \$ 34,954           |
| Trade receivables, net                            | 152                 | 72,483                    | 178,929                           |  | 251,564             |
| Inventories                                       | 4,582               | 152,445                   | 131,710                           | (96,114)                                     | 192,623             |
| Other current assets                              | 42,267              | 411,398                   | 33,845                            | (422,055)                                    | 65,455              |
| <b>Total current assets</b>                       | <b>48,497</b>       | <b>639,749</b>            | <b>374,519</b>                    | <b>(518,169)</b>                             | <b>544,596</b>      |
| Property, plant and equipment                     | 13,859              | 27,967                    | 130,605                           |  | 172,431             |
| Goodwill and intangibles, net                     | 29,673              | 1,394,441                 | 495,012                           | (32,200)                                     | 1,886,926           |
| Other assets                                      | 163,196             | 26,122                    | 50,169                            | (137,906)                                    | 101,581             |
| Investments in subsidiaries                       | 2,600,467           | 3,697,670                 | 2,302,157                         | (8,600,294)                                  |                     |
| <b>Total assets</b>                               | <b>\$ 2,855,692</b> | <b>\$ 5,785,949</b>       | <b>\$ 3,352,462</b>               | <b>\$ (9,288,569)</b>                        | <b>\$ 2,705,534</b> |
| <b>Liabilities and stockholders' equity:</b>      |                     |                           |                                   |  |                     |
| Short-term debt                                   | \$ 4,500            | \$                        | \$                                | \$   | \$ 4,500            |
| Accounts payable and accrued expenses             | 393,152             | 69,713                    | 178,877                           | (394,319)                                    | 247,423             |
| <b>Total current liabilities</b>                  | <b>397,652</b>      | <b>69,713</b>             | <b>178,877</b>                    | <b>(394,319)</b>                             | <b>251,923</b>      |
| Long-term debt, net of current portion            | 1,540,980           |                           |                                   |  | 1,540,980           |
| Other liabilities                                 | 266,449             | 52,701                    | 80,085                            | (137,215)                                    | 262,020             |
| <b>Total liabilities</b>                          | <b>2,205,081</b>    | <b>122,414</b>            | <b>258,962</b>                    | <b>(531,534)</b>                             | <b>2,054,923</b>    |
| <b>Total stockholders' equity</b>                 | <b>650,611</b>      | <b>5,663,535</b>          | <b>3,093,500</b>                  | <b>(8,757,035)</b>                           | <b>650,611</b>      |
| <b>Total liabilities and stockholders' equity</b> | <b>\$ 2,855,692</b> | <b>\$ 5,785,949</b>       | <b>\$ 3,352,462</b>               | <b>\$ (9,288,569)</b>                        | <b>\$ 2,705,534</b> |

**Condensed Consolidating Balance Sheet**

| December 31, 2007 (in thousands)               | Parent<br>Company   | Guarantor<br>Subsidiaries | Non-<br>Guarantor<br>Subsidiaries | Consolidating<br>Entries and<br>Eliminations | Consolidated        |
|--|---------------------|---------------------------|-----------------------------------|--|---------------------|
| <b>Assets:</b>                                 |                     |                           |                                   |  |                     |
| Cash and equivalents                           | \$ 236              | \$ 2,031                  | \$ 32,258                         | \$   | \$ 34,525           |
| Trade receivables, net                         | 2,084               | 89,008                    | 158,926                           |  | 250,018             |
| Inventories                                    | 7,301               | 141,651                   | 107,900                           | (96,585)                                     | 160,267             |
| Other current assets                           | 38,370              | 312,884                   | 30,953                            | (303,906)                                    | 78,301              |
| <b>Total current assets</b>                    | <b>47,991</b>       | <b>545,574</b>            | <b>330,037</b>                    | <b>(400,491)</b>                             | <b>523,111</b>      |
| Property, plant and equipment, net             | 14,021              | 31,998                    | 131,656                           |  | 177,675             |
| Goodwill and intangibles, net                  | 29,673              | 1,432,099                 | 520,786                           | (44,068)                                     | 1,938,490           |
| Other assets                                   | 158,899             | 32,956                    | 49,097                            | (131,892)                                    | 109,060             |
| Investments in subsidiaries                    | 2,520,217           | 2,694,404                 | 2,270,788                         | (7,485,409)                                  |                     |
| <b>Total assets</b>                            | <b>\$ 2,770,801</b> | <b>\$ 4,737,031</b>       | <b>\$ 3,302,364</b>               | <b>\$ (8,061,860)</b>                        | <b>\$ 2,748,336</b> |
| <b>Liabilities and stockholders' equity:</b>   |                     |                           |                                   |  |                     |
| Short-term borrowings                          | \$ 64,500           | \$                        | \$                                | \$   | \$ 64,500           |
| Accounts payable and other current liabilities | 298,626             | 84,075                    | 256,442                           | (361,049)                                    | 278,094             |
| <b>Total current liabilities</b>               | <b>363,126</b>      | <b>84,075</b>             | <b>256,442</b>                    | <b>(361,049)</b>                             | <b>342,594</b>      |
| Long-term debt, net of current portion         | 1,543,230           |                           |                                   |  | 1,543,230           |

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|   |              |              |              |                |              |
|---|--------------|--------------|--------------|----------------|--------------|
| Other liabilities                         | 265,709      | 50,664       | 78,605       | (131,202)      | 263,776      |
| Total liabilities                         | 2,172,065    | 134,739      | 335,047      | (492,251)      | 2,149,600    |
| Total stockholders equity                 | 598,736      | 4,602,292    | 2,967,317    | (7,569,609)    | 598,736      |
| Total liabilities and stockholders equity | \$ 2,770,801 | \$ 4,737,031 | \$ 3,302,364 | \$ (8,061,860) | \$ 2,748,336 |

**Table of Contents****Condensed Consolidating Statement of Operations****Three months ended September 26, 2008**

| (in thousands)                       | Parent<br>Company | Guarantor<br>Subsidiaries | Non-<br>Guarantor<br>Subsidiaries | Consolidating<br>Entries and<br>Eliminations | Consolidated |
|--------------------------------------|-------------------|---------------------------|-----------------------------------|--|--------------|
| Net sales                            | \$ 31,620         | \$ 168,651                | \$ 250,070                        | \$ (174,706)                                 | \$ 275,635   |
| Operating costs and expenses:        |                   |                           |                                   |  |              |
| Cost of sales                        | 23,249            | 156,840                   | 156,432                           | (225,951)                                    | 110,570      |
| Selling, general and administrative  | 30,329            | 45,009                    | 43,863                            | (1,102)                                      | 118,099      |
| Research and development             | 17,850            | 9,709                     | (10,683)                          |  | 16,876       |
| Restructuring Charges                | (768)             | 1,330                     | 2,885                             |  | 3,447        |
| Operating (loss) income              | (39,040)          | (44,237)                  | 57,573                            | 52,347                                       | 26,643       |
| Non-operating (income) expense, net  | (17,446)          | (49,279)                  | (8,725)                           | 90,685                                       | 15,235       |
| Equity in earnings of subsidiaries   | (23,907)          | (58,143)                  |                                   | 82,050                                       |              |
| Earnings before income taxes         | 2,313             | 63,185                    | 66,298                            | (120,388)                                    | 11,408       |
| (Benefit) provision for income taxes | (4,760)           | 4,352                     | 4,743                             |  | 4,335        |
| Net earnings                         | \$ 7,073          | \$ 58,833                 | \$ 61,555                         | \$ (120,388)                                 | \$ 7,073     |

**Condensed Consolidating Statement of Operations****Three months ended September 28, 2007**

| (in thousands)                              | Parent<br>Company | Guarantor<br>Subsidiaries | Non-<br>Guarantor<br>Subsidiaries | Consolidating<br>Entries and<br>Eliminations | Consolidated |
|---|-------------------|---------------------------|-----------------------------------|--|--------------|
| Net sales                                   | \$ 64,660         | \$ 187,402                | \$ 208,564                        | \$ (187,432)                                 | \$ 273,194   |
| Operating costs and expenses:               |                   |                           |                                   |  |              |
| Cost of sales                               | 54,244            | 112,293                   | 139,508                           | (185,015)                                    | 121,030      |
| Selling, general and administrative         | 21,093            | 52,240                    | 66,224                            | (1,641)                                      | 137,916      |
| Research and development                    | 5,439             | 7,467                     | 8,069                             |  | 20,975       |
| Operating (loss) income                     | (16,116)          | 15,402                    | (5,237)                           | (776)  | (6,727)      |
| Non-operating expense (income), net         | 51,512            | (26,875)                  | (405)                             | 306  | 24,538       |
| Equity in (earnings) losses of subsidiaries | (26,305)          | 5,469                     |                                   | 20,836                                       |              |
| (Loss) earnings before income taxes         | (41,323)          | 36,808                    | (4,832)                           | (21,918)                                     | (31,265)     |
| (Benefit) provision for income taxes        | (15,386)          | 10,900                    | (842)                             |  | (5,328)      |
| Net loss                                    | \$ (25,937)       | \$ 25,908                 | \$ (3,990)                        | \$ (21,918)                                  | \$ (25,937)  |

**Table of Contents****Condensed Consolidating Statement of Operations**

Nine months ended September 26, 2008

| (in thousands)                      | Parent<br>Company | Guarantor<br>Subsidiaries | Non-<br>Guarantor<br>Subsidiaries | Consolidating<br>Entries and<br>Eliminations | Consolidated |
|-------------------------------------|-------------------|---------------------------|-----------------------------------|--|--------------|
| Net sales                           | \$ 115,469        | \$ 556,342                | \$ 810,031                        | \$ (581,979)                                 | \$ 899,863   |
| Operating costs and expenses:       |                   |                           |                                   |  |              |
| Cost of sales                       | 75,599            | 413,177                   | 511,636                           | (650,974)                                    | 349,438      |
| Selling, general and administrative | 69,603            | 134,550                   | 175,603                           | (3,688)                                      | 376,068      |
| Research and development            | 29,160            | 20,185                    | 6,849                             |  | 56,194       |
| Restructuring charges               | 7,635             | 7,697                     | 9,200                             |  | 24,532       |
| Net gain on legal contingencies     | (8,812)           |                           | (11,680)                          |  | (20,492)     |
| Operating (loss) income             | (57,716)          | (19,267)                  | 118,423                           | 72,683                                       | 114,123      |
| Non-operating expense (income)      | 13,936            | (52,388)                  | (40,736)                          | 135,311                                      | 56,123       |
| Equity in earnings of subsidiaries  | (112,979)         | (136,495)                 |                                   | 249,474                                      |              |
| Earnings before income taxes        | 41,327            | 169,616                   | 159,159                           | (312,102)                                    | 58,000       |
| Provision for income taxes          | 5,367             | 5,603                     | 11,070                            |  | 22,040       |
| Net earnings                        | \$ 35,960         | \$ 164,013                | \$ 148,089                        | \$ (312,102)                                 | \$ 35,960    |

**Condensed Consolidating Statement of Operations**

Nine months ended September 28, 2007

| (in thousands)                       | Parent<br>Company | Guarantor<br>Subsidiaries | Non-<br>Guarantor<br>Subsidiaries | Consolidating<br>Entries and<br>Eliminations | Consolidated |
|--------------------------------------|-------------------|---------------------------|-----------------------------------|--|--------------|
| Net sales                            | \$ 175,504        | \$ 530,909                | \$ 595,360                        | \$ (515,509)                                 | \$ 786,264   |
| Operating costs and expenses:        |                   |                           |                                   |  |              |
| Cost of sales                        | 127,167           | 336,836                   | 397,966                           | (513,286)                                    | 348,683      |
| Selling, general and administrative  | 61,069            | 143,989                   | 197,465                           | (5,387)                                      | 397,136      |
| Research and development             | 14,106            | 18,072                    | 28,641                            |  | 60,819       |
| In-process research and development  |                   | 86,980                    |                                   |  | 86,980       |
| Operating loss                       | (26,838)          | (54,968)                  | (28,712)                          | 3,164  | (107,354)    |
| Non-operating expense (income), net  | 81,790            | (75,951)                  | 47,765                            | 2,180  | 55,784       |
| Equity in losses of subsidiaries     | 128,007           | 94,614                    |                                   | (222,621)                                    |              |
| Loss before income taxes             | (236,635)         | (73,631)                  | (76,477)                          | 223,605                                      | (163,138)    |
| (Benefit) provision for income taxes | (56,013)          | 55,150                    | 18,347                            |  | 17,484       |
| Net loss                             | \$ (180,622)      | \$ (128,781)              | \$ (94,824)                       | \$ 223,605                                   | \$ (180,622) |

