MENTOR CORP /MN/
Form 10-Q
August 06, 2008

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q

(Mark One)

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

For the quarterly period ended
June 27, 2008
or

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

For the transition period from _____ to _____
Commission File No. 001-31744
MENTOR CORPORATION
(Exact Name of Registrant as Specified in its Charter)

Minnesota	41-0950791
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)

201 Mentor Drive, Santa Barbara, California 93111
(Address of principal executive offices) (Zip Code)
(805) 879-6000
(Registrant s telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or 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 þ No o
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. (Check one):

Large accelerated filer þ	Accelerated filer o	Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes o No þ
As of August 1, 2008 there were approximately 33,774,689 Common Shares, $.10 par value per share, outstanding.

MENTOR CORPORATION
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PART I FINANCIAL INFORMATION

Item 1. Consolidated Financial Statements

Mentor Corporation
Consolidated Balance Sheets
(Unaudited)

(in thousands)	June 27, 2008	March 31, 2008
Assets		
Current assets:		
Cash and cash equivalents	**$ 74,635**	$ 79,697
Marketable securities	**31,148**	30,218
Accounts receivable, net	**85,869**	82,060
Inventories	**51,275**	49,940
Deferred income taxes	**27,406**	29,040
Prepaid income taxes	**5,566**	8,074
Prepaid expenses and other	**10,527**	11,233
Total current assets	**286,426**	290,262
Property and equipment, net	**65,852**	58,252
Intangible assets, net	**39,419**	36,336
Goodwill, net	**50,179**	49,707
Other assets	**5,695**	6,022
Total assets	**$ 447,571**	$ 440,579

See notes to consolidated financial statements.

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Mentor Corporation
Consolidated Balance Sheets
(Unaudited)

(in thousands, except share data)	June 27, 2008	March 31, 2008
Liabilities and shareholders equity		
Current liabilities:		
Accounts payable and accrued liabilities	**$ 46,328**	$ 43,209
Sales returns	**16,379**	17,344
Accrued compensation	**14,568**	22,026
Dividends payable	**6,752**	6,748
Product liability reserves	**6,628**	6,945
Deferred revenue	**2,638**	2,693
Warranty reserve	**2,370**	2,534
Short-term portion of long-term debt	**828**	935
Other	**17,446**	15,955
Total current liabilities	**113,937**	118,389
Long-term accrued liabilities	**27,698**	27,536
Long-term debt	**1,356**	1,620
Convertible subordinated notes	**150,000**	150,000
Commitments and contingencies		
Shareholders equity:		
Common stock, $.10 par value:		
Authorized 150,000,000 shares; issued and outstanding		
33,758,085 shares at June 27, 2008;		
33,739,203 shares at March 31, 2008;	**3,376**	3,374
Preferred stock, $.01 par value:		
Authorized 25,000,000 shares; none issued and outstanding		
Capital in excess of par value	**3,348**	
Accumulated other comprehensive income	**32,221**	31,992
Retained earnings	**115,635**	107,668
Total shareholders equity	**154,580**	143,034
Total liabilities and shareholders equity	**$ 447,571**	$ 440,579

See notes to consolidated financial statements.

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Mentor Corporation
Consolidated Statements of Income
(Unaudited)

	Three Months Ended	
(in thousands, except per share data)	**June 27, 2008**	June 29, 2007
Net sales	**$ 105,536**	$ 95,564
Cost of sales	**29,395**	21,224
Gross profit	**76,141**	74,340
Selling, general, and administrative	**42,967**	36,045
Research and development	**10,982**	10,314
	53,949	46,359
Operating income from continuing operations	**22,192**	27,981
Interest expense	**(1,470)**	(1,464)
Interest income	**594**	4,774
Other income (expense), net	**34**	(294)
Income from continuing operations before income taxes	**21,350**	30,997
Income taxes	**6,248**	9,253
Income from continuing operations	**15,102**	21,744
Loss from discontinued operations, net of tax benefit of $212 and $32, respectively	**(385)**	(60)
Gain on sale of discontinued operations, net of tax of $20		54
Net income	**$ 14,717**	$ 21,738
Basic earnings (loss) per share		
Continuing operations	**$ 0.45**	$ 0.54
Discontinued operations	**$ (0.01)**	$
Basic earnings per share	**$ 0.44**	$ 0.54
Diluted earnings (loss) per share		
Continuing operations	**$ 0.40**	$ 0.48
Discontinued operations	**$ (0.01)**	$
Diluted earnings per share	**$ 0.40**	$ 0.48

Dividends per share	**$**	**0.20**	$	0.20
Weighted average shares outstanding				
Basic		**33,472**		40,465
Diluted		**39,277**		46,950

See notes to consolidated financial statements.

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Mentor Corporation
Consolidated Statements of Cash Flows
(Unaudited)

	Three Months Ended	
(in thousands)	June 27, 2008	June 29, 2007
Net income:	**$ 14,717**	$ 21,738
Less: loss from discontinued operations, net of income taxes	**385**	6
Income from continuing operations	$ **15,102**	$ 21,744
Operating Activities:		
Adjustments to derive cash flows from continuing operating activities:		
Depreciation	**2,079**	1,556
Amortization	**1,942**	849
Deferred income taxes	**792**	1,452
Non-cash compensation	**2,962**	3,242
Tax benefit from exercise of stock options	**10**	231
Excess tax benefits from equity compensation	**(107)**	(134)
Loss (gain) on long-term marketable securities, net	**40**	(40)
Cash provided by (used in) changes in operating assets and liabilities:		
Accounts receivable	**(3,907)**	(5,908)
Inventories	**(1,000)**	1,443
Other current assets	**3,742**	6
Accounts payable and accrued liabilities	**(3,694)**	(58)
Net cash provided by continuing operating activities	**17,961**	24,383
Net cash used for discontinued operating activities	**(385)**	(6)
Net cash provided by operating activities	**17,576**	24,377
Investing Activities:		
Purchases of property and equipment	**(10,080)**	(3,717)
Purchases of intangibles	**(5,073)**	
Purchases of marketable securities	**(7,681)**	(5,711)
Sales of marketable securities	**6,881**	3,403
Acquisitions, net of cash acquired	**(173)**	
Net cash used for continuing investing activities	**(16,126)**	(6,025)
Financing Activities:		
Repurchase of common stock	**(209)**	(210,496)
Proceeds from exercise of stock options and ESPP	**588**	1,170
Excess tax benefits from equity compensation	**107**	134
Dividends paid	**(6,748)**	(8,480)
Repayments of debt	**(398)**	

Net cash used for continuing financing activities		**(6,660)**		(217,672)
Effect of currency exchange rates of continuing operations		**148**		544
Decrease in cash and cash equivalents		**(5,062)**		(198,776)
Cash and cash equivalents at beginning of year		**79,697**		371,525
Cash and cash equivalents at end of period	**$**	**74,635**	$	172,749

See notes to consolidated financial statements.

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MENTOR CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
June 27, 2008

Note A Business Activity

Mentor Corporation was incorporated in April 1969. Unless the context indicates otherwise, when we refer to Mentor, we, us, our, or the Company in these notes, we are referring to Mentor Corporation and its subsidiaries on a consolidated basis. Presently, the Company develops, manufactures, licenses and markets a range of products serving the aesthetic and general surgery markets, including plastic and reconstructive surgery.

On June 2, 2006, the Company completed a transaction for the sale of the Surgical Urology and the Clinical and Consumer Healthcare segments (together referred to as the Urology Business) to Coloplast A/S (Coloplast). Please see Note N to the consolidated financial statements for further information.

Note B Summary of Significant Accounting Policies

The consolidated financial statements include the accounts of the Company and all of its subsidiaries in which a controlling interest is maintained. All intercompany accounts and transactions have been eliminated.

Basis of Presentation

The accompanying unaudited consolidated financial statements for the three months ended June 27, 2008 and June 29, 2007 have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and with instructions to Form 10-Q and Article 10 of Regulation S-X and in the opinion of management includes all adjustments (consisting only of normally recurring accruals, unless otherwise indicated) that the Company considers necessary for a fair presentation of the results of operations for this period.

Interim results are not necessarily indicative of results for the full fiscal year. The balance sheet at March 31, 2008 has been derived from the audited financial statements as of that date, but does not include all of the information and notes required by accounting principles generally accepted in the United States for complete financial statements.

The consolidated financial statements should be read in conjunction with the Company s Annual Report on Form 10-K for the year ended March 31, 2008.

Use of Estimates

Financial statements prepared in accordance with accounting principles generally accepted in the United States require management to make estimates and judgments that affect amounts and disclosures reported in the financial statements. Actual results could differ from those estimates.

Revenue Recognition

The Company recognizes product revenue, net of discounts, returns, rebates, and taxes collected from customers in accordance with Statement of Financial Accounting Standards (SFAS) No. 48, Revenue Recognition When the Right of Return Exists, and Staff Accounting Bulletin (SAB) No. 104, Revenue Recognition. As required by these standards, revenue is recorded when persuasive evidence of a sales arrangement exists, delivery has occurred, the buyer s price is fixed or determinable, contractual obligations have been satisfied, and collectibility is reasonably assured. These requirements are met, and sales and related cost of sales are recognized upon the shipment of products, or in the case of consignment inventories, upon the notification of usage by the customer. The Company records estimated reductions to revenue for customer programs and other volume-based incentives. Should the actual level of customer participation in these programs differ from those estimated, additional adjustments to revenue may be required. The Company also allows credit for products returned within its policy terms. The Company records an allowance for estimated returns at the time of sale based on historical experience, recent gross sales levels, any notification of pending returns and other relevant information. Should the actual returns differ from those estimated, additional adjustments to revenue and cost of sales may be required.

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The Company has current and long term deferred revenue, which include funds received in connection with purchases of the Company s Enhanced Advantage Breast Implant Limited Warranty program. The fees received in connection with a sale of the Enhanced Advantage Breast Implant Limited Warranty are deferred and recognized evenly over the life of the warranty term.

Warranty Reserves

The Company offers limited warranty coverage on some of its products (see Note F for details). While the Company engages in extensive product quality programs and processes, including actively monitoring and evaluating the quality of our component and raw material suppliers, the limited warranty obligation is affected by reported rates of warranty claims and levels of financial assistance specified in the limited warranties. Should actual patient claim rates reported differ from the Company s estimates and/or changes in claim rates result in revised actuarial assumptions, additional adjustments to the estimated limited warranty liability may be required. These adjustments would be included in cost of sales. The Company s limited warranty programs may be modified in the future in response to the competitive market environment. Such changes may impact the amount and timing of the associated revenue and expense for these programs.

Product Liability Reserves

The Company has product liability reserves for product-related claims to the extent those claims may result in litigation expenses, settlements or judgments within the Company s self-insured retention limits. The Company has also established additional reserves for its continuing operations, through its wholly-owned captive insurance company, for estimated liabilities for product-related claims based on actuarially determined estimated liabilities taking into account its excess insurance coverages and retention levels. The actuarial valuations are based on historical information and certain assumptions about future events. Product liability costs are recorded in selling, general and administrative expenses as they are directly under the control of its General Counsel and other general and administrative staff and are directly impacted by the Company s overall risk management strategy; or in the case of products related to discontinued operations, including urology products or ophthalmic products, product liability costs are recorded in discontinued operations. Should actual product liability experience differ from the estimates and assumptions used to develop these reserves, subsequent changes in reserves will be recorded in selling, general and administrative expenses or discontinued operations, and may affect the Company s operating results in future periods.

Employee Stock-Based Payments

The Company has employee compensation plans under which various types of stock-based instruments have been granted. These instruments principally include stock options, restricted stock and performance units. As of June 27, 2008, these plans have instruments outstanding that might require the issuance of 4.9 million shares of common stock to its employees and directors. Stock-based awards under the Company s employee compensation plans are made with authorized, but unissued, shares reserved for this purpose.

Effective April 1, 2006, the Company adopted the fair value recognition provisions of SFAS No. 123(R), Share-Based Payment (SFAS 123(R)). In addition to recognizing compensation expense related to restricted stock and performance units, SFAS 123(R) also requires the Company to recognize compensation expense related to the estimated fair value of stock options and other equity based compensation instruments. The Company adopted SFAS 123(R) using the modified-prospective-transition method. Under that transition method, compensation expense recognized subsequent to adoption includes: (a) compensation cost for all share-based payments granted prior to, but not yet vested, as of April 1, 2006, based on the values estimated in accordance with the original provisions of SFAS 123, and (b) compensation cost for all share-based payments granted subsequent to April 1, 2006 based on the grant-date fair values estimated in accordance with the provisions of SFAS 123(R).

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Effects of Recent Accounting Pronouncements

In September 2006, the Financial Accounting Standards Board (FASB) issued SFAS No. 157, Fair Value Measurements (SFAS 157). This statement defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles (GAAP), and expands disclosure about fair value measurements. This statement applies under other accounting pronouncements that require or permit fair value measurements. Accordingly, this statement does not require any new fair value measurements. The Company adopted SFAS 157 in the first quarter of fiscal 2009, and it did not have a material impact on the Company s results of operations or financial position.

In February 2007, FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Liabilities including an amendment of FASB Statement No. 115 (SFAS 159). SFAS 159 permits entities to choose to measure certain financial assets and liabilities at fair value. Unrealized gains and losses, arising subsequent to adoption, are reported in earnings. SFAS 159 was effective April 1, 2008. The Company did not elect the fair value option for any of its eligible financial instruments and other items.

In June 2007, FASB ratified Emerging Issues Task Force Issue No. 07-3, Accounting for Nonrefundable Advance Payments for Goods or Services Received for Use in Future Research and Development Activities (EITF No. 07-3). EITF No. 07-3 requires that nonrefundable advance payments for goods and services that will be used or rendered in future research and development activities pursuant to executory contractual arrangements should be deferred and recognized as an expense in the period that the related goods are delivered or services are performed. The Company adopted EITF No. 07-3 in the first quarter of fiscal 2009, and it did not have a material impact on the Company s results of operations or financial position.

In December 2007, FASB ratified Emerging Issues Task Force Issue No. 07-1, Accounting for Collaborative Arrangements (EITF No. 07-1). EITF No. 07-1 requires a company in a collaborative arrangement to present the results of activities for which it acts as the principal on a gross basis and to report any payments received from (made to) other collaborators based on other applicable GAAP or, in the absence of other applicable GAAP, based on analogy to authoritative literature or a reasonable, rational, and consistently applied accounting policy election. The Company is required to adopt EITF No. 07-1 for annual periods beginning after December 15, 2008. The Company is currently evaluating the requirements of EITF No. 07-1 and it is not expected to have a material impact on the Company s consolidated financial statements.