**Table of Contents****Condensed Consolidating Statement of Cash Flows**

Nine months ended September 26, 2008

| (in thousands)                                      | Parent<br>Company | Guarantor<br>Subsidiaries | Non-<br>Guarantor<br>Subsidiaries | Consolidating<br>Entries and<br>Eliminations | Consolidated |
|---|-------------------|---------------------------|-----------------------------------|--|--------------|
| Net cash provided by operating activities           | \$ 60,920         | \$ 22,751                 | \$ 5,150                          | \$   | \$ 88,821    |
| Cash flows from investing activities                |                   |                           |                                   |  |              |
| Capital contribution                                | (114)             | (14,818)                  |                                   | 14,932                                       |              |
| Acquisition of business, net of cash acquired       |                   | (77)                      |                                   |  | (77)         |
| Additions to property, plant and equipment          | (2,229)           | (5,267)                   | (9,482)                           |  | (16,978)     |
| Proceeds from sale of property, plant and equipment |                   |                           | 615                               |  | 615          |
| Proceeds from sale of investment                    | 3,318             | 1,099                     |                                   |  | 4,417        |
| Additions to software and other long-lived assets   | (733)             | (18)                      | (19)                              |  | (770)        |
| Additions to demonstration and bundled equipment    |                   | (2,392)                   | (7,552)                           |  | (9,944)      |
| Net cash provided by (used in) investing activities | 242               | (21,473)                  | (16,438)                          | 14,932                                       | (22,737)     |
| Cash flows from financing activities                |                   |                           |                                   |  |              |
| Capital contribution                                |                   | 114                       | 14,818                            | (14,932)                                     |              |
| Repayment of short-term borrowings, net             | (60,000)          |                           |                                   |  | (60,000)     |
| Repayment of long-term debt                         | (2,250)           |                           |                                   |  | (2,250)      |
| Payment of financing-related costs                  | (2,763)           |                           |                                   |  | (2,763)      |
| Proceeds from issuance of common stock              | 5,111             |                           |                                   |  | 5,111        |
| Net cash (used in) provided by financing activities | (59,902)          | 114                       | 14,818                            | (14,932)                                     | (59,902)     |
| Effect of exchange rates on cash and equivalents    |                   |                           | (5,753)                           |  | (5,753)      |
| Net increase (decrease) in cash and equivalents     | 1,260             | 1,392                     | (2,223)                           |  | 429          |
| Cash and equivalents at beginning of period         | 236               | 2,031                     | 32,258                            |  | 34,525       |
| Cash and equivalents at end of period               | \$ 1,496          | \$ 3,423                  | \$ 30,035                         | \$   | \$ 34,954    |

**Condensed Consolidating Statement of Cash Flows**

Nine months ended September 28, 2007

| (in thousands)                                      | Parent<br>Company | Guarantor<br>Subsidiaries | Non-<br>Guarantor<br>Subsidiaries | Consolidating<br>Entries and<br>Eliminations | Consolidated |
|---|-------------------|---------------------------|-----------------------------------|--|--------------|
| Net cash provided by (used in) operating activities | \$ 95,274         | \$ (23,214)               | \$ (40,353)                       | \$   | \$ 31,707    |
| Cash flows from investing activities:               |                   |                           |                                   |  |              |
| Capital contribution                                | (838,742)         | (66,925)                  |                                   | 905,667                                      |              |
| Acquisition of business, net of cash acquired       |                   | (737,773)                 |                                   |  | (737,773)    |
| Additions to property, plant and equipment          | (1,200)           | (4,827)                   | (18,214)                          |  | (24,241)     |
| Proceeds from sale of property, plant and equipment |                   | 2                         | 749                               |  | 751          |
| Additions to software and other long-lived assets   | (2,204)           | (3,149)                   | (38)                              |  | (5,391)      |
| Additions to demonstration and bundled equipment    |                   | (1,424)                   | (4,904)                           |  | (6,328)      |
| Net cash used in investing activities               | (842,146)         | (814,096)                 | (22,407)                          | 905,667                                      | (772,982)    |
| Cash flows from financing activities:               |                   |                           |                                   |  |              |
| Capital contribution                                |                   | 838,742                   | 66,925                            | (905,667)                                    |              |

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|  |          |          |           |           |           |
|--|----------|----------|-----------|-----------|-----------|
| Proceeds from short-term borrowings, net         | 51,000   |          |           |           | 51,000    |
| Repayment of long-term debt                      | (2,250)  |          |           |           | (2,250)   |
| Payments of financing-related cost               | (15,386) |          |           |           | (15,386)  |
| Proceeds from issuance of long-term debt         | 695,500  |          |           |           | 695,500   |
| Proceeds from issuance of common stock           | 18,651   |          |           |           | 18,651    |
| Repurchase of treasury stock                     | (64)     |          |           |           | (64)      |
| Net cash provided by financing activities        | 747,451  | 838,742  | 66,925    | (905,667) | 747,451   |
| Effect of exchange rates on cash and equivalents |          |          | (4,149)   |           | (4,149)   |
| Net increase in cash and equivalents             | 579      | 1,432    | 16        |           | 2,027     |
| Cash and equivalents at beginning of period      | 344      | 1,187    | 32,991    |           | 34,522    |
| Cash and equivalents at end of period            | \$ 923   | \$ 2,619 | \$ 33,007 | \$        | \$ 36,549 |



**Table of Contents****Note 5: Fair Value Measurement**

The Company enters into foreign exchange option and forward contracts to reduce earnings and cash flow volatility associated with foreign exchange rate changes to allow management to focus its attention on its core business operations. Accordingly, the Company enters into contracts that change in value as foreign exchange rates change to economically offset the effect of changes in foreign currency on the Company's assets and liabilities, commitments and anticipated foreign currency denominated sales and operating expenses. The Company enters into foreign exchange option and forward contracts in amounts between minimum and maximum anticipated foreign exchange exposures, generally for periods not to exceed one year. These derivative instruments are not designated as accounting hedges. The Company does not enter into speculative derivative transactions.

The Company uses foreign currency option contracts, which provide for the sale of foreign currencies to offset foreign currency exposures expected to arise in the normal course of the Company's business. While these instruments are subject to fluctuations in value, such fluctuations are anticipated to offset changes in the value of the underlying exposures. The principal currencies subject to this process are the Japanese yen and the euro. The foreign exchange forward contracts are entered into to protect the value of foreign currency denominated monetary assets and liabilities and the changes in the fair value of the foreign exchange forward contracts are economically designed to offset the changes in the revaluation of the foreign currency denominated monetary assets and liabilities. These forward contracts are denominated in currencies that represent material exposures. The changes in the fair value of foreign currency option and forward contracts are recorded through earnings as Unrealized (gain) loss on derivative instruments, while any realized gains or losses on expired contracts are recorded through earnings as Other, net in the accompanying consolidated statements of operations. Any premium cost of purchased foreign exchange option contracts is recorded in Other current assets and amortized over the life of the options.

As described in Note 1, the Company adopted SFAS No. 157 effective January 1, 2008. SFAS No. 157 expands disclosure for each major asset and liability category measured at fair value on either a recurring or nonrecurring basis.

SFAS No. 157 establishes a three-tier fair value hierarchy, which prioritizes the inputs used in measuring fair value as follows: (Level 1) observable inputs such as quoted prices in active markets; (Level 2) inputs, other than the quoted prices in active markets, that are observable either directly or indirectly; and (Level 3) unobservable inputs in which there are little or no market data, which require the reporting entity to develop its own assumptions.

Assets and liabilities measured at fair value are based on one or more of three valuation techniques described in SFAS No. 157. Valuation techniques utilized for each individual asset and liability category are referenced in the tables below. Where more than one technique is noted, individual assets or liabilities were valued using multiple techniques. The valuation techniques are as follows:

- (a) Market approach Prices and other relevant information generated by market transactions involving identical or comparable assets or liabilities;
- (b) Income approach Techniques to convert future amounts to a single present amount based on market expectations (including present value techniques, option-pricing and excess earnings models); and
- (c) Cost approach Amount that would be required to replace the service capacity of an asset (replacement cost).

Assets and liabilities measured at fair value as of September 26, 2008 on a recurring basis are as follows:

| (in millions)                               | Assets<br>Significant<br>other<br>observable<br>inputs<br>(Level 2) | Liabilities<br>Significant<br>other<br>observable<br>inputs<br>(Level 2) | Valuation<br>Technique |
|---|---|--|------------------------|
| Foreign currency option contracts           | \$ 0.1  | \$   | (a)                    |
| Foreign currency forward exchange contracts |   |  | (a)                    |

There were no changes in the valuation techniques used to measure asset or liability fair values on a recurring basis in the nine months ended September 26, 2008.

**Table of Contents****Note 6: Earnings (Loss) Per Share**

Basic earnings (loss) per share is calculated by dividing net earnings (loss) by the weighted average number of common shares outstanding during the period. Diluted earnings per share is calculated by adjusting net earnings (loss) and the weighted average outstanding shares, assuming the conversion of all potentially dilutive convertible securities, stock options and stock purchase plan awards.

For the three and nine months ended September 26, 2008, the Company included the dilutive effect of stock options, Employee Stock Purchase Plans ( ESPP ) and unvested restricted stock of approximately 2.1 million shares and 1.9 million shares, respectively. For the three and nine months ended September 26, 2008, there were 6.6 million and 5.5 million antidilutive stock options excluded from the computation of dilutive shares outstanding, respectively. The three and nine months ended September 28, 2007 exclude the aggregate dilutive effect of approximately 1.9 million and 2.2 million shares, respectively, for stock options, ESPP and unvested restricted stock as the effect would be antidilutive due to the net loss in each of these periods. For all periods presented, there were no potentially diluted common shares associated with the 2 1/2% Notes, the 1.375% Notes and the 3.25% Notes as the Company's quarter-end stock price was less than the conversion prices of the notes.

**Note 7: Common Stock**

AMO has an Incentive Compensation Plan ( ICP ) and a Stock Incentive Plan ( SIP ) that provide for the granting of stock options, restricted stock and restricted stock units to directors, employees and consultants. The Company has two ESPPs for United States and international employees, respectively, which allow employees to purchase AMO common stock. A total of 5 million shares of common stock have been authorized for issuance under the ICP and approximately 2 million shares of common stock have been authorized for issuance under the SIP after April 2, 2007, the date the SIP was assumed following the IntraLase acquisition.

*Share-Based Compensation Expense*

Total share-based compensation expense included in the unaudited consolidated statements of operations for the three and nine months ended September 26, 2008 and September 28, 2007 was as follows (in thousands):

|                                     | Three Months Ended |                    | Nine Months Ended  |                    |
|-------------------------------------|--------------------|--------------------|--------------------|--------------------|
|                                     | September 26, 2008 | September 28, 2007 | September 26, 2008 | September 28, 2007 |
| Cost of sales                       | \$ 571             | \$ 607             | \$ 1,496           | \$ 1,771           |
| Operating Expenses                  |                    |                    |                    |                    |
| Research and development            | 732                | 849                | 2,309              | 2,148              |
| Selling, general and administrative | 4,632              | 4,209              | 13,419             | 11,585             |
| Restructuring charges               | 287                |                    | 1,090              |                    |
|                                     | 5,651              | 5,058              | 16,818             | 13,733             |
| Pre-tax expense                     | 6,222              | 5,665              | 18,314             | 15,504             |
| Income tax benefit                  | (2,105)            | (1,878)            | (6,103)            | (4,960)            |
| After tax expense                   | \$ 4,117           | \$ 3,787           | \$ 12,211          | \$ 10,544          |

Approximately \$0.3 million and \$1.1 million of pre-tax share-based compensation expense was included in restructuring charges in the unaudited consolidated statements of operations for the three and nine months ended September 26, 2008, respectively, due to acceleration of vesting of certain awards in connection with the restructuring.

*Stock Options*

Stock options granted to employees are exercisable at a price equal to the fair market value of the common stock on the date of the grant and generally vest at a rate of 25% per year beginning twelve months after the date of grant. Grants under these plans expire ten years from the date of grant.

The Company issues new shares to satisfy option exercises.