In December 2007, FASB issued SFAS No. 141(R), Business Combinations (SFAS 141(R)) and SFAS No. 160, Accounting and Reporting of Noncontrolling Interests in Consolidated Financial Statements an amendment of ARB No. 51 (SFAS 160). These standards will significantly change the accounting and reporting for business combination transactions and noncontrolling (minority) interests in consolidated financial statements, including capitalizing at the acquisition date the fair value of acquired in-process research and development and remeasuring and writing down these assets, if necessary, in subsequent periods during their development. These new standards will be applied prospectively for business combinations that occur on or after January 1, 2009, except that presentation and disclosure requirements of SFAS 160 regarding noncontrolling interests shall be applied retrospectively.

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In May 2008, FASB issued FASB Staff Position (FSP) Accounting Principles Board (APB) 14-1, Accounting for Convertible Debt Instruments That May Be Settled in Cash upon Conversion (Including Partial Cash Settlement) (FSP APB 14-1). FSP 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 of the conversion option. FSP APB 14-1 requires bifurcation of the instrument into a debt component that is initially recorded at fair value and an equity component. The difference between the fair value of the debt component and the initial proceeds from issuance of the instrument is recorded as a component of equity. The liability component of the debt instrument is accreted to par using the effective yield method; accretion is reported as a component of interest expense. The equity component is not subsequently re-valued as long as it continues to qualify for equity treatment. FSP APB 14-1 must be applied retrospectively to previously issued cash-settleable convertible instruments as well as prospectively to newly issued instruments. FSP APB 14-1 is effective for fiscal years beginning after December 15, 2008, and interim periods within those fiscal years. The Company is currently evaluating the requirements of FSP APB 14-1 and based on the fact that upon conversion the notes would be entirely settled in shares, the FSP is not expected to have a material impact on the Company s consolidated financial statements.

In June 2008, the FASB ratified the consensus reached on EITF Issue No. 07-05, Determining Whether an Instrument (or Embedded Feature) Is Indexed to an Entity s Own Stock (EITF No. 07-05). EITF No. 07-05 clarifies the determination of whether an instrument (or an embedded feature) is indexed to an entity s own stock, which would qualify as a scope exception under SFAS 133, Accounting for Derivative Instruments and Hedging Activities . EITF No. 07-05 is effective for financial statements issued for fiscal years beginning after December 15, 2008. Early adoption for an existing instrument is not permitted. The Company is currently evaluating the requirements of EITF No. 07-05 and it is not expected to have a material impact on the Company s consolidated financial statements.

Note C Cash Equivalents, Marketable Securities, and Long-Term Marketable Securities and Investments

All highly liquid investments with maturities of three months or less at the date of purchase are considered to be cash equivalents.

The Company considers its marketable securities available-for-sale as defined in SFAS No. 115, Accounting for Certain Investments in Debt and Equity Securities. Available-for-sale securities are reported at fair market value. Realized gains and losses, and declines in value considered to be other than temporary, are included in income. The cost of securities sold is based on the specific identification method. Unrealized gains and losses are excluded from income, and are reported as a net amount in Accumulated Other Comprehensive Income in Shareholders Equity. The Company s short-term marketable securities consist primarily of state and municipal government and government agency obligations, Federal Home Loan Bank and Mortgage Association bonds, and investment-grade corporate obligations, including commercial paper. None of our investments include auction rate securities.

Cash and available-for-sale investments at June 27, 2008 were as follows:

(in thousands)	Adjusted Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Cash balances	$ 69,337	$	$	$ 69,337
Money market funds	5,298			5,298
U.S. Government and agency obligations	16,234		(36)	16,198
State and Municipal agency obligations	14,667	3		14,670
Corporate debt	281		(1)	280
Total available-for-sale investments	$ 105,817	$ 3	$ (37)	$ 105,783
Included in cash and cash equivalents	$ 74,635	$	$	$ 74,635
Included in current marketable securities	31,182	3	(37)	31,148

Total available-for-sale investments	**$ 105,817**	**$ 3**	**$ (37)**	**$ 105,783**

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Cash and available-for-sale investments at March 31, 2008 were as follows:

(in thousands)	Adjusted Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Cash balances	$ 71,756	$	$	$ 71,756
Money market funds	7,941			7,941
U.S. Government and agency obligations	15,336	16		15,352
State and Municipal agency obligations	14,582	3		14,585
Corporate debt	281			281
Total available-for-sale investments	$ 109,896	$ 19	$	$ 109,915
Included in cash and cash equivalents	$ 79,697	$	$	$ 79,697
Included in current marketable securities	30,199	19		30,218
Total available-for-sale investments	$ 109,896	$ 19	$	$ 109,915

Our debt securities include U.S. Government and agency obligations and corporate debt with maturities within one year and highly liquid variable rate State and Municipal agency obligations with maturities greater than ten years.

Fair Values of Financial Instruments

As disclosed in Note B, Basis of Presentation, SFAS No. 159 was effective on April 1, 2008. The Company did not elect the fair value option as allowed by SFAS No. 159 for its financial assets and liabilities that were not previously carried at fair value. Therefore, material financial assets and liabilities that are not carried at fair value, such as short-term and long-term debt obligations and trade accounts receivable and payable, are still reported at their historical carrying values, which approximates fair value.

The Company adopted the provisions of SFAS No. 157, Fair Value Measurements effective April 1, 2008. This statement defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles (GAAP), and expands disclosure about fair value measurements. This statement applies under other accounting pronouncements that require or permit fair value measurements. Accordingly, this statement does not require any new fair value measurements. The adoption of SFAS No. 157 did not have a material impact on the Company s results of operations or financial position.

The fair value hierarchy established by SFAS No. 157 includes three levels which are based on the priority of the inputs to the valuation technique. The fair value hierarchy gives the highest priority to quoted prices in active markets for identical assets or liabilities (Level 1) and the lowest priority to unobservable inputs (Level 3). If the inputs used to measure the financial instruments fall within different levels of the hierarchy, the categorization is based on the lowest level input that is significant to the fair value measurement of the instrument. The Company has no financial instruments categorized under Level 3. In accordance with SFAS No. 157, the Company s financial assets that are recorded on the Consolidated Balance Sheets are categorized as Level 1 or Level 2 based on the inputs to the valuation techniques as follows:

Level 1 Valuations based on unadjusted quoted prices for identical assets or liabilities in an active market that the Company has the ability to access.

Level 2 Valuations based on quoted prices for similar assets or liabilities in active markets, quoted prices for identical or similar assets or liabilities in markets that are not active or model inputs that are observable either directly or indirectly for substantially the full term of the asset or liability.

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The following fair value hierarchy table presents information about each major category of the Company s financial assets and liabilities measured at fair value on a recurring basis as of June 27, 2008:

	Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)	**Balance as of June 27, 2008**
Assets (in thousands)				
Money market funds	**$ 5,298**	**$**	**$**	**$ 5,298**
U.S. Government and agency obligations		**16,198**		**16,198**
State and Municipal agency obligations		**14,670**		**14,670**
Corporate debt		**280**		**280**
Total	**$ 5,298**	**$ 31,148**	**$**	**$ 36,446**

There were no remeasurements to fair value during the three months ended June 27, 2008 of financial assets and liabilities that are not measured at fair value on a recurring basis.

Note D Inventories

Inventories are stated at the lower of cost or market, under which cost is determined by the first-in, first-out (FIFO) method. In the case of inventory acquired in an acquisition, inventory is valued at fair value. The Company writes down its inventory for estimated obsolescence or unmarketable inventory equal to the difference between the cost of inventory and the estimated market value based upon assumptions about future demand and market conditions. Inventories at June 27, 2008 and March 31, 2008 consisted of:

(in thousands)	**June 27, 2008**	March 31, 2008
Raw materials	**$ 8,735**	$ 7,327
Work in process	**6,503**	6,950
Finished goods on consignment	**17,200**	18,058
Finished goods	**18,837**	17,605
	$ 51,275	$ 49,940

Note E Long-Lived Assets

Property and equipment is stated at cost. Depreciation is based on the useful lives of the assets and computed using the straight-line method. Buildings are depreciated over 17 to 30 years, furniture and equipment over three to 10 years and leasehold improvements over the shorter of their estimated useful lives ranging from three to 15 years or lease terms. Significant improvements and betterments are capitalized while maintenance and repairs are charged to operations as incurred.

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Property and equipment at June 27, 2008 and March 31, 2008 consisted of:

(in thousands)	June 27, 2008	March 31, 2008
Land	$ 275	$ 276
Buildings	13,737	13,909
Leasehold improvements	23,727	23,747
Furniture, fixtures and equipment	72,067	70,832
Construction in progress	29,242	20,657
	139,048	129,421
Less accumulated depreciation and amortization	(73,196)	(71,169)
	$ 65,852	$ 58,252

Intangible assets include a $5.0 million milestone payment paid to Genzyme Biopharmaceuticals in the first quarter of fiscal 2009. This milestone payment is being amortized over five years which is based on the term of the expected product life cycle of the underlying product.

Note F Warranty Reserves

The Company offers two types of limited warranties relating to its breast implants in the United States and Canada: a standard limited warranty which is offered at no additional charge and an enhanced limited warranty, generally at an additional charge of $100 in the U.S. ($100 CAD in Canada), both of which provide limited financial assistance in the event of a deflation or rupture and free product replacement. The Company s standard limited warranty is also offered in certain European and other international countries for silicone gel-filled breast implants. During the fourth quarter of fiscal 2007, the Company began a limited-time offer of free enrollment in its Enhanced Advantage Limited Warranty for MemoryGel implants implanted after February 15, 2007 in the U.S. The Company provides an accrual for the estimated cost of the standard and/or free limited breast implant warranties at the time revenue is recognized. The cost of the enhanced limited warranty, when sold at an additional charge to the patient, is recognized as costs are incurred. Costs related to warranties are recorded in cost of sales. The accrual for the standard and/or free limited warranty is based on estimates, which are based on relevant factors such as unit sales, historical experience, the limited warranty period, estimated costs, and information developed using actuarial techniques. The accrual is analyzed periodically for adequacy. During the first quarter of fiscal 2008, the Company recorded an adjustment reducing its domestic warranty reserves as a result of this periodic analysis in the amount of $2.9 million relating to pre-existing warranties.

Information on changes in the Company s accrued product warranty reserves is as follows:

	Three Months Ended	
(in thousands)	June 27, 2008	June 29, 2007
Beginning warranty reserves	$ 11,944	$ 14,308
Costs of warranty claims	(677)	(673)
Accruals for product warranties	941	1,230
Adjustments made to accruals related to pre-existing warranties		(2,914)
Ending warranty reserves	$ 12,208	$ 11,951

The total warranty reserve of $12.2 million as of June 27, 2008 is made up of a current portion of $2.4 million included in current liabilities and a long-term portion of $9.8 million included in Long-term accrued liabilities on the Company s Consolidated Balance Sheet.

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Note G Comprehensive Income

Comprehensive income is net income adjusted for changes in unrealized gains and losses on marketable securities and foreign currency translations.

Comprehensive income for the three month periods ended June 27, 2008 and June 29, 2007 was:

	Three Months Ended	
(in thousands)	**June 27, 2008**	June 29, 2007
Net income	**$ 14,717**	$ 21,738
Foreign currency translation adjustment	**269**	1,674
Unrealized losses on marketable securities and investment activities, net	**(40)**	(40)
Comprehensive income	**$ 14,946**	$ 23,372

Note H Income Taxes

The effective tax rate for the three months ended June 27, 2008 is different from the statutory rate primarily as a result of indefinitely invested earnings of our foreign operations. We do not provide for U.S. income taxes on undistributed earnings of our foreign operations that are intended to be invested indefinitely outside the United States.

One or more of our legal entities file income tax returns in the U.S. federal jurisdiction, various U.S. state jurisdictions and certain foreign jurisdictions. Our income tax returns are routinely audited by the tax authorities in those jurisdictions. Significant disputes can arise with these tax authorities involving issues of the timing and amount of deductions and allocations of income among various tax jurisdictions because of differing interpretations of tax laws and regulations. We are no longer subject to U.S. federal income tax examinations for years ending on or before March 31, 2004 or to California state income tax examinations for years ending on or before March 31, 2003.

During the three months ended June 27, 2008, the gross amount of our unrecognized tax benefits (UTBs) increased approximately $0.6 million as a result of tax positions taken during the current year. The majority of our UTBs at June 27, 2008, if recognized, would affect our effective tax rate.

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Note I Earnings per Share

A reconciliation of net income as reported to net income used to calculate diluted earnings per share follows:

	Three Months Ended	
(in thousands)	**June 27, 2008**	June 29, 2007
Net income from continuing operations: as reported	**$ 15,102**	$ 21,744
Add back after tax interest expense on convertible notes	**802**	802
Net income from continuing operations for numerator of diluted earnings per share	**$ 15,904**	$ 22,546

	Three Months Ended	
(in thousands)	**June 27, 2008**	June 29, 2007
Net loss from discontinued operations	**$ (385)**	**$ (6)**
Net income: as reported	**14,717**	21,738
Add back after tax interest expense on convertible notes	**802**	802
Net income for numerator of diluted earnings per share	**$ 15,519**	$ 22,540

A reconciliation of weighted average shares outstanding, used to calculate basic earnings per share, to weighted average shares outstanding assuming dilution, used to calculate diluted earnings per share, follows:

	Three Months Ended	
(in thousands, except per share data)	**June 27, 2008**	June 29, 2007
Weighted average outstanding shares: basic	**33,472**	40,465
Unvested restricted grants	**338**	285
Shares issuable through exercise of stock options	**271**	678
Shares issuable through convertible notes	**5,196**	5,165
Shares issuable through warrants		357
Weighted average outstanding shares: diluted	**39,277**	46,950
Basic earnings (loss) per share		
Continuing operations	**$ 0.45**	$ 0.54
Discontinued operations	**$ (0.01)**	$
Basic earnings per share	**$ 0.44**	$ 0.54
Diluted earnings (loss) per share		
Continuing operations	**$ 0.40**	$ 0.48
Discontinued operations	**$ (0.01)**	$
Diluted earnings per share	**$ 0.40**	$ 0.48

Employee stock options, restricted shares and performance stock units

Shares issuable under the Company s Long Term Incentive Plan, including employee stock options, restricted shares and performance stock units, may be included in the diluted earnings per share calculation using the treasury stock method. The Company would exclude the potential stock issuances in the diluted earnings per share calculation when the combined exercise price, average unamortized fair values and assumed tax benefits upon exercise are greater than the average market price for the Company s underlying common stock as the inclusion of these shares in the diluted shares outstanding would be anti-dilutive. The total number of shares excluded based on this policy for the three month period ended June 27, 2008 and June 29, 2007, was approximately 3.9 million and 0.3 million shares, respectively. This calculation is performed on an instrument-by-instrument basis.