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The following is a summary of stock option activity (in thousands, except per share amounts):

|   | Number of<br>Shares | Weighted<br>Average<br>Exercise Price |
|---|---------------------|---------------------------------------|
| Outstanding at December 31, 2007                  | 7,518               | \$ 27.95                              |
| Granted   | 1,452               | 22.93                                 |
| Exercised   | (213)               | 10.49                                 |
| Forfeitures, cancellations and expirations        | (258)               | 36.14                                 |
| Outstanding at September 26, 2008                 | 8,499               | \$ 27.29                              |
| Vested and expected to vest at September 26, 2008 | 8,236               | \$ 27.11                              |
| Exercisable at September 26, 2008                 | 5,817               | \$ 25.37                              |

**Note 8: Comprehensive Income (Loss)**

The following tables summarize the components of comprehensive income (loss) (in thousands):

|  | Three Months Ended   |               |                      |                      |               |                      |
|--|----------------------|---------------|----------------------|----------------------|---------------|----------------------|
|  | September 26, 2008   |               |                      | September 28, 2007   |               |                      |
|  | Before-tax<br>amount | Income<br>tax | Net-of-tax<br>amount | Before-tax<br>amount | Income<br>Tax | Net-of-tax<br>amount |
| Foreign currency translation adjustments | \$ (51,331)          | \$            | \$ (51,331)          | \$ 30,378            | \$            | \$ 30,378            |
| Net earnings (loss)                      |                      |               | 7,073                |                      |               | (25,937)             |
| Total comprehensive (loss) income        |                      |               | \$ (44,258)          |                      |               | \$ 4,441             |

|  | Nine Months Ended    |               |                      |                      |               |                      |
|--|----------------------|---------------|----------------------|----------------------|---------------|----------------------|
|  | September 26, 2008   |               |                      | September 28, 2007   |               |                      |
|  | Before-tax<br>amount | Income<br>tax | Net-of-tax<br>amount | Before-tax<br>amount | Income<br>Tax | Net-of-tax<br>amount |
| Foreign currency translation adjustments | \$ (12,174)          | \$            | \$ (12,174)          | \$ 36,822            | \$            | \$ 36,822            |
| Net earnings (loss)                      |                      |               | 35,960               |                      |               | (180,622)            |
| Total comprehensive income (loss)        |                      |               | \$ 23,786            |                      |               | \$ (143,800)         |

**Note 9: Business Segment Information**

The operating segments are segments for which separate financial information is available and upon which operating results are evaluated on a timely basis to assess performance and to allocate resources.

The Company's reportable segments reflect the way it currently manages its business. These reportable segments are represented by three business units: cataract, refractive and eye care. The cataract business sells monofocal intraocular lenses, phacoemulsification systems, viscoelastics and related products used in ocular surgery. The refractive business sells and provides service for wavefront diagnostic devices, femtosecond lasers and associated patient interface devices, excimer laser systems and treatment cards, and refractive implants. The eye care business sells disinfecting solutions, enzymatic cleaners, lens rewetting drops and artificial tears. Effective January 1, 2008, net sales of refractive implant products and the related impact on operating income are reported in the refractive business segment. Prior to 2008, refractive implant products were included in the cataract business segment. Accordingly, net sales and the impact on operating income attributable to refractive implant products in the three and nine months ended September 28, 2007 have been reclassified from the cataract to refractive

business segments to conform to the new presentation.

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The Company evaluates segment performance based on operating income, excluding certain costs such as business repositioning and restructuring costs, acquisition-related costs and stock-based compensation expense. Research and development costs, manufacturing operations and related variances, inventory provision/repricing costs and supply chain costs are managed on a global basis and are considered corporate costs. The Company presents segment information, which management believes is determined in accordance with measurement principles that are consistent with those used in the corresponding amounts in the consolidated financial statements. Because operating segments are generally defined by the products each segment manufactures and sells, they do not generally make sales to each other. Depreciation and amortization related to the manufacturing of goods, excluding amortization of intangible assets, is included in the operating income of the Company's reportable segments. The Company does not discretely allocate assets to its operating segments, nor does the Company's chief operating decision maker evaluate operating segments using discrete asset information.

**Business Segments**

| (In thousands)           | Net Sales                                   |                       | Operating Income (Loss)                     |                       |
|--------------------------|---|-----------------------|---|-----------------------|
|                          | Three Months Ended<br>September 26,<br>2008 | September 28,<br>2007 | Three Months Ended<br>September 26,<br>2008 | September 28,<br>2007 |
| Operating segments:      |   |                       |   |                       |
| Cataract                 | \$ 129,441                                  | \$ 118,888            | \$ 70,558                                   | \$ 61,142             |
| Refractive               | 96,003                                      | 112,149               | 59,054                                      | 68,858                |
| Eye Care                 | 50,191                                      | 42,157                | 15,999                                      | 715                   |
| Total segments           | 275,635                                     | 273,194               | 145,611                                     | 130,715               |
| Global operations        |   |                       | (43,277)                                    | (55,053)              |
| Research and development |   |                       | (16,876)                                    | (20,975)              |
| Restructuring charges    |   |                       | (3,447)                                     |                       |
| General corporate        |   |                       | (55,368)                                    | (61,414)              |
| Total                    | \$ 275,635                                  | \$ 273,194            | \$ 26,643                                   | \$ (6,727)            |

| (In thousands)                      | Net Sales                                  |                       | Operating Income (Loss)                    |                       |
|-------------------------------------|--|-----------------------|--|-----------------------|
|                                     | Nine Months Ended<br>September 26,<br>2008 | September 28,<br>2007 | Nine Months Ended<br>September 26,<br>2008 | September 28,<br>2007 |
| Operating segments:                 |  |                       |  |                       |
| Cataract                            | \$ 398,257                                 | \$ 359,553            | \$ 212,465                                 | \$ 188,067            |
| Refractive                          | 334,781                                    | 306,207               | 200,946                                    | 188,233               |
| Eye Care                            | 166,825                                    | 120,504               | 56,472                                     | (4,448)               |
| Total segments                      | 899,863                                    | 786,264               | 469,883                                    | 371,852               |
| Global operations                   |  |                       | (130,763)                                  | (147,372)             |
| Research and development            |  |                       | (56,194)                                   | (60,819)              |
| In-process research and development |  |                       |  | (86,980)              |
| Restructuring charges               |  |                       | (24,532)                                   |                       |
| General corporate                   |  |                       | (144,271)                                  | (184,035)             |
| Total                               | \$ 899,863                                 | \$ 786,264            | \$ 114,123                                 | \$ (107,354)          |

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| (In thousands)                                 | Net Sales                                   |   |  |  |
|--|---|---|--|--|
|  | Three Months Ended<br>September 26,<br>2008 | Three Months Ended<br>September 28,<br>2007 | Nine Months Ended<br>September 26,<br>2008 | Nine Months Ended<br>September 28,<br>2007 |
| <b>United States:</b>                          |   |   |  |  |
| Cataract                                       | \$ 39,565                                   | \$ 37,468                                   | \$ 111,945                                 | \$ 107,446                                 |
| Refractive                                     | 45,725                                      | 69,036                                      | 182,295                                    | 204,330                                    |
| Eye Care                                       | 14,285                                      | 8,991                                       | 43,665                                     | 31,347                                     |
| <b>Total United States</b>                     | <b>99,575</b>                               | <b>115,495</b>                              | <b>337,905</b>                             | <b>343,123</b>                             |
| <b>Americas, excluding United States:</b>      |   |   |  |  |
| Cataract                                       | 10,074                                      | 9,178                                       | 31,022                                     | 27,508                                     |
| Refractive                                     | 4,738                                       | 5,494                                       | 15,064                                     | 13,459                                     |
| Eye Care                                       | 1,322                                       | (77)  | 4,295                                      | 2,815                                      |
| <b>Total Americas, excluding United States</b> | <b>16,134</b>                               | <b>14,595</b>                               | <b>50,381</b>                              | <b>43,782</b>                              |
| <b>Europe/Africa/Middle East:</b>              |   |   |  |  |
| Cataract                                       | 47,212                                      | 42,816                                      | 161,165                                    | 142,019                                    |
| Refractive                                     | 19,143                                      | 18,158                                      | 65,138                                     | 47,355                                     |
| Eye Care                                       | 17,600                                      | 14,224                                      | 55,654                                     | 44,930                                     |
| <b>Total Europe/Africa/Middle East</b>         | <b>83,955</b>                               | <b>75,198</b>                               | <b>281,957</b>                             | <b>234,304</b>                             |
| <b>Japan:</b>                                  |   |   |  |  |
| Cataract                                       | 19,610                                      | 17,469                                      | 55,999                                     | 47,843                                     |
| Refractive                                     | 15,618                                      | 9,121                                       | 39,222                                     | 16,789                                     |
| Eye Care                                       | 11,011                                      | 14,562                                      | 41,792                                     | 34,863                                     |
| <b>Total Japan</b>                             | <b>46,239</b>                               | <b>41,152</b>                               | <b>137,013</b>                             | <b>99,495</b>                              |
| <b>Asia Pacific:</b>                           |   |   |  |  |
| Cataract                                       | 12,980                                      | 11,957                                      | 38,126                                     | 34,737                                     |
| Refractive                                     | 10,779                                      | 10,340                                      | 33,062                                     | 24,274                                     |
| Eye Care                                       | 5,973                                       | 4,457                                       | 21,419                                     | 6,549                                      |
| <b>Total Asia Pacific</b>                      | <b>29,732</b>                               | <b>26,754</b>                               | <b>92,607</b>                              | <b>65,560</b>                              |
| <b>Total</b>                                   | <b>\$ 275,635</b>                           | <b>\$ 273,194</b>                           | <b>\$ 899,863</b>                          | <b>\$ 786,264</b>                          |

The United States information is presented separately as it is the Company's headquarters country, and U.S. sales represented 36.1% and 37.6% of total net sales for the three and nine months ended September 26, 2008, respectively, and 42.3% and 43.6% of total net sales for the three and nine months ended September 28, 2007, respectively. Additionally, sales in Japan represented 16.8% and 15.2% of total net sales for the three and nine months ended September 26, 2008, respectively, and 15.1% and 12.7% of total net sales for the three and nine months ended September 28, 2007, respectively. No other country, or single customer, generated over 10% of total net sales in the periods presented.

**Note 10: Commitments and Contingencies***Product Recall*



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In May 2007, the Company initiated a global recall of the *Complete MoisturePlus* multipurpose formulation (the 2007 Recall ) after being informed by the U.S. Food and Drug Administration of an association with acanthamoeba keratitis. The 2007 Recall resulted in the following charges during the year ended December 31, 2007: a provision for sales returns of \$41.5 million and charges totaling \$67.5 million, which comprised \$37.5 million in costs of goods sold for impairment of inventory and distribution costs, \$29.7 million in selling, general and administrative costs associated with public relations, communication, investigation, processing and handling of

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distributor and end-customer reimbursements and \$0.3 million in research and development costs. As of September 26, 2008, the Company had approximately \$2.3 million in accrued liabilities and \$0.7 million in accrued sales returns associated with the 2007 Recall.

Management continues to review its estimates of the overall recall costs, which could result in additional charges in the future.

On August 24, 2007 and September 13, 2007, two purported class action complaints were filed by Scott Kairalla and Barry Galison (the Galison case), respectively, in the U.S. District Court of the Central District of California on behalf of purchasers of our securities between January 4 and May 25, 2007. The Galison case was dismissed without prejudice on November 20, 2007. An amended consolidated complaint was filed on January 18, 2008 (the Consolidated Complaint). The Consolidated Complaint alleges claims under the Securities Exchange Act of 1934 against the Company and certain of its officers and directors. The Consolidated Complaint alleges that the Company made material misrepresentations concerning the Company's *Complete MoisturePlus* product. The Company filed a motion to dismiss the Consolidated Complaint on February 29, 2008 on behalf of all defendants. On June 6, 2008, the Court granted AMO's motion, dismissed the Consolidated Complaint without prejudice, and granted plaintiffs leave to amend on or before July 7, 2008. Rather than file an amended complaint, Plaintiffs agreed to voluntarily dismiss the Consolidated Complaint and the case was dismissed with prejudice on July 11, 2008.

As of September 26, 2008, the Company has been served or is aware that it has been named as a defendant in approximately 146 product liability lawsuits pending in various state and federal courts within the U.S. as well as certain jurisdictions outside the U.S. in relation to the 2007 Recall. These suits involve allegations of personal injury to 174 consumers. Of these 146 cases, 127 have been filed in various U.S. courts, 13 in Canada and two in jurisdictions outside North America. None of the U.S. personal injury actions have been filed as purported class actions; however, ten of the Canadian personal injury matters seek class action status. In addition to personal injury suits, three U.S. and four Canadian matters have been filed as purported class actions by uninjured consumers seeking reimbursement for discarded product pursuant to various consumer protection statutes.

These cases involve complex medical and scientific issues relating to both liability and damages. Moreover, most of the plaintiffs seek unspecified damages. Because of this, and because these types of suits are inherently unpredictable, the Company is unable at this time to predict the outcome of these matters. The Company intends to vigorously defend itself in these matters; however, litigation may be both time-consuming and disruptive to the Company's operations and cause significant expense and diversion of management attention, regardless of the merits of the cases. In recognition of these considerations, the Company could enter into settlements or incur judgments that, individually or in the aggregate, could have a material adverse impact on its financial condition, results of operations or cash flows in any such period.

While the Company is involved from time to time in litigation arising in the ordinary course of business, including product liability claims, the Company is not currently aware of any other actions against it or Allergan, Inc. (Allergan) relating to the optical medical device business that it believes would have a material adverse effect on its business, financial condition, results of operations or cash flows. The Company may be subject to future litigation and infringement claims, which could cause it to incur significant expenses or prevent it from selling its products. The Company operates in an industry susceptible to significant product liability claims. Product liability claims may be asserted against it in the future arising out of the 2007 Recall and/or events not known to it at the present time. Under the terms of the contribution and distribution agreement affecting the Company's spin-off from Allergan, Allergan agreed to assume responsibility for, and to indemnify it against, all current and future litigation relating to its retained businesses and the Company agreed to assume responsibility for, and to indemnify Allergan against, all current and future litigation related to the optical medical device business.

**Table of Contents****Note 11: Pension Benefit Plans**

The Company sponsors defined benefit pension plans in Japan and in certain European countries. Components of net periodic benefit cost under these plans were (in thousands):

|   | Three Months Ended    |                       | Nine months Ended     |                       |
|---|-----------------------|-----------------------|-----------------------|-----------------------|
|   | September 26,<br>2008 | September 28,<br>2007 | September 26,<br>2008 | September 28,<br>2007 |
| Service cost                              | \$ 546                | \$ 551                | \$ 1,638              | \$ 1,653              |
| Interest cost                             | 209                   | 174                   | 627                   | 522                   |
| Expected return on plan assets            | (84)                  | (80)                  | (252)                 | (240)                 |
| Amortization of prior service cost        | 12                    | 11                    | 36                    | 33                    |
| Amortization of net actuarial (gain) loss | (6)                   | 26                    | (18)                  | 78                    |
| Net periodic benefit cost                 | \$ 677                | \$ 682                | \$ 2,031              | \$ 2,046              |

**Note 12: Subsequent Events**

In October 2008, the Company purchased approximately \$124 million aggregate principal amount of its 3.25% convertible senior subordinated notes due 2026 for approximately \$52 million and approximately \$57 million aggregate principal amount of its 2<sup>1</sup>/<sub>2</sub>% convertible senior subordinated notes due 2024 for approximately \$45 million resulting in a pre-tax gain of \$84 million. The Company has not yet determined the effect of the gain on certain tax attributes, including net operating loss carryforwards and tax credits. These repurchases were consummated pursuant to privately negotiated transactions with holders of the notes that had previously contacted the Company. The Company funded these repurchases by drawing approximately \$97 million on its senior revolving credit facility.

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ADVANCED MEDICAL OPTICS, INC.

**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations for the Quarter Ended September 26, 2008**

*The following discussion and analysis presents the factors that had a material effect on AMO's cash flows and results of operations during the three and nine months ended September 26, 2008, and the Company's financial position at that date. Except for the historical information contained herein, the following discussion contains forward-looking statements that involve risk and uncertainties. Our actual results may differ significantly from the results discussed in the forward-looking statements. Factors that might cause such differences include, but are not limited to, those discussed in the subsection entitled "Certain Factors and Trends Affecting AMO and Its Businesses." The following discussion should be read in conjunction with the 2007 Form 10-K and the unaudited consolidated financial statements and notes thereto included elsewhere in this Form 10-Q.*

**OVERVIEW**

We are a global leader in the development, manufacture and marketing of medical devices for the eye. AMO is focused on providing the full range of advanced refractive technologies and support to help eye care professionals deliver optimal vision and lifestyle experiences to patients of all ages. Our reportable segments are represented by our three business units: cataract, refractive and eye care. Our cataract business sells monofocal intraocular lenses ( monofocal IOLs ), phacoemulsification systems, viscoelastics and related products used in ocular surgery. Our refractive business sells and provides service for wavefront diagnostic devices, femtosecond lasers and associated patient interface devices, excimer laser systems and treatment cards, and refractive implants. Our eye care business sells disinfecting solutions, enzymatic cleaners, lens rewetting drops and artificial tears.

We have operations in approximately 27 countries and sell our products in approximately 60 countries within the following four region structure:

Americas (North and South America);

Europe, Africa and Middle East;

Japan; and

Asia Pacific (excluding Japan, but including Australia and New Zealand).

*Restructuring Plan*

After our acquisition of IntraLase Corp. in the second quarter of 2007, we continued femtosecond laser manufacturing operations in Irvine, California (Irvine Plant). As part of the overall integration of IntraLase, on December 13, 2007, we committed to a plan to relocate the femtosecond laser manufacturing operations from the Irvine Plant to our excimer laser and phacoemulsification manufacturing facility in Milpitas, California (Milpitas Plant), in order to consolidate equipment manufacturing in one location and to maximize opportunities to leverage core strengths. We also moved the assembly of IntraLase disposable patient interfaces from the Irvine Plant to our facility in Puerto Rico in order to obtain additional synergies.

As a continuation of our commitment to further enhance our global competitiveness, operating leverage and cash flow, our Board of Directors on February 12, 2008 approved an additional plan to reduce our fixed costs. The additional plan included a net workforce reduction of approximately 150 positions, or about 4% of our global workforce. In addition, we consolidated certain operations, including the relocation of all non-manufacturing related activities at the Irvine Plant, to improve our overall facility utilization.

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These plans include workforce reductions and transfers, outplacement assistance, relocation of certain employees, facilities-related costs, and accelerated amortization of certain long-lived assets and termination of redundant supplier contracts. These plans also resulted in start-up costs such as expenses for moving, incremental travel, recruiting and duplicate personnel associated with hiring staff during ramp-up, as well as incremental costs associated with capacity underutilization of the Milpitas Plant during the ramp-up period.

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We currently expect to complete these activities in 2008 and estimate the total pre-tax charges resulting from these plans to be in the range of \$36 million to \$43 million, substantially all of which are expected to be cash expenditures. The Company has recognized the following costs associated with the restructuring plans (in thousands):

|   | <b>Three Months Ended<br/>September 26, 2008</b> | <b>Nine Months Ended<br/>September 26, 2008</b> |
|---|--|---|
| <b><u>Costs included in cost of sales:</u></b>  |  |   |
| Facilities related and other costs  | \$ 4,721   | \$ 4,721  |
| Termination of redundant supplier contracts   | 166  | 166   |
| Incremental costs for transition and start-up activities at the Milpitas Plant            | 803  | 803   |
|   | 5,690  | 5,690   |
| <b><u>Costs included in selling, general and administrative expenses:</u></b>             |  |   |
| Accelerated depreciation relating to the restructuring                                    | 1,839  | 3,678   |
| <b><u>Costs included in restructuring charges:</u></b>                                    |  |   |
| Severance, retention bonuses, employee relocation and other one-time termination benefits | 1,991  | 22,463  |
| Facilities related and other costs  |  | 613   |
| Travel and relocation   | 1,456  | 1,456   |
|   | 3,447  | 24,532  |
| <b>Total</b>  | <b>\$ 10,976</b>                                 | <b>\$ 33,900</b>                                |

Cumulative charges from plan inception through September 26, 2008 were \$34.3 million. Expected annualized cost savings from these restructuring actions are expected to range from \$12 million to \$16 million. Actual cost savings could be significantly different from the estimated range if any unforeseen events or changes occur.

**CRITICAL ACCOUNTING POLICIES AND ESTIMATES**

The preparation of consolidated financial statements and related disclosures in conformity with accounting principles generally accepted in the United States of America requires management to make judgments, assumptions and estimates that affect the amounts reported. Actual results could differ materially from those estimates. Certain of these significant accounting policies are considered to be critical accounting policies as more fully described in Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations, of the our Annual Report on Form 10-K for the year ended December 31, 2007. Management believes that at September 26, 2008 there has been no material change to this information.

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We performed our annual impairment test of goodwill and purchased intangible assets with indefinite lives during the second quarter of 2008 and determined there was no impairment. The valuation of goodwill and purchased intangible assets with indefinite lives requires assumptions and estimates of many critical factors, including revenue and market growth, operating cash flows, investments in capital equipment and working capital, and discount rates. As compared to our internal projections, we have experienced declines in our Refractive revenue during the third quarter as a result of the ongoing impact of deteriorating economic conditions on this business. Adverse changes in expected operating results and/or unfavorable changes in other economic factors used to estimate fair values could result in a non-cash impairment charge related to intangible assets and/or goodwill prior to the next annual review in the second quarter of 2009, which could be material to our consolidated financial statements.

**RESULTS OF OPERATIONS**

The following tables present net sales and operating income (loss) by operating segment for the three and nine months ended September 26, 2008 and September 28, 2007:

| (In thousands)           | Net Sales<br>Three Months Ended |                       | Operating Income<br>Three Months Ended |                       |
|--------------------------|---------------------------------|-----------------------|--|-----------------------|
|                          | September 26,<br>2008           | September 28,<br>2007 | September 26,<br>2008                  | September 28,<br>2007 |
| Cataract                 | \$ 129,441                      | \$ 118,888            | \$ 70,558                              | \$ 61,142             |
| Refractive               | 96,003                          | 112,149               | 59,054                                 | 68,858                |
| Eye Care                 | 50,191                          | 42,157                | 15,999                                 | 715                   |
| Total operating segments | \$ 275,635                      | \$ 273,194            | \$ 145,611                             | \$ 130,715            |

| (In thousands)           | Net Sales<br>Nine Months Ended |                       | Operating Income (Loss)<br>Nine Months Ended |                       |
|--------------------------|--------------------------------|-----------------------|--|-----------------------|
|                          | September 26,<br>2008          | September 28,<br>2007 | September 26,<br>2008                        | September 28,<br>2007 |
| Cataract                 | \$ 398,257                     | \$ 359,553            | \$ 212,465                                   | \$ 188,067            |
| Refractive               | 334,781                        | 306,207               | 200,946                                      | 188,233               |
| Eye Care                 | 166,825                        | 120,504               | 56,472                                       | (4,448)               |
| Total operating segments | \$ 899,863                     | \$ 786,264            | \$ 469,883                                   | \$ 371,852            |

*Net sales.* Total net sales increased 0.9% and 14.4% in the three and nine months ended September 26, 2008, respectively, compared to the same periods last year. The increases in net sales in the three and nine months ended September 26, 2008 resulted from higher net sales in our Cataract and Eye Care operating segments, partially offset by a decrease in net sales in the third quarter of 2008 in our Refractive operating segment. Net sales also include a favorable foreign currency impact of 2.7% and 5.4% in the three and nine months ended September 26, 2008, respectively. Our sales and earnings may be favorably impacted during times of a weakening U.S. dollar. Sales in the U.S. represented 36.1% and 37.6% of total net sales for the three and nine months ended September 26, 2008, respectively. Additionally, sales in Japan represented 16.8% and 15.2% of total net sales in the three and nine months ended September 26, 2008, respectively. No other country, or single customer, generated over 10% of total net sales in the periods presented.

Net sales from our Cataract business increased by 8.9% and 10.8% in the three and nine months ended September 26, 2008, respectively, compared with the same periods last year. The increases in net sales were the result of strong performance in all product categories both domestically and internationally. Total IOL sales increased by 9.0% and 9.6% to \$67.0 million and \$209.7 million in the three and nine months ended September 26, 2008, respectively, compared with the same periods last year, driven by our proprietary *Tecnis* line of aspheric monofocal IOLs, including *Tecnis 1-piece*, our first single piece acrylic IOL offering. Net sales from viscoelastics and phacoemulsification systems were up 5.7% and 12.0% to \$55.4 million and \$172.5 million in the three and nine months ended September 26, 2008, respectively, compared with the same periods last year, due to increased sales of our *WhiteStar Signature* system and continued growth of our *Sovereign Compact* phacoemulsification system and increases in surgical pack sales.





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Cataract net sales growth in the U.S. of 5.6% and 4.2% and in the Other Americas of 9.8% and 12.8% in the three and nine months ended September 26, 2008, respectively, was due to strong demand for our core products, partially offset by decreases in sales of older-technology intraocular lenses and viscoelastics. Sales in Europe/Africa/Middle East increased by 10.3% and 13.5% in the three and nine months ended September 26, 2008, respectively, primarily due to continued strong IOL sales driven by our proprietary *Tecnis* line of aspheric monofocal IOLs. Sales in Japan increased by 12.3% and 17.0% in the three and nine months ended September 26, 2008, respectively. Sales in Asia Pacific increased by 8.6% and 9.8% in the three and nine months ended September 26, 2008, respectively, compared with the same periods last year. The increases reflect growth for all product lines. Net sales in our Cataract business reflect a favorable foreign currency impact of 3.8% and 7.0% in the three and nine months ended September 26, 2008, respectively, largely from fluctuations of the yen and the euro versus the U.S. dollar.