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Convertible subordinated notes and warrants

The terms of the Company s convertible subordinated notes include restrictions which prevent the holder from converting the notes until the Company s share price exceeds the 120% conversion price on 20 trading days of the 30 consecutive trading day period ending on the first day of such fiscal quarter. However, EITF No. 04-8 The Effect of Contingently Convertible Debt on Diluted Earnings per Share (EITF 04-8) requires that the Company use the if-converted method to determine the dilutive impact of the convertible subordinated notes described in Note L Long Term Debt. Under the if-converted method, the numerator of the diluted earnings per share calculation is increased by the after-tax interest expense not recognized for the period upon conversion and the denominator of the calculation is increased by approximately 5.2 million shares potentially issued upon conversion for both that current reporting period and the corresponding year-to-date reporting period.

As described in Note L, the Company purchased a convertible note hedge and sold warrants which, in combination, have the effect of reducing the dilutive impact of the convertible subordinated notes by increasing the effective conversion price for the notes from the Company s perspective to $38.8613. SFAS No. 128, Earnings per Share (SFAS 128), however, requires the Company to analyze the impact of the convertible note hedge and warrants on diluted earnings per share separately. As a result, the purchase of the convertible note hedge is excluded because its impact will always be anti-dilutive. SFAS 128 further requires that the impact of the sale of the warrants be computed using the treasury stock method.

For example, using the treasury stock method, if the average price of the Company s stock during the period ended June 27, 2008 had been $38.00, $50.00 or $60.00, the shares from the warrants to be included in diluted earnings per share would have been -0-, 1.2 million and 1.8 million shares, respectively. The total maximum number of shares that could potentially be included under the warrants is approximately 5.2 million. The average share price of our stock during the quarter ended June 27, 2008 did not exceed the $38.8613 conversion price of the warrants. The impact of these warrants was that no shares were added to the diluted shares and diluted earnings per share calculation during the quarter ended June 27, 2008.

Note J Stock Options, Restricted Stock and Employee Stock Purchase Plan

Employee Stock Purchase Plan

In September 2005, the Company s Board of Directors approved its Employee Stock Purchase Plan (ESPP). The ESPP is intended to assist the Company in securing and retaining its U.S. based employees by allowing them to participate in the ownership and growth of the Company through the grant of certain rights to purchase shares of the Company s common stock at an initial discount of 5% from the fair market value of its shares. The granting of such rights serves as partial consideration for employment and gives employees an additional inducement to remain in the service of the Company and its subsidiaries and provides them with an increased incentive to work toward the Company s success. Under the ESPP, each eligible employee is permitted to purchase shares of common stock through regular payroll deductions and/or cash payments in amounts ranging from 1% to 15% of the employee s compensation for each payroll period. The fair market value of the shares of common stock which may be purchased by any employee under this or any other plan of the Company is intended to comply with Section 423 of the Internal Revenue Code.

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The ESPP provides for a series of consecutive offering periods that are three months long commencing on each Grant Date. Offering periods commence on January 1, April 1, July 1 and October 1 of each year. During each offering period, participating employees are able to purchase shares of common stock at a purchase price equal to 95% of the fair market value of the common stock at the end of each offering period. Under terms of the ESPP, 400,000 shares of common stock have been reserved for issuance to employees. As of June 27, 2008, approximately 6,000 shares have been sold under the plan.

Long-Term Incentive Plans

The Company has two plans under which equity awards have been issued, the 1991 Stock Option Plan and the Mentor Corporation 2005 Long-Term Incentive Plan, which was amended in November 2005, September 2006 and September 2007 (as amended, the 2005 Plan). The current aggregate share limit for the 2005 Plan is 7,600,000 shares. The 2005 Plan reflects, among other things, amendments to the earlier plans to (i) provide the Company with flexibility to grant awards other than stock options, including but not limited to restricted stock, stock bonuses, stock units and dividend equivalents; (ii) allow the Company to grant awards intended to qualify as performance-based compensation within the meaning of Section 162(m) of the U.S. Internal Revenue Code; and (iii) extend the term of the plan to July 24, 2015.

Persons eligible to receive awards under the 2005 Plan include directors, officers or employees of the Company, and certain of its consultants and advisors. The types of awards that may be granted under the 2005 Plan include stock options, restricted stock, stock bonuses, stock units and dividend equivalents, and other forms of awards granted or denominated in the Company s common stock or units of the Company s common stock, as well as certain cash bonus awards.

On August 9, 2007 the Company s Board of Directors approved the 2007 Strategic Equity Incentive Plan (the Sub-Plan) under the 2005 Plan. The Board s objective in establishing the Sub-Plan was to create a long-term incentive plan for the Company s top 40 executives and senior managers, including the Company s executive officers, designed to reward the participants for achieving superior financial results for the Company over a period of approximately four fiscal years.

The Sub-Plan provides for the grants of non-qualified stock options to key employees of the Company. The exercise price for the shares subject to the options was set at a premium to the closing trading price of the Company s common stock as reported by the New York Stock Exchange on the date of grant. The shares subject to the options will vest subject to the attainment of specified earnings per share (EPS) targets over the second half of fiscal 2008 and the full fiscal years 2009, 2010 and 2011. The vesting percentages are disproportionately skewed to the achievement of the EPS targets in fiscal years 2010 and 2011, and the EPS targets represent compounded growth rates that are in excess of recent EPS growth rates for the Company.

Restricted Stock

Restricted stock vests and restrictions lapse, with respect to one-fifth of the total number of shares of restricted stock on each of the first, second, third, fourth and fifth anniversaries of the Award Date. The vesting schedule requires continued employment or service through each applicable vesting date as a condition to the vesting of the applicable installment of the restricted stock.

Stock compensation expense is recognized over the five-year vesting period of the restricted stock grants. As of June 27, 2008 there was $5.1 million of total unrecognized compensation expense related to nonvested shares. That expense is expected to be recognized over a weighted-average period of 3.3 years. The Company recognizes total compensation cost on a straight-line basis over the service period of each vesting tranche.

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The total fair value of shares vested during the three months ended June 27, 2008 and June 29, 2007 was $0.7 million and $1.3 million, respectively.

The fair value of shares of restricted stock is determined based on the closing price of the Company s common stock on the grant dates. Information regarding our restricted stock during the three months ended June 27, 2008 is as follows:

Nonvested shares (in thousands, except per share amounts)	Shares	Weighted-average grant date fair value
Nonvested at March 31, 2008	287	$ 46.03
Restrictions lapsed	(24)	41.05
Forfeited	(6)	49.67
Nonvested at June 27, 2008	**257**	**$ 46.41**

Options

The Company has granted options to key employees and non-employee directors under its 2005 Plan and 1991 Plan. With the exception of options issued under the Sub-Plan described above, options granted under both plans are generally exercisable in four equal annual installments beginning one year from the date of grant, and expire ten years from the date of grant. Options are granted at the fair market value on the date of grant.

Options issued under the Sub-Plan are exercisable, subject to the attainment of EPS targets over a forty-two month period and expire seven years from the date of grant. The EPS targets are disproportionately skewed to the achievement of the EPS targets in fiscal 2010 and 2011. They were issued with an exercise price at a premium to the fair market value on the date of grant.