Net sales from our Refractive business decreased by 14.4% to \$96.0 million in the three months ended September 26, 2008, compared with the same period last year. The decrease primarily reflects a \$3.9 million decline in the sales of refractive implants, an \$8.5 million decrease in system sales and declines in excimer and femtosecond procedure volumes associated with economic weakness affecting the United States, which were down about 35% in the current quarter. We expect U.S. procedures to continue to be impacted throughout 2008 and into 2009. An acceleration of this decline in the U.S. or globally would have a material adverse impact on our revenue, results of operations, financial condition and liquidity. Net sales from our Refractive business increased by 9.3% to \$334.8 million in the nine months ended September 26, 2008, compared with the same period last year. The increase primarily reflects increased procedure and related and increased systems sales in the first two quarters of 2008, partially offset by an \$8.7 million decline in sales of refractive implants and the decline in sales of procedure volumes discussed above. Net sales decreased in the U.S. by 33.8% and 10.8% in the three and nine months ended September 26, 2008, respectively, compared with the same periods last year, due to lower excimer and femtosecond laser procedure volumes. Net sales decreased in the Other Americas by 13.8% in the three months ended September 26, 2008 due to lower excimer and femtosecond laser procedure volumes. Net sales increased in the Other Americas by 11.9% in the nine months ended September 26, 2008, compared with the same period last year, due to a favorable shift toward *CustomVue* procedures. Net sales in the three and nine months ended September 26, 2008 increased in Europe/Africa/Middle East, Japan and Asia Pacific, as a result of our international expansion strategy for the Refractive business, offset by lower procedure volumes in Europe in the third quarter of 2008. Net sales in our Refractive business reflect a favorable foreign currency impact of 0.6% and 2.0% in the three and nine months ended September 26, 2008, respectively, largely from fluctuations of the yen and the euro versus the U.S. dollar.

Net sales from our Eye Care business increased by 19.1% and 38.4% in the three and nine months ended September 26, 2008, respectively, compared with the same periods last year. The increase in net sales reflects our continued recovery from the 2007 Recall with renewed sales of our multipurpose solutions, growing demand for our newly launched line of over-the-counter dry eye products sold under the *blink*<sup>®</sup> Tears brand and increased sales of hydrogen peroxide-based products, principally in Europe and Japan. Net sales increased significantly in every region in the three and nine months ended September 26, 2008, compared with the same periods last year, primarily as a result of higher multipurpose solutions sales attributable to the recovery from the 2007 Recall. Additionally, net sales in the U.S. and Europe benefitted from growing demand for our recently launched over-the-counter dry eye product. Net sales in our Eye Care business included a favorable foreign currency impact of 4.8% and 9.4% in the three and nine months ended September 26, 2008, respectively, largely resulting from fluctuations of the yen and the euro versus the U.S. dollar.

*Gross margin and gross profit.* Our gross margin percentage was 59.9% and 61.2% in the three and nine months ended September 26, 2008, respectively, compared with 55.7% in the same periods last year. The increases were a result of revenue shifts away from lower margin refractive equipment toward higher margin refractive procedures and cataract offerings, offset by \$5.7 million of charges relating to the restructuring included in gross profit for the three and nine months ended September 26, 2008. Gross profit for the nine months ended September 28, 2007 included a \$72.6 million negative impact from the 2007 Recall associated with sales returns and product-related costs. Gross profit for the nine months ended September 28, 2007 also included a \$2.3 million negative impact from the 2006 China Eye Care recall, a \$7.7 million non-cash charge for the step-up of inventory to fair value in connection with the IntraLase acquisition and a \$4.7 million charge to discontinue the Amadeus microkeratome distributor agreement in the first quarter of 2007.

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*Selling, general and administrative.* Selling, general and administrative ( SG&A ) expenses decreased as a percent of net sales by 7.7 percentage points to 42.8%, and by 8.7 percentage points to 41.8% in the three and nine months ended September 26, 2008, respectively, compared with the same periods last year. The significant contributors to the decreases include lower headcount related spending, significantly lower discretionary spending and reductions in variable and performance based expenses. Also, these decreases are net of a \$1.8 million charge and \$3.7 million charge in the three and nine months ended September 26, 2008, respectively, for accelerated depreciation of the former IntraLase headquarters building we exited early in the fourth quarter of 2008 as part of our restructuring initiative. Integration-related costs associated with the IntraLase acquisition in the three and nine months ended September 28, 2007 were \$4.9 million and \$11.5 million, respectively. The nine months ended September 28, 2007 included \$8.2 million in expenses for costs incurred in connection with a proposed acquisition of another company in the ophthalmic segment which we withdrew in August 2007, \$2.1 million in China 2006 Eye Care recall-related costs in the first quarter of 2007 and a \$16.8 million charge in 2007 Recall and product re-launch expenses.

*Research and development.* Research and development expenditures decreased as a percent of net sales by 1.6 percentage points to 6.1%, and by 1.5 percentage points to 6.2% in the three and nine months ended September 26, 2008, respectively, compared with the same periods last year. The decrease was due to the planned synergies following the IntraLase integration. In 2007, research and development as a percentage of sales reflected a loss in sales as a result of the 2007 Recall. We also recognized an impairment charge of \$1.0 million in the first quarter of 2007 in connection with a research and development licensing agreement. Our research and development strategy is to develop proprietary products for vision correction that are safe and effective and address unmet needs. We are currently focusing on new advancements that will build on our *Tecnis*, *Healon* and phacoemulsification technologies, corneal and lens-based solutions to presbyopia, projects from the acquisitions of WFSI and IntraLase, and additional multipurpose solutions and dry eye products.

*In-process research and development.* In the nine months ended September 28, 2007, we recorded an \$87.0 million in-process research and development ( IPR&D ) charge from the IntraLase and WFSI acquisitions. This charge represented the estimated fair value of projects that, as of the acquisition date, had not reached technological feasibility and had no alternative future use.

*Restructuring charges.* In the three and nine months ended September 26, 2008, we incurred \$3.4 million and \$24.5 million, respectively, of pre-tax charges which comprised severance, retention bonuses and other one-time termination benefits of \$2.0 million and \$22.5 million, respectively, and travel, relocation and facilities related costs of \$1.5 million and \$2.1 million, respectively.

*Net gain on legal contingencies.* We recognized a net gain on legal contingencies of \$20.5 million, net of legal costs incurred, in the second quarter of 2008 from the execution of an agreement with Alcon, Inc. As part of the agreement, Alcon made a payment of \$31 million to us and we made a payment to Alcon of \$10 million. We received the net cash proceeds of \$21 million in the second quarter of 2008.

*Operating Income (Loss).* Operating income as a percentage of net sales, or operating margin, was 9.7% and 12.7% in the three and nine months ended September 26, 2008, respectively. Operating income of \$26.6 million in the three months ended September 26, 2008 includes \$9.1 million in restructuring charges, a \$1.8 million charge for accelerated depreciation of leasehold improvements related to the restructuring, \$17.1 million of intangible amortization included in SG&A and \$5.9 million in share-based compensation expense. The net impact from these items reduced operating margin by 12.3 percentage points in the three months ended September 26, 2008. Operating income of \$114.1 million in the nine months ended September 26, 2008 includes \$20.5 million net gain on legal contingencies, \$30.2 million in restructuring charges, a \$3.7 million charge for accelerated depreciation of leasehold improvements related to the restructuring, \$51.4 million of intangibles amortization included in SG&A and \$17.2 million in share-based compensation expense. The net impact from these items reduced operating margin by 9.1 percentage points in the nine months ended September 26, 2008.

Operating loss as a percentage of net sales, or operating margin, was 2.5% and 13.7% in the three and nine months ended September 28, 2007, respectively. Operating loss of \$6.7 million in the three months ended September 28, 2007 includes \$5.1 million for IntraLase integration-related costs, \$6.8 million from incremental amortization of acquired IntraLase intangible assets and \$5.7 million in share-based compensation expense. The negative impact on operating loss from the 2007 Recall was \$31.1 million in the third quarter of 2007 associated

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with sales returns and product-related costs. The net impact from these items reduced operating margin by 17.8 percentage points in addition to the net effect of the decline in Eye Care sales in the three months ended September 28, 2007. Operating loss of \$107.4 million in the nine months ended September 28, 2007 includes \$120.0 million of IntraLase acquisition-related charges (including amortization expense of \$13.6 million), \$4.4 million from the 2006 China Eye Care recall in the first quarter, \$15.5 million in share-based compensation expense, \$8.2 million in connection with the proposal to acquire another company in the ophthalmic segment, \$4.7 million related to the discontinuation of a distributor contract, \$1.0 million impairment related to a R&D licensing agreement and \$1.6 million for IPR&D related to the WFSI acquisition. The negative impact on operating loss from the 2007 Recall was \$89.5 million year to date associated with sales returns and product-related costs. These charges reduced operating margin by 31.2 percentage points in addition to the net effect of the decline in Eye Care sales in the nine months ended September 28, 2007.

Operating income from our Cataract business increased by \$9.4 million and \$24.4 million in the three and nine months ended September 26, 2008, respectively, primarily due to the increase in net sales of IOL products, viscoelastics and phacoemulsification systems discussed above. Operating income from our Refractive business decreased by \$9.8 million in the three months ended September 26, 2008, primarily due to lower U.S. procedure volumes and decreased refractive IOL sales in the U.S. Operating income from our Refractive business increased by \$12.7 million in the nine months ended September 26, 2008, primarily due to the impact of the IntraLase acquisition, which was completed in the second quarter of 2007. Operating income from our Eye Care business increased by \$15.3 million and \$60.9 million in the three and nine months ended September 26, 2008, respectively, primarily due to the recovery from the 2007 Recall discussed above.

*Non-operating expense.* Interest expense was \$17.6 million and \$56.6 million in the three and nine months ended September 26, 2008, respectively, compared with \$20.6 million and \$48.8 million in the three and nine months ended September 28, 2007, respectively. The decrease in the three months ended September 26, 2008 was due to lower interest rates during the quarter on variable rate borrowings. The increase in the nine months ended September 26, 2008 was due to the issuance of more than \$700 million in debt in April 2007 in connection with the IntraLase acquisition, partially offset by lower interest rates during the third quarter of 2008 on variable rate borrowings. Interest expense in the nine months ended September 28, 2007 includes a \$1.3 million deferred financing cost write-off associated with the IntraLase acquisition.

We recorded an unrealized gain on derivative instruments of \$5.8 million and \$6.4 million in the three and nine months ended September 26, 2008, respectively, compared to an unrealized loss on derivative instruments of \$2.4 million and \$2.7 million in the three and nine months ended September 28, 2007, respectively. We record as unrealized (gain) loss on derivative instruments, net the mark-to-market adjustments on the outstanding foreign currency options and forward contracts which we enter into as part of our overall risk management strategy to reduce the volatility of expected earnings in currencies other than the U.S. dollar. The net gain in the first nine months of 2008 and net loss in the nine months ended September 28, 2007 were largely attributable to euro and Japanese yen instruments.

*Income taxes.* We recorded a provision for income taxes of \$4.3 million and \$22.0 million in the three and nine months ended September 26, 2008, respectively, resulting in effective tax rates of approximately 38.0% for both periods. The effective tax rate reflected a benefit from stock-based compensation expense of \$2.1 million recognized at an estimated effective rate of approximately 34% for the nine months ended September 26, 2008.

We recorded a provision (benefit) for income taxes of (\$5.3) million and \$17.5 million in the three and nine months ended September 28, 2007, resulting in overall effective tax rates of 17.0% and (10.7%), respectively. For the three months ended September 28, 2007, the 2007 Recall continued to impact lower-tax foreign jurisdictions and resulted in a reduced tax benefit. The tax rate for the nine months ended September 28, 2007 was negatively impacted by the 2007 Recall, including the related impact on utilization of foreign tax credits resulting in a net deferred tax expense of \$21 million. The results for the nine months ended September 28, 2007 included \$87.0 million of IPR&D charges related to the purchase of IntraLase and WFSI and a \$1.0 million write-off associated with a research and development agreement for which no tax benefits were recorded and a \$19.2 million deferred tax expense associated with the integration of IntraLase.

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Our future effective income tax rate may vary depending on our mix of domestic and international taxable income or loss and the various tax and treasury methodologies that we implement, including our policy regarding repatriation of future accumulated foreign earnings.

The 2008 tax provision and tax rate may be reduced as a result of the passage of the Emergency Economic Stabilization Act of 2008, which extended the Federal Research and Development Tax Credit and the California Budget Act of 2008 (AB 1452) which has made substantial changes in the limitations on the use of California business credits; both of which were enacted subsequent to September 26, 2008.

As of September 26, 2008, the liability for income taxes associated with uncertain tax positions was \$47.6 million and the net amount of \$31.4 million, if recognized, would favorably affect the Company's effective tax rate. The difference primarily relates to timing differences and amounts arising from past business combinations which, if recognized, would be recorded to goodwill. During the third quarter of 2008, the amount of uncertain tax positions decreased by \$1.6 million reflecting decreases related to both statute expirations and foreign currency translation offset by increases for ongoing open matters. The amount of the decrease that favorably impacted our effective tax rate for the third quarter of 2008 was \$0.6 million. Accrued penalties and interest of \$3.6 million (net of a tax benefit of \$1.8 million) at June 27, 2008 increased to \$3.8 million (net of a tax benefit of \$1.9 million) at September 26, 2008.

## LIQUIDITY AND CAPITAL RESOURCES

Management assesses our liquidity by our ability to generate cash to fund operations. Significant factors in the management of liquidity are: funds generated by operations; levels of accounts receivable, inventories, accounts payable and capital expenditures; adequate lines of credit; and financial flexibility to attract long-term capital on satisfactory terms. As of September 26, 2008, we had cash and equivalents of \$35.0 million.

Historically, we have generated cash from operations in excess of working capital requirements, and we expect to do so in the future. Net cash provided by operating activities was \$88.8 million and \$31.7 million in the nine months ended September 26, 2008 and September 28, 2007, respectively. Cash provided by operating activities was impacted by the cash outlay for restructuring actions, timing of accounts receivable collections, rate of inventory turnover, the buildup of bridging inventories to support our manufacturing move, the decrease in equipment sales in the third quarter of 2008, the buildout of our global service structure and the payment of accounts payable and other current liabilities. In addition, cash provided by operating activities includes the net cash proceeds from a gain on legal contingencies of \$20.5 million.

Net cash used in investing activities was \$22.7 million and \$773.0 million in the nine months ended September 26, 2008 and September 28, 2007, respectively. Expenditures for property, plant and equipment totaled \$17.0 million and \$24.2 million in the nine months ended September 26, 2008 and September 28, 2007, respectively. Expenditures in the nine months ended September 26, 2008 primarily comprised expenditures associated with the new Milpitas Plant and continuation of upgrades and expansion of our Eye Care facility in China. Expenditures in the nine months ended September 28, 2007 primarily comprised expenditures to upgrade and expand our Eye Care manufacturing facility in China and continuation of upgrades to our manufacturing facilities in Puerto Rico and Uppsala, Sweden. Expenditures for demonstration (demo) and bundled equipment, primarily phacoemulsification equipment, were \$9.9 million and \$6.3 million in the nine months ended September 26, 2008 and September 28, 2007, respectively. We maintain demo and bundled equipment to facilitate future sales of similar equipment and related products to our customers. Expenditures for capitalized internal-use software and other long-lived assets were \$0.8 million and \$5.4 million in the nine months ended September 26, 2008 and September 28, 2007, respectively, which primarily comprised a company-wide system upgrade as part of the overall expansion of our business. In the nine months ended September 28, 2007, we used \$724.0 million, net of cash acquired, to purchase IntraLase and \$13.8 million to acquire WFSI. In 2008, we expect to invest approximately \$35.0 million to \$45.0 million in property, plant and equipment, demo and bundled equipment, and capitalized software as part of the overall expansion of our business.

Net cash used in financing activities was \$59.9 million in the nine months ended September 26, 2008, which primarily comprised \$65.0 million of debt repayments and financing-related costs, partially offset by \$5.1 million from the sale of stock to employees. Net cash provided by financing activities was \$747.5 million in the nine months ended September 28, 2007. We had net borrowings of \$746.5 million in short-term and long-term debt that were used to finance the IntraLase acquisition and related financing costs.

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We have access to a credit facility (the Credit Facility ), which is comprised of a \$300 million revolving line of credit maturing in April 2013 (the Revolver ) and a \$450 million term loan maturing in April 2014 (the Term Loan ). As of September 26, 2008, the Revolver included commitments to support letters of credit totaling \$8.5 million issued on our behalf for normal operating purposes, which resulted in an available balance of \$291.5 million. The outstanding balance on the Term Loan was \$444.4 million as of September 26, 2008.

In October 2008, we purchased approximately \$124 million aggregate principal amount of our 3.25% convertible senior subordinated notes due 2026 for approximately \$52 million and approximately \$57 million aggregate principal amount of our 2<sup>1/2</sup>% convertible senior subordinated notes due 2024 for approximately \$45 million resulting in a net reduction of our total debt of \$84 million. These repurchases were consummated pursuant to privately negotiated transactions with holders of the notes that had previously contacted the Company. The Company funded these repurchases by drawing approximately \$97 million on the Revolver. After the purchase, the resulting available balance of the Revolver was approximately \$195 million. We may purchase additional convertible notes from time to time, at prevailing market prices, through open market purchases or privately negotiated transactions.

Borrowings under the Credit Facility, if any, bear interest at current market rates plus a margin based upon our ratio of debt to EBITDA, as defined. The incremental interest margin on borrowings under the Credit Facility decreases as our ratio of debt to EBITDA decreases to specified levels. During the third quarter of 2008, this interest margin was 1.75% over the applicable LIBOR rate. Additionally, we can borrow at the prevailing prime rate of interest plus an interest margin of 0.75%. The average annual rate of interest during the third quarter of 2008, inclusive of incremental margin, was 4.84% and 4.57% for the Revolver and Term Loan, respectively.

Under the Credit Facility, certain transactions may trigger mandatory prepayment of borrowings. Such transactions may include certain equity or debt offerings, asset dispositions and extraordinary receipts. We pay a quarterly fee (1.875% per annum at September 26, 2008) on the average balance of outstanding letters of credit and a quarterly commitment fee (0.50% per annum at September 26, 2008) on the average unused portion of the Revolver. In addition, we make mandatory quarterly amortization payments (1.0% per annum at September 26, 2008) on the outstanding balance of the Term Loan.

The Credit Facility provides that we maintain certain financial and operating covenants in order to continue to have access to the financing under the agreement. These covenants include, among other provisions, maintaining specific leverage and interest coverage ratios (the Financial Covenants ) which pertain only to the Revolver. We were in compliance with the Financial Covenants at September 26, 2008. Certain covenants under the Credit Facility may limit the incurrence of additional indebtedness. Our Credit Facility prohibits dividend payments by us. On October 5, 2007, as a result of the 2007 Recall, we amended the Credit Facility. The amendment changed the Maximum Consolidated Total Leverage Ratio for certain quarterly periods. Additionally, for purposes of calculating this ratio as well as the Minimum Consolidated Interest Coverage Ratio, we were permitted to exclude certain recall costs and related impacts. On July 30, 2008, in anticipation of the effects to the LASIK business of the slowing U.S. economy, we amended the Credit Facility a second time. The amendment changed the Maximum Consolidated Total Leverage Ratio for certain quarterly periods. The Credit Facility is collateralized by a first priority perfected lien on, and pledge of, all of our combined present and future property and assets (subject to certain exclusions), 100% of the stock of the domestic subsidiaries, 66% of the stock of foreign subsidiaries and all present and future intercompany debts.

Our cash position includes amounts denominated in foreign currencies, and the repatriation of those cash balances from some of our non-U.S. subsidiaries may result in additional tax costs. However, these cash balances are generally available without legal restriction to fund ordinary business operations.

We believe that the net cash provided by our operating activities and cash collections from customers, supplemented as necessary with borrowings available under our Credit Facility and existing cash and equivalents, will provide sufficient resources to fund our operating, capital expenditure, working capital, debt service and other cash needs over the next year. However, our ongoing ability to meet the Financial Covenants as well as our debt repayment and other obligations will be dependent upon our future performance, which is subject to business, economic, financial and other factors. We will not be able to control some of these factors such as continued adverse economic conditions in the refractive markets where we operate. We cannot be certain that our customers will pay timely on accounts receivable and that our cash flow from operating activities will be sufficient to allow us to pay

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principal and interest on our debt, support our operations and meet our other obligations. If any or all these business, economic, financial or other factors, either individually or in combination, affect our financial performance such that we are not in compliance with any Financial Covenant, including our obligation to make required principal or interest payments when due, our Revolver lenders would, under certain circumstances, be permitted to accelerate our obligation to repay the indebtedness owed them and if we were unable to repay, re-finance or restructure that indebtedness, they could take other actions, including proceeding against the collateral securing that indebtedness.

In the event of pending or actual non-compliance with the Financial Covenants, we would seek to amend the Financial Covenants or obtain waivers for non-compliance, either of which could result in additional costs in terms of fees and/or interest expense, if any amendment or waiver were granted at all. In the event the required percentage of lender banks were unwilling to amend the Financial Covenants or waive our non-compliance, and in the event our non-compliance continued beyond the relevant cure period, that event would constitute a default under our Term Loan and could result in an acceleration of our obligation to pay this indebtedness. If an acceleration of debt repayment were to occur and continue on our Credit Facility, we would then be in an event of default with our convertible and senior subordinated notes and potentially need to repay these amounts on demand.

If an amendment to the Financial Covenants required a change to the pricing schedule (i.e. the interest rates we are required to pay our Credit Facility lenders) then this higher interest rate would accrue to the benefit of both the Revolver banks as well as the Term Loan banks and could result in us paying substantial additional costs in terms of fees and/or interest expense.

We cannot guarantee that we would be able to negotiate any required waivers, amendments or refinancings or restructurings as contemplated above on terms favorable to us, if at all. In addition, the terms of existing or future waivers, amendments or debt agreements may restrict us from pursuing any of these alternatives.

Any of these above mentioned outcomes would have a material adverse effect on our business, our ability to repay debt principal, our financial condition and our liquidity.

We are partially dependent upon the reimbursement policies of government and private health insurance companies. Government and private sector initiatives to limit the growth of health care costs, including price regulation and competitive pricing, are continuing in many countries where we do business. As a result of these changes, the marketplace has placed increased emphasis on the delivery of more cost-effective medical therapies. While we have been unaware of significant price resistance resulting from the trend toward cost containment, changes in reimbursement policies and other reimbursement methodologies and payment levels could have an adverse effect on our pricing flexibility. Additionally, the current trend among U.S. hospitals and other customers of medical device manufacturers is to consolidate into larger purchasing groups to enhance purchasing power. The enhanced purchasing power of these larger customers may also increase the pressure on product pricing, although we are unable to estimate the potential impact at this time.

*Inflation.* Although at reduced levels in recent years, inflation may cause upward pressure on the cost of goods and services used by us. The competitive and regulatory environments in many markets substantially limit our ability to fully recover these higher costs through increased selling prices. We continually seek to mitigate the adverse effects of inflation through cost containment and improved productivity and manufacturing processes.

*Foreign currency fluctuations.* Approximately 62.4% of our revenues for the nine months ended September 26, 2008 were derived from operations outside the United States and a significant portion of our cost structure is denominated in currencies other than the U.S. dollar, primarily the Japanese yen and the euro. Therefore, we are subject to fluctuations in sales and earnings reported in U.S. dollars as a result of changing currency exchange rates. We expect the euro to experience devaluation during 2009.

The impact of foreign currency fluctuations on sales resulted in an increase of \$42.4 million and \$15.6 million for the nine months ended September 26, 2008 and September 28, 2007, respectively. These fluctuations were due primarily to fluctuations of the Japanese yen and the euro versus the U.S. dollar.

*Contractual obligations.* We have contractual obligations for long-term debt, interest on long-term debt, operating lease obligations, service contracts and other purchase obligations that were summarized in a table of Contractual Obligations in our Annual Report on Form 10-K for the year ended December 31, 2007. Since December 31, 2007, there have been no material changes to the table of Contractual Obligations of the Company, outside of the ordinary course of business.

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*Off-balance sheet arrangements.* We had no off-balance sheet arrangements at September 26, 2008 as defined in Regulation S-K Item 303(a)(4).

**Recent Accounting Standards**

In September 2006, the Financial Accounting Standards Board ( FASB ) issued Statement of Financial Accounting Standards No. 157, Fair Value Measurements ( SFAS No. 157 ). SFAS No. 157 defines fair value, establishes a framework for measuring fair value within generally accepted accounting principles, and expands disclosure requirements regarding fair value measurements. Although SFAS No. 157 does not require any new fair value measurements, its application may, in certain instances, change current practice. Where applicable, SFAS No. 157 simplifies and codifies fair value related guidance previously issued within GAAP. We have adopted FASB Staff Position 157-2, Effective Date of FASB Statement No. 157 ( FSP 157-2 ), issued February 2008, and as a result we applied the provisions of SFAS No. 157 that are applicable as of January 1, 2008, which had no material effect on our consolidated financial statements. FSP 157-2 delays the effective date of SFAS No. 157 for certain non-financial assets and non-financial liabilities until January 1, 2009.