Activity in the stock option plans during the three months ended June 27, 2008 was as follows:

(in thousands, except per share amounts and years)	**Options**	**Weighted-average exercise price**	**Weighted-average remaining contractual life (Yrs)**	**Aggregate intrinsic value**
Balance outstanding at March 31, 2008	4,638	$ 40.39		
Granted	46	28.52		
Exercised	(34)	16.51		
Forfeited/expired	(15)	39.27		
Balance outstanding at June 27, 2008	**4,635**	**$ 40.45**	**6.44**	**$ 7,356**
Vested and Expected to Vest at June 27, 2008	**4,326**	**$ 40.00**	**6.37**	**$ 7,356**
Exercisable at June 27, 2008	**1,503**	**$ 26.70**	**5.22**	**$ 7,356**

As of June 27, 2008, there was $5.9 million of total unrecognized compensation expense related to stock options granted under the 2005 and 1991 Plans expected to be recognized over a weighted average period of 2.79 years. The Company recognizes total compensation cost on a straight-line basis over the service period of each vesting tranche. Additionally, there was $26.2 million of unrecognized compensation expense related to stock options granted under the Sub-Plan which will be recognized if specified EPS targets are met. No amounts have yet been recognized related to options granted under the Sub-Plan. It is unknown how much, or when, any expense will be recognized.

At June 27, 2008, the 2005 Plan had options for 4.4 million shares granted and outstanding, and 0.2 million shares available for grant. The 1991 Plan had options for 0.2 million shares granted and outstanding at June 27, 2008. No

additional options can be granted under the 1991 Plan.

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The weighted-average fair value of stock options granted was $6.44 per share for the three months ended June 27, 2008. There were 45,500 stock options granted during the three months ended June 27, 2008. No stock options were granted during the three months ended June 29, 2007. The weighted-average fair value of stock options were estimated at the date of grant using the Black-Scholes option valuation model and the following assumptions:

	June 27, 2008
Risk-free interest rate	**3.0%**
Expected life (in years)	**5.1**
Expected volatility	**34%**
Expected dividend yield	**2.8%**

Performance Award Program

In June and July 2006, certain management-level employees received grants of Performance Stock Units (PSUs). A PSU gives the recipient the right to receive common stock that is contingent upon achievement of specified pre-established performance goals over a performance period ending March 31, 2009. The performance goals are based upon Mentor s total shareholder return compared to the average total shareholder return reported by the Russell 2500 Growth Index over the performance period.

PSUs are assigned a unit value based on the fair market value of the Company s common stock on the grant date. The ultimate level of attainment of performance goals is determined at the end of the performance period and expressed as a percentage (within a range of 0% to 200%). This percentage is multiplied by the number of PSUs initially granted to determine the number of shares of common stock payable to the recipient. In addition, dividends that would have accrued over the performance period attributable to the final share grant under the program will be payable to the recipients.

Vesting of the PSUs occurs entirely on March 31, 2009. Consequently, no PSUs have yet vested, no common stock has been issued and no dividends have been accrued or paid to any recipient as of June 27, 2008. The fair value of the PSUs at the date of grant is being amortized as compensation expense over the performance period. The fair value of the PSUs at the date of grant was determined using a Monte Carlo Simulation Model.

Information regarding our PSUs during the three months ended June 27, 2008 is as follows, assuming the maximum distribution under the plan:

Nonvested performance stock units (in thousands)	Shares	Fair market value at date of grant
Nonvested at March 31, 2008	302	$ 6,411
Forfeited		(2)
Nonvested at June 27, 2008	**302**	**$ 6,409**

As of June 27, 2008 there was $1.6 million of total unrecognized compensation expense related to nonvested shares. That expense is expected to be recognized over a weighted-average period of 10 months. The Company recognizes total compensation cost on a straight-line basis over the service period of each vesting tranche. Because no shares vested during the three months ended June 27, 2008, the total fair value of shares vested was $0.

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Compensation Expense

The following table reflects the components of stock-based compensation expense recognized in the Company s Consolidated Statements of Income for the three months ended June 27, 2008 and June 29, 2007, respectively:

	Three Months Ended	
(in thousands)	**June 27, 2008**	June 29, 2007
Stock options	**$ 1,464**	$ 962
Restricted stock	**976**	1,698
Performance units	**522**	582
Total stock-based compensation expense, pre-tax	**2,962**	3,242
Tax benefit from stock-based compensation expense	**(856)**	(1,103)
Total stock-based compensation expense, net of tax	**$ 2,106**	$ 2,139

The employee stock-based compensation cost reflected above that would be properly capitalized as part of inventory and included in research and development expense for the three months ended June 27, 2008 was minor.

Note K Share Repurchase Program

The Company has a share repurchase program, primarily to reduce the overall number of shares outstanding and to offset the dilutive effects of the Company s employee equity compensation programs and dilution related to the Company s convertible notes from the inclusion of contingently convertible debt in fully diluted earnings per share calculations.

On June 16, 2006, the Company entered into a stock purchase plan with Citigroup Global Markets Inc. for the purpose of repurchasing up to 5.0 million shares of the Company s common stock, up to a cumulative purchase price of $166 million, under a Rule 10b5-1 Plan (the 2006 10b5 Plan) compliant with Rule 10b-18. In connection with the entry into the 2006 10b5 Plan, the Company s Board of Directors increased the authorized number of shares available for repurchase pursuant to the stock repurchase program from 3.3 million to 5.0 million shares. In the three months ended June 29, 2007, the Company purchased 3.9 million shares for a total purchase price of $157.8 million under the 2006 10b5 Plan, and the 2006 10b5 Plan terminated on June 15, 2007.

On June 18, 2007, the Company entered into a second Rule 10b5-1 stock purchase plan (the 2007 10b5 Plan) compliant with Rule 10b-18 with Citigroup Global Markets Inc. for the purpose of repurchasing its common stock, up to a cumulative purchase price of $200 million. In connection with the entry into the 2007 10b5 Plan, the Company s Board of Directors increased the authorized number of shares available for repurchase pursuant to the stock repurchase program by 5.0 million shares. In the three months ended June 29, 2007, the Company purchased 1.3 million shares for a total purchase price of $52.7 million under the 2007 10b5 Plan, and the 2007 10b5 terminated on June 17, 2008.

During the quarter ended June 29, 2007, the Company repurchased an aggregate of 5.2 million shares of its common stock under the 2006 and 2007 10b5 Plans for a total of $210.5 million. No shares were repurchased under the 2007 10b5 Plan during the quarter ended June 27, 2008.

In addition to the share repurchases mentioned above, the Company acquired an additional 7,617 and 4,937 shares for the payment of withholding taxes related to the lapsing of restrictions on certain outstanding restricted stock grants during the three month period ending June 27, 2008 and June 29, 2007, respectively.

As of June 27, 2008, approximately 0.8 million shares remained authorized by the Company s Board of Directors for future repurchase under the Company s stock repurchase program. All shares previously repurchased under the program have been retired and are no longer deemed to be outstanding. The timing of repurchases is subject to market conditions, cash availability and the terms of any stock repurchase plan in place at that time. There is no guarantee that the remaining shares authorized for repurchase by the Board will ultimately be repurchased. The additional shares available for repurchase are subject to limitations set forth in the Company s Credit Agreement previously entered into

on May 26, 2005, amended on May 31, 2006 and further amended on March 30, 2007.