In October 2008, the FASB issued Staff Position No. 157-3, Determining the Fair Value of a Financial Asset When the Market for That Asset Is Not Active ( FSP No. 157-3 ). FSP No. 157-3 clarifies the application of SFAS No. 157 in a market that is not active and provides an example to illustrate key considerations in determining the fair value of a financial asset when the market for that financial asset is not active. FSP No. 157-3 was effective upon issuance on October 10, 2008, including prior periods for which financial statements had not been issued. The application of the provisions of FSP No. 157-3 did not materially affect our results of operations or financial condition as of and for the three and nine months ended September 26, 2008.

In December 2007, the FASB issued SFAS No. 141(R), Business Combinations ( SFAS No. 141R ), and SFAS No. 160, Accounting and Reporting of Noncontrolling Interest in Consolidated Financial Statements, an amendment of ARB No. 51 ( SFAS No. 160 ). These new standards will significantly change the financial accounting and reporting of business combination transactions and noncontrolling (or minority) interests in consolidated financial statements. We will be required to adopt SFAS No. 141R and SFAS No. 160 effective January 1, 2009. We have not yet determined the effect, if any, that the adoption of SFAS No. 141R and SFAS No. 160 will have on its consolidated financial statements.

In March 2008, the FASB issued SFAS No. 161, Disclosures about Derivative Instruments and Hedging Activities ( SFAS No. 161 ). SFAS No. 161 is intended to improve financial reporting of derivative instruments and hedging activities by requiring enhanced disclosures to enable investors to better understand their effects on an entity's financial position, financial performance, and cash flows. SFAS No. 161 is effective for us beginning January 1, 2009. We are evaluating the impact of this new standard and currently do not anticipate a material impact on our financial statements as a result of the implementation of SFAS No. 161.

In April 2008, the FASB issued FASB Staff Position No. 142-3, Determination of the Useful Life of Intangible Assets ( FSP No. 142-3 ). FSP No. 142-3 amends the factors that should be considered in developing assumptions about renewal or extension used in estimating the useful life of a recognized intangible asset under SFAS No. 142, Goodwill and Other Intangible Assets. ( SFAS No. 142 ). This standard is intended to improve the consistency between the useful life of a recognized intangible asset under SFAS No. 142 and the period of expected cash flows used to measure the fair value of the asset under SFAS No. 141R and other GAAP. FSP No. 142-3 is effective for financial statements issued for fiscal years beginning after December 15, 2008. The measurement provisions of this standard will apply only to intangible assets acquired after January 1, 2009.

In May 2008, the FASB issued SFAS No. 162, The Hierarchy of Generally Accepted Accounting Principles ( SFAS No. 162 ), which identifies the sources of accounting principles and the framework for selecting the principles to be used in the preparation of financial statements of non-governmental entities that are presented in conformity with GAAP in the United States. SFAS No. 162 is effective sixty days following the SEC's approval of The Public Company Accounting Oversight Board's related amendments to remove the GAAP hierarchy from auditing standards.

In May 2008, the FASB issued FASB Staff Position No. APB 14-1, Accounting for Convertible Debt Instruments That May Be Settled in Cash Upon Conversion (Including Partial Cash Settlement) ( FSP No. APB 14-1 ). FSP No. APB 14-1 applies to convertible debt instruments that, by their stated terms, may be settled in cash

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(or other assets) upon conversion, including partial cash settlement, unless the embedded conversion option is required to be separately accounted for as a derivative under SFAS 133. FSP No. APB 14-1 specifies that issuers of convertible debt instruments should separately account for the liability and equity components in a manner that will reflect the entity's nonconvertible debt borrowing rate when interest cost is recognized in subsequent periods. FSP No. APB 14-1 is effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those fiscal years. FSP No. APB 14-1 shall be applied retrospectively to all periods presented. The cumulative effect of the change in accounting principle on periods prior to those presented shall be recognized as of the beginning of the first period presented. An offsetting adjustment shall be made to the opening balance of retained earnings for that period, presented separately. We have not yet determined the effect, if any, that the adoption of FSP No. APB 14-1 will have on our consolidated financial statements.

### **Certain Factors and Trends Affecting AMO and Its Businesses**

Our disclosure and analysis in this report contain forward-looking information about our company's financial results and estimates, business prospects and future products that involve substantial risks and uncertainties. These statements constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. From time to time, we also may provide oral or written forward-looking statements in other materials we release to the public. Forward-looking statements give our current expectations or forecasts of future events. You can identify these statements by the fact that they do not relate strictly to historic or current facts. They use words such as anticipate, estimate, expect, project, intend, plan, believe, will, and other words and terms of similar meaning in connection with any discussion of operating or financial performance. In particular, these include statements relating to future actions, prospective products, product approvals or approved indications, reimbursement rates, future performance or results of current and anticipated products, sales efforts, expenses, interest rates, foreign exchange rates, and the outcome of contingencies, such as legal proceedings, financial results, and the expected results and benefits of our strategic initiatives and restructuring activities. Among the factors that could cause actual results to differ materially are the following:

risks associated with the timing, costs and expected benefits of our restructuring activities;

uncertainties associated with the research and development and regulatory processes;

our ability to make and successfully integrate acquisitions or enter into strategic alliances;

exposure to risks associated with doing business outside of the United States, where we conduct a significant amount of our sales and operations;

foreign currency risks and fluctuation in interest rates;

our ability to introduce new commercially successful products in a timely and effective manner;

our ability to maintain a sufficient and timely supply of products we manufacture;

our reliance on sole source suppliers for raw materials and other products, and single sites of manufacturing;

competitor consolidations increasing already intense competition from companies with substantially more resources and a greater marketing scale;



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risks and expenses associated with our ability to protect our intellectual property rights;

risks and expenses associated with intellectual property litigation and infringement claims;

losses due to product liability claims, product recalls or corrections, or other litigation;

risks associated with our ability to regain market share in the multipurpose solution segment following our 2006 and 2007 recalls;

our ability to maintain our relationships with health care providers;

concentration of revenue with corporate LASIK chains and our ability to collect on accounts receivable;

risks, uncertainties and delays associated with extensive government regulation of our business, including risks associated with regulatory compliance, quality systems standards, complaint-handling, reimbursement and regulation of relationships with health care providers;

our ability to attract, hire and retain qualified personnel;

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risks associated with indemnification obligations and potential tax liabilities associated with our spin-off from Allergan;

our significant debt, which contains covenants limiting our business activities and our ability to continue to comply with those covenants, amend our senior credit facility on favorable terms if necessary, or to obtain financing from other sources;

changes in market acceptance of laser vision correction;

the possibility of long-term side effects and adverse publicity regarding laser correction surgery; and

the effect of the weak and volatile global economy on the ability of individuals to afford refractive procedures, which has already had, and is likely to continue to have, a material impact on our Refractive business in 2008.

We cannot guarantee that any forward-looking statement will be realized. Achievement of future results is subject to risks, uncertainties and inaccurate assumptions. Should known or unknown risks or uncertainties materialize, or should underlying assumptions prove inaccurate, actual results could vary materially from past results and those anticipated, estimated or projected. Investors should bear this in mind as they consider forward-looking statements.

We undertake no obligation to publicly update forward-looking statements, whether as a result of new information, future events or otherwise. You are advised, however, to consult any further disclosures we make on related subjects in our Forms 10-Q, 8-K and 10-K reports to the Securities and Exchange Commission. Our Form 10-K filing for the 2007 fiscal year listed various important factors that could cause actual results to differ materially from expected and historic results. We note these factors for investors as permitted by the Private Securities Litigation Reform Act of 1995. Readers can find them in Item 1A of the Form 10-K under the heading Risk Factors. We incorporate that section of that Form 10-K in this filing and encourage investors to refer to it. You should understand that it is not possible to predict or identify all such factors. Consequently, you should not consider any such list to be a complete set of all potential risks or uncertainties.

### **Item 3. Quantitative and Qualitative Disclosures About Market Risk**

We routinely monitor the risks associated with fluctuations in currency exchange rates and interest rates. We address these risks through controlled risk management that may include the use of derivative financial instruments to economically hedge or reduce these exposures. We do not expect to enter into financial instruments for trading or speculative purposes.

Given the inherent limitations of forecasting and the anticipatory nature of the exposures intended to be hedged, there can be no assurance that such programs will offset more than a portion of the adverse financial impact resulting from unfavorable movements in either interest or foreign exchange rates. In addition, the timing of the accounting for recognition of gains and losses related to mark-to-market instruments for any given period may not coincide with the timing of gains and losses related to the underlying economic exposures and, therefore, may adversely affect our operating results and financial position.

To ensure the adequacy and effectiveness of our interest rate and foreign exchange hedge positions, we continually monitor, from an accounting and economic perspective, our interest rate swap positions and foreign exchange forward and option positions, when applicable, both on a stand-alone basis and in conjunction with our underlying interest rate and foreign currency exposures.

*Interest rate risk.* At September 26, 2008, our debt comprises solely domestic borrowings and comprises \$1.1 billion of fixed rate debt and \$444.4 million of variable rate debt. If the interest rates on our variable rate debt were to increase or decrease by 1% for the year, annual interest expense would increase or decrease by approximately \$4.4 million based on the amount of outstanding variable rate debt at September 26, 2008.

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The tables below present information about our debt obligations as of September 26, 2008 and December 31, 2007:

**September 26, 2008**

|                                       | 2008     | 2009     | 2010     | Maturing in |          |              | Total        | Fair Market Value |
|---------------------------------------|----------|----------|----------|-------------|----------|--------------|--------------|-------------------|
|                                       |          |          |          | 2011        | 2012     | Thereafter   |              |                   |
| (in thousands, except interest rates) |          |          |          |             |          |              |              |                   |
| <b>LIABILITIES</b>                    |          |          |          |             |          |              |              |                   |
| <b>Debt Obligations:</b>              |          |          |          |             |          |              |              |                   |
| Fixed Rate                            | \$       | \$       | \$       | \$          | \$       | \$ 246,105   | \$ 246,105   | \$ 219,033        |
| Weighted Average Interest Rate        |          |          |          |             |          | 2.50%        | 2.50%        |                   |
| Fixed Rate                            | \$       | \$       | \$       | \$          | \$       | \$ 105,000   | \$ 105,000   | \$ 76,558         |
| Weighted Average Interest Rate        |          |          |          |             |          | 1.375%       | 1.375%       |                   |
| Fixed Rate                            | \$       | \$       | \$       | \$          | \$       | \$ 500,000   | \$ 500,000   | \$ 330,150        |
| Weighted Average Interest Rate        |          |          |          |             |          | 3.25%        | 3.25%        |                   |
| Fixed Rate                            | \$       | \$       | \$       | \$          | \$       | \$ 250,000   | \$ 250,000   | \$ 226,250        |
| Weighted Average Interest Rate        |          |          |          |             |          | 7.50%        | 7.50%        |                   |
| Variable Rate                         | \$ 2,250 | \$ 4,500 | \$ 4,500 | \$ 4,500    | \$ 4,500 | \$ 424,125   | \$ 444,375   | \$ 444,375        |
| Weighted Average Interest Rate        | 5.40%    | 5.75%    | 5.75%    | 5.75%       | 6.00%    | 6.00%        | 5.75%        |                   |
| Total Debt Obligations                | \$ 2,250 | \$ 4,500 | \$ 4,500 | \$ 4,500    | \$ 4,500 | \$ 1,525,230 | \$ 1,545,480 | \$ 1,296,366      |
| Weighted Average Interest Rate        | 5.40%    | 5.75%    | 5.75%    | 5.75%       | 6.00%    | 4.46%        | 4.41%        |                   |

**December 31, 2007**

|                                       | 2008      | 2009     | 2010     | Maturing in |          |              | Total        | Fair Market Value |
|---------------------------------------|-----------|----------|----------|-------------|----------|--------------|--------------|-------------------|
|                                       |           |          |          | 2011        | 2012     | Thereafter   |              |                   |
| (in thousands, except interest rates) |           |          |          |             |          |              |              |                   |
| <b>LIABILITIES</b>                    |           |          |          |             |          |              |              |                   |
| <b>Debt Obligations:</b>              |           |          |          |             |          |              |              |                   |
| Fixed Rate                            | \$        | \$       | \$       | \$          | \$       | \$ 246,105   | \$ 246,105   | \$ 226,038        |
| Weighted Average Interest Rate        |           |          |          |             |          | 2.50%        | 2.50%        |                   |
| Fixed Rate                            | \$        | \$       | \$       | \$          | \$       | \$ 105,000   | \$ 105,000   | \$ 92,400         |
| Weighted Average Interest Rate        |           |          |          |             |          | 1.375%       | 1.375%       |                   |
| Fixed Rate                            | \$        | \$       | \$       | \$          | \$       | \$ 500,000   | \$ 500,000   | \$ 400,425        |
| Weighted Average Interest Rate        |           |          |          |             |          | 3.25%        | 3.25%        |                   |
| Fixed Rate                            | \$        | \$       | \$       | \$          | \$       | \$ 250,000   | \$ 250,000   | \$ 230,000        |
| Weighted Average Interest Rate        |           |          |          |             |          | 7.50%        | 7.50%        |                   |
| Variable Rate                         | \$ 60,000 | \$       | \$       | \$          | \$       | \$           | \$ 60,000    | \$ 60,000         |
| Weighted Average Interest Rate        | 5.00%     |          |          |             |          |              | 5.00%        |                   |
| Variable Rate                         | \$ 4,500  | \$ 4,500 | \$ 4,500 | \$ 4,500    | \$ 4,500 | \$ 424,125   | \$ 446,625   | \$ 446,625        |
| Weighted Average Interest Rate        | 5.00%     | 5.25%    | 5.50%    | 5.50%       | 5.75%    | 5.75%        | 5.50%        |                   |
| Total Debt Obligations                | \$ 64,500 | \$ 4,500 | \$ 4,500 | \$ 4,500    | \$ 4,500 | \$ 1,525,230 | \$ 1,607,730 | \$ 1,455,488      |
| Weighted Average Interest Rate        | 5.00%     | 5.25%    | 5.50%    | 5.50%       | 5.75%    | 4.39%        | 4.36%        |                   |

*Foreign currency risk.* Overall, we are a net recipient of currencies other than the U.S. dollar and, as such, we benefit from a weaker dollar and are adversely affected by a stronger dollar relative to major currencies worldwide. Accordingly, changes in exchange rates, and in particular a strengthening of the U.S. dollar, may negatively affect our consolidated net sales and gross profit as expressed in U.S. dollars.

We may enter into foreign exchange option and forward contracts to reduce earnings and cash flow volatility associated with foreign exchange rate changes to allow management to focus its attention on its core business operations. Accordingly, we enter into contracts which change in value as foreign exchange rates change to economically offset the effect of changes in value of foreign currency assets and liabilities, commitments and anticipated foreign currency denominated sales and operating expenses. We enter into foreign exchange option and forward contracts in amounts between minimum and maximum anticipated foreign exchange exposures, generally for periods not to exceed one year. We do not enter into foreign exchange option and forward contracts for trading purposes.



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We use foreign currency option contracts, which provide for the sale of foreign currencies to offset foreign currency exposures expected to arise in the normal course of our business. While these instruments are subject to fluctuations in value, such fluctuations are anticipated to offset changes in the value of the underlying exposures. The principal currencies subject to this process are the Japanese yen and the euro. The foreign exchange forward contracts are entered into to protect the value of foreign currency denominated monetary assets and liabilities, and the changes in the fair value of the foreign exchange forward contracts were economically designed to offset the changes in the revaluation of the foreign currency denominated monetary assets and liabilities. These forward contracts are denominated in currencies which represent material exposures. The changes in the fair value of foreign currency option and forward contracts are recorded through earnings as Unrealized (gain) loss on derivative instruments, while any realized gains or losses on expired contracts are recorded through earnings as Other, net in the accompanying unaudited consolidated statements of operations. Any premium cost of purchased foreign exchange option contracts are recorded in Other current assets and amortized over the life of the options.

The following table provides information about our foreign currency derivative financial instruments outstanding as of September 26, 2008 and December 31, 2007, respectively. The information is provided in U.S. dollar amounts, as presented in our consolidated financial statements.

|  | September 26,<br>2008                 |  | December 31, 2007                     |  |
|--|---------------------------------------|--|---------------------------------------|--|
|  | Notional<br>Amount<br>(in \$millions) | Average<br>Contract<br>or Strike<br>Rate | Notional<br>Amount<br>(in \$millions) | Average<br>Contract<br>or Strike<br>Rate |
| <b>Foreign currency forward contracts:</b>     |                                       |  |                                       |  |
| <b>Pay US\$/Receive Foreign Currency:</b>      |                                       |  |                                       |  |
| U.K. Pound                                     | \$ 20.2                               | 0.54                                     | \$ 17.9                               | 0.50                                     |
| Danish Krone                                   | 1.3                                   | 5.09                                     | 1.4                                   | 5.11                                     |
| Swiss Franc                                    | 5.1                                   | 1.09                                     | 4.4                                   | 1.13                                     |
| Norwegian Krone                                |                                       |  | 0.8                                   | 5.44                                     |
| Swedish Krona                                  | 2.3                                   | 6.63                                     |                                       |  |
| <b>Receive US\$/Pay Foreign Currency:</b>      |                                       |  |                                       |  |
| Swedish Krona                                  |                                       |  | 24.9                                  | 6.42                                     |
| Canadian Dollar                                | 4.3                                   | 1.03                                     | 9.1                                   | 0.99                                     |
| Australia Dollar                               | 2.5                                   | 1.21                                     | 3.5                                   | 1.14                                     |
| Japanese Yen                                   | 1.9                                   | 105.94                                   | 16.8                                  | 112.90                                   |
| <b>Total Notional</b>                          | <b>\$ 37.6</b>                        |  | <b>\$ 78.8</b>                        |  |
| <b>Estimated Fair Value</b>                    | <b>\$</b>                             |  | <b>\$ (0.2)</b>                       |  |
| <b>Foreign currency purchased put options:</b> |                                       |  |                                       |  |
| Japanese Yen                                   | \$ 15.1                               | 112.80                                   | \$ 35.8                               | 119.02                                   |
| Euro   | 22.8                                  | 1.43                                     | 46.0                                  | 1.32                                     |
| <b>Foreign currency sold call options:</b>     |                                       |  |                                       |  |
| Japanese Yen                                   | 18.1                                  | 93.96                                    | 29.3                                  | 114.97                                   |
| Euro   | 25.2                                  | 1.58                                     | 46.0                                  | 1.32                                     |
| <b>Total Notional</b>                          | <b>\$ 81.2</b>                        |  | <b>\$ 157.1</b>                       |  |
| <b>Estimated Fair Value</b>                    | <b>\$ 0.1</b>                         |  | <b>\$ (6.1)</b>                       |  |

The notional principal amount provides one measure of the transaction volume outstanding as of the end of the period, and does not represent the amount of our exposure to market loss. The estimate of fair value is based on applicable and commonly used prevailing financial market information as of September 26, 2008 and December 31, 2007, respectively. The amounts ultimately realized upon settlement of these financial instruments, together with the gains and losses on the underlying exposures, will depend on actual market conditions during the remaining life of the instruments.



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**Item 4. Controls and Procedures**

As of the end of the period covered by this report, we carried out an evaluation, under the supervision and with the participation of our principal executive officer and principal financial officer, of the effectiveness of the design and operation of our disclosure controls and procedures. Based on this evaluation, our principal executive officer and principal financial officer concluded that our disclosure controls and procedures (as defined in Rule 13a-15(e) and Rule 15d-15(e) under the Securities Exchange Act of 1934) are effective. There have been no changes during the fiscal quarter ended September 26, 2008 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

**PART II OTHER INFORMATION****Item 1. Legal Proceedings**

On August 24, 2007 and September 13, 2007, two purported class action complaints were filed by Scott Kairalla and Barry Galison (the Galison case), respectively, in the U.S. District Court of the Central District of California on behalf of purchasers of our securities between January 4 and May 25, 2007. The Galison case was dismissed without prejudice on November 20, 2007. An amended consolidated complaint was filed on January 18, 2008 (Consolidated Complaint). The Consolidated Complaint alleges claims under the Securities Exchange Act of 1934 against us and certain of our officers and directors. The Consolidated Complaint alleges that we made material misrepresentations concerning our *Complete MoisturePlus* product. We filed a motion to dismiss the Consolidated Complaint on February 29, 2008 on behalf of all defendants. On June 6, 2008, the Court granted AMO's motion, dismissed the Consolidated Complaint without prejudice, and granted plaintiffs leave to amend on or before July 7, 2008. Rather than file an amended complaint, Plaintiffs agreed to voluntarily dismiss the Consolidated Complaint and the case was dismissed with prejudice on July 11, 2008.

As of September 26, 2008, we have been served or are aware that we have been named as a defendant in approximately 146 product liability lawsuits pending in various state and federal courts within the U.S. as well as certain jurisdictions outside the U.S. in relation to the May 25, 2007 recall of *Complete MoisturePlus* Multi-Purpose Solution. These suits involve allegations of personal injury to 174 consumers. Of these 146 cases, 127 have been filed in various U.S. courts, 13 in Canada and two in jurisdictions outside North America. None of the U.S. personal injury actions have been filed as purported class actions; however, ten of the Canadian personal injury matters seek class action status. In addition to personal injury suits, three U.S. and four Canadian matters have been filed as purported class actions by uninjured consumers seeking reimbursement for discarded product pursuant to various consumer protection statutes.

These cases involve complex medical and scientific issues relating to both liability and damages. Moreover, most of the plaintiffs seek unspecified damages. Because of this, and because these types of suits are inherently unpredictable, we are unable at this time to predict the outcome of these matters. We intend to vigorously defend ourselves in these matters; however, litigation may be both time-consuming and disruptive to our operations and cause significant expense and diversion of management attention, regardless of the merits of the cases. In recognition of these considerations, we could enter into settlements or incur judgments that, individually or in the aggregate, could have a material adverse impact on our financial condition or results of operations in any such period.

While we are involved from time to time in litigation arising in the ordinary course of business, including product liability claims, we are not currently aware of any other actions against us or Allergan, Inc. (Allergan) relating to the optical medical device business that we believe would have a material adverse effect on our business, financial condition, results of operations or cash flows. We may be subject to future litigation and infringement claims, which could cause us to incur significant expenses or prevent us from selling our products. We operate in an industry susceptible to significant product liability claims. Product liability claims may be asserted against us in the future arising out of the 2007 Recall and/or events not known to us at the present time. Under the terms of the contribution and distribution agreement affecting our spin-off from Allergan, Allergan agreed to assume responsibility for, and to indemnify us against, all current and future litigation relating to its retained businesses and we agreed to assume responsibility for, and to indemnify Allergan against, all current and future litigation related to the optical medical device business.

**Table of Contents****Item 1A. Risk Factors**

As a result of developments in the global economy and its impact upon the refractive industry, in particular, we are providing an update of the risk factor below. Except as set forth below, there have been no material changes to the risk factors disclosed in our Annual Report on Form 10-K for the year ended December 31, 2007.

Risks Relating to Our Business

*General economic conditions have had, and may continue to have, a negative impact on our business, financial position, and results of operations.*

Because laser vision correction is not subject to reimbursement from third-party payors such as insurance companies or government programs, the cost of laser vision correction is typically borne by individuals directly. The global economic weakness has caused, and we expect it to continue to cause, individuals to be less willing to incur the procedure cost associated with laser vision correction, until the economy improves. This decline in economic conditions, especially in the United States and Europe, has resulted in a decline in the number of laser vision correction procedures performed. Excimer and femtosecond laser system sales have also declined, and may continue to decline, until economic conditions begin to recover. Some of our customers, in particular our corporate LASIK chain customers, are experiencing financial difficulties as a result of the economic weakness and its effect on the refractive industry. As a result, we may not be able to maintain our level of profitability or collect cash that is due to us from these customers. Lower procedure and system sale revenues in our Refractive business, as well as an inability to collect on accounts receivable, could have a material adverse effect on our business and our ability to generate cash flow from operations, which in turn could impact our ability to reduce debt and comply with our debt covenants under our senior credit facility.

**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds****ISSUER PURCHASES OF EQUITY SECURITIES**

| Period                                | (a) Total Number<br>of Shares<br>(or Units)<br>Purchased(1) | (b) Average<br>Price Paid per<br>Share (or unit) | (c) Total Number<br>of Shares (or Units)<br>Purchased as Part of<br>Publicly Announced<br>Plans or Programs | (d) Maximum Number<br>(or Approximate Dollar<br>Value) of Shares (or Units)<br>that May Yet Be<br>Purchased Under the Plans<br>or Programs |
|---------------------------------------|---|--|---|--|
| June 28, 2008 to July 25, 2008        | 3,706   | \$ 18.54   |   |  |
| July 26, 2008 to August 29, 2008      |   |  |   |  |
| August 30, 2008 to September 26, 2008 | 526   | \$ 22.33   |   |  |
| Total                                 | 4,232   | \$ 19.01   |   |  |

(1) Represents shares purchased from employees to pay taxes related to an employee benefit plan.



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**Item 6. Exhibits**

- 31.1 Certification of James V. Mazzo pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2 Certification of Michael J. Lambert pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32.1 Certification of James V. Mazzo and Michael J. Lambert pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

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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.

Date: November 4, 2008

ADVANCED MEDICAL OPTICS, INC.

/s/ MICHAEL J. LAMBERT

**Michael J. Lambert**

**Executive Vice President and Chief Financial Officer**

**(Principal Financial Officer)**

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EXHIBIT INDEX

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