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The amended Credit Agreement now permits the repurchase of up to $400 million of equity securities, a portion of which was utilized in the repurchases described above, leaving a remaining amount of $31.4 million as of June 27, 2008. In addition, after the $400 million is utilized for such repurchases, the Company may repurchase during any four consecutive quarters additional equity securities in an amount limited to the Company s consolidated net income, less dividends paid, for the preceding four quarters. See Note M Short Term Bank Borrowings for additional information on the Credit Agreement.

Note L Long Term Debt

On December 22, 2003, the Company completed an offering of $150 million of convertible subordinated notes due January 1, 2024 pursuant to Rule 144A under the Securities Act of 1933. The notes bear interest at 2 3/4% per annum and are convertible into shares of the Company s common stock at an adjusted conversion price of $28.8684 per share and are subordinated to all existing and future senior debt.

Holders of the notes may convert their notes only if any of the following conditions is satisfied:

- during any fiscal quarter prior to January 1, 2019, if the closing price of the Company s common stock for at least 20 trading days in the 30 consecutive trading day period ending on the first trading day of such fiscal quarter is more than 120% of the conversion price per share of the Company s common stock on such trading day;
- any business day on or after January 1, 2019, if the closing price of the Company s common stock on the immediately preceding trading day is more than 120% of the conversion price per share of the Company s common stock on such trading day;
- during the five business day period after any five consecutive trading day period if the average of the trading prices of the notes for such five consecutive trading day period is less than 98% of the average of the conversion values of the notes during such period, subject to certain limitations;
- if the Company has called the notes for redemption; or
- if the Company makes certain significant distributions to holders of its common stock or the Company enters into specified corporate transactions.

At an initial conversion price of $29.289, each $1,000 principal amount of notes was convertible into 34.1425 shares of common stock. As a result of the Company s dividend increases, the conversion price has been adjusted to $28.8684, and each $1,000 principal amount will be convertible into 34.64 shares of common stock.

The holders of the notes may redeem all or part of the notes for cash on January 1, 2009 at a price equal to 100.25% of the principle amount of the notes being redeemed, plus accrued interest. Based on a commitment we have received from our bank to extend our Credit Agreement in the amount of $150 million through October 31, 2009 (see further discussion of our Credit Agreement in Note M Short Term Bank Borrowings) and our intent to utilize the credit facility to refinance the notes if required, the notes have been classified as long term in the accompanying consolidated balance sheets.

Concurrent with the issuance of the convertible subordinated notes, the Company purchased a convertible note hedge from Credit Suisse First Boston LLC. The note hedge expires on January 1, 2009 and gives the Company the ability to purchase shares of its common stock equal to the number of shares the Company is obligated to issue under any convertible notes converted by the holder prior to the hedge expiration date at a purchase price equal to the conversion price of the convertible notes.

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Concurrent with the issuance of the notes, the Company also issued warrants to Credit Suisse First Boston LLC. The warrants are European-style call warrants, which also expire on January 1, 2009. The holder of the warrants is entitled to purchase 5.2 million shares of the Company s common stock at $38.8613. The number of shares and exercise price of the warrants are subject to adjustment from time to time in a similar manner to the convertible notes.

Both the note hedge and the warrants may be settled either in cash or shares at the Company s option. The Company is not obligated under either the warrants or the note hedge to settle its obligations in cash. Under no circumstance is the Company obligated to issue shares under the note hedge. The warrants do require the Company to settle its obligations thereunder in cash or shares, do permit the Company to settle its obligation in unregistered shares and contain no provision obligating the Company to settle its obligations in freely-tradable shares, and the Company is not required to make any cash payments under the warrants for failure to have a registration statement declared effective. There are no required cash payments to the holder of the warrants if the shares initially delivered upon settlement are subsequently sold by the holder and the sales proceeds are insufficient to provide the holder with an expected return. The Company has sufficient authorized shares to settle the warrants and the convertible notes in shares, considering all of its obligations under the instruments for their full terms. The warrants, note hedge, and convertible notes each contain an express limit on the number of shares issuable thereunder. The warrants and note hedge expressly indicate that the holder of the warrants has no rank higher than those of a shareholder of the stock underlying the warrants. Under certain circumstances in a change of control of the Company it may be required to issue additional shares under a make-whole provision under the warrant. The Company has no obligation to post collateral under the warrants, convertible notes or note hedge.

The cost of the note hedge and the proceeds from the sale of warrants has been included in shareholders equity in accordance with the guidance in EITF No. 00-19, Accounting for Derivative Financial Instruments Indexed to and Potentially Settled in a Company s Own Stock. Any proceeds received or payments made upon termination of these instruments will be recorded in shareholders equity.

On July 2, 2007, the Company acquired all of the outstanding shares of Perouse Plastie SAS, including the assumption of approximately 3.0 million in net debt. The debt consists primarily of installment loans with an average term of 6 years and a weighted average interest rate of 3.8%. Approximately 1.4 million, or $2.2 million, is currently outstanding, of which $1.4 million is considered long term. The loans may be repaid at any time, subject to certain notice requirements of the lenders. See Note Q for further information regarding this acquisition.

Note M Short Term Bank Borrowings

Credit Agreement

On May 26, 2005, the Company entered into a Credit Agreement (the Credit Agreement) that provides a $200 million senior revolving credit facility, subject to a $20 million sublimit for the issuance of standby and commercial letters of credit, a $10 million sublimit for swing line loans and a $50 million alternative currency sublimit. The Credit Agreement expires on September 30, 2008. At the election of the Company, and subject to lender approval, the amount available for borrowings under the Credit Agreement may be increased by an additional $50 million. Funds under the Credit Agreement are available to the Company to finance permitted acquisitions, for stock repurchases up to certain dollar limitations, and for other general corporate purposes.

During the quarter ended June 28, 2006, the Company entered into an Amendment to the Credit Agreement (First Amendment) to permit the Company to consummate the sale of its surgical urology and clinical and consumer health care segments. Additionally, the First Amendment released urology subsidiaries as guarantors, released the pledges of the capital stock of urology subsidiaries, modified the minimum EBITDA, modified certain covenants restricting the Company to enter into certain investments, incur indebtedness and increased the amount of its equity securities the Company is allowed to repurchase.

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On March 30, 2007, the Company amended the Credit Agreement a second time. The amendment permits the Company to declare or pay annual dividends up to $0.90 per share and repurchase up to an aggregate of $400 million worth of its common stock after March 30, 2007. The Company has one standby letter of credit totaling $0.8 million outstanding which is secured by the Credit Agreement. Accordingly, although there were no borrowings outstanding under the Credit Agreement at June 27, 2008, only $199 million was available for borrowings.

Interest on borrowings (other than swing line loans) under the Credit Agreement is at a variable rate that is calculated, at the Company s option, at either prime rate or LIBOR, plus an additional percentage that varies depending on the Company s senior leverage ratio (as defined in the Credit Agreement) at the time of the borrowing. Swing line loans bear interest at the prime rate plus additional basis points, depending on the Company s senior leverage ratio at the time of the loan. In addition, the Company paid certain fees to the lenders to initiate the Credit Agreement and pays an unused commitment fee based on the Company s senior leverage ratio and unborrowed lender commitments.

Borrowings under the Credit Agreement are guaranteed by certain of the Company s domestic subsidiaries and are also secured by a pledge of 100% of the outstanding capital stock of certain other domestic subsidiaries. In addition, if the ratio of total funded debt to adjusted EBITDA exceeds 2.50 to 1.00, the Company is obligated to grant to the lenders a first priority perfected security interest in essentially all of its domestic assets.

The Credit Agreement imposes certain financial and operational restrictions on the Company and its subsidiaries, including financial covenants that require the Company to maintain a maximum consolidated funded debt leverage ratio of not greater than 4.00 to 1.00, a senior funded debt ratio of not greater than 2.50 to 1.00, minimum quarterly EBITDA, and a minimum fixed charge ratio of greater than 1.25 to 1.00. The covenants also restrict the Company s ability, among other things, to make certain investments, incur certain types of indebtedness or liens, make acquisitions in excess of $20 million except in compliance with certain criteria, and repurchase shares of common stock, pay dividends or dispose of assets above specified thresholds. The Credit Agreement also contains customary events of default, including payment defaults, material inaccuracies in its representations and warranties, covenant defaults, bankruptcy and involuntary proceedings, monetary judgment defaults in excess of specified amounts, cross-defaults to certain other agreements, change of control, and ERISA defaults. If an event of default occurs and is continuing, the commitments under the Credit Agreement may be terminated and the principal amount and all accrued but unpaid interest and other amounts owed thereunder may be declared immediately due and payable. As of June 27, 2008, all covenants and restrictions had been satisfied, and there were no borrowings outstanding under the Credit Agreement.

Other Financing

On October 4, 2005, Mentor Medical Systems B.V., (Mentor BV), a wholly-owned subsidiary of Mentor Corporation, entered into a Loan and Overdraft Facility (the Facility) with Cooperative RaboBank Leiden, Leiderdorp en Oestgstgeest U.A. (RaboBank).

The Facility provides Mentor BV with an initial 15 million loan and overdraft facility, which began decreasing by 375,000 quarterly in September 2006. Under the Facility, Mentor BV may borrow up to 12.5 million in fixed amount advances, with terms of three to six months, and a further sublimit of up to 5 million of loans in fixed amount advances with a term of up to five years. Up to 10 million of the Facility may be drawn in the form of U.S. Dollars. Funds under the Facility are available to Mentor BV to finance certain dividend payments to Mentor Corporation and for other normal business purposes. As of June 27, 2008, there was no outstanding balance under the Facility, and accordingly, $18.9 million was available for borrowing.

Interest on borrowings under the Facility is at a rate equal to 0.55% over the RaboBank base lending rate, Euribor, or LIBOR depending upon the currency and term of each borrowing. Interest rates on borrowings other than overdrafts are fixed for the term of the advance. Borrowings by Mentor BV under the Facility are guaranteed by Mentor s wholly-owned subsidiary Mentor Medical Systems CV through a Joint and Several Debtorship agreement. In addition, borrowings under the Facility are secured by certain real estate owned by Mentor BV.

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The Facility imposes certain financial and operational restrictions on Mentor BV, including financial covenants that require Mentor BV and Mentor Medical Systems CV to maintain a minimum combined defined solvency ratio, a maximum combined debt leverage ratio of not greater than 4 to 1, a senior funded debt ratio of not greater than 2.5 to 1, minimum quarterly operational results, and a minimum interest coverage ratio of greater than 5 to 1. The Facility also contains customary events of default, including cross default and material or adverse change provisions. If an event of default occurs, the commitments under the Facility may be terminated and the principal amount and all accrued but unpaid interest and other amounts owed thereunder may be declared immediately due and payable. As of June 27, 2008, all covenants and restrictions were satisfied.

Mentor BV paid 15,000 in certain fees to the RaboBank upon entry into the Facility, and Mentor BV is obligated to pay, over the ten year term of the Facility, a commitment fee of 0.25% of the committed and unborrowed balances. Fees are payable quarterly in arrears.

At June 27, 2008 and March 31, 2008, there was approximately $0.8 million and $0.9 million, respectively, in short term debt outstanding. A total of $218.2 million was available under all lines of credit at June 27, 2008, and approximately $218.8 million was available under all lines of credit at March 31, 2008.

Note N Discontinued Operations

In May 2006, the Company executed a definitive agreement for the sale of the Company s surgical urology and clinical and consumer healthcare business segments to Coloplast for $463 million, of which $456 million was in cash and $7 million in non-cash consideration consisting of an indemnification by Coloplast to Mentor related to certain foreign tax credits. The sale was completed on June 2, 2006. Operations associated with these discontinued segments and other former businesses have been classified as income from discontinued operations in the accompanying consolidated statements of income, and cash flows associated with these segments are included in cash flows from discontinued operations in the consolidated statements of cash flows. Net cash used in discontinued operations for the three months ended June 27, 2008 and June 29, 2007, was $0.4 million and $6,000, respectively.

For the three months ending June 27, 2008 and June 29, 2007, loss before income taxes from discontinued operations was $0.6 million and $92,000, respectively.

Note O Postretirement Benefit Plan

The Company s Savings and Investment Plan is a qualified salary-reduction plan under Section 401(k) of the Internal Revenue Code in which substantially all of our U.S. employees may participate by contributing a portion of their compensation. The Company matches contributions up to a specified percentage of each employee s compensation. Charges against income for the matching contributions were $0.5 million and $0.2 million for the three month periods ending June 27, 2008 and June 29, 2007, respectively.

Note P Contingencies

Warranty, product liability and related claims are a regular and ongoing aspect of the medical device and biologics industries. At any one time, the Company may be subject to claims against it and may be involved in litigation. These actions can be brought by an individual, a group of patients, or by a group of patients purported to be a class action. The Company is currently involved in a number of product liability legal actions and related claims, the outcomes of which are not within its control and may not be known for prolonged periods of time. The Company has retained liabilities associated with warranty and product liability and related claims arising out of its discontinued products, including urology products sold prior to the June 2, 2006 closing date of the sale of the urology business to Coloplast A/S. No individual product liability case or group of cases in which the Company is currently involved, is considered material and there are no certified class actions currently pending against the Company. In accordance with SFAS No. 5 Accounting for Contingencies, a liability is recorded in the consolidated financial statements when a loss is known or considered probable and the amount can be reasonably estimated. If the reasonable estimate of a known or probable loss is a range, and no amount within the range is a better estimate, the minimum amount of the range is accrued. If a loss is not probable or cannot be reasonably estimated, no liability is recorded in the consolidated financial statements.

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The Company carries product liability insurance on all its products. This insurance is subject to certain self-insured retention and other limits of the policy, exclusions and deductibles that the Company believes to be appropriate. The Company had established reserves of $1.8 million and $2.4 million at June 27, 2008 and March 31, 2008, respectively, for product-related claims to the extent that those claims may result in settlements or judgments within its self-insured retention limits. In addition, the Company had established additional reserves for its continuing operations of $4.8 million and $4.5 million at June 27, 2008 and March 31, 2008, respectively, through its wholly-owned captive insurance subsidiary based on actuarially determined estimates and taking the Company s excess insurance coverage into account. Those reserves were actuarially determined based on historical information, trends and certain assumptions about future claims and are primarily for claims that have been asserted. Should actual product liability experience differ from the estimates and assumptions used to develop these reserves, subsequent changes in these reserves will be recorded in selling, general and administrative expenses or discontinued operations and may affect the Company s operating results in future periods.

In addition, the Company also offers limited warranty coverage on some of its products (see Note F for details). While the Company engages in extensive product quality programs and processes, including actively monitoring and evaluating the quality of its raw material and component suppliers, the limited warranty obligation is affected by reported rates of product problems as well as the costs incurred in correcting product problems. Should actual warranty experience differ from the estimates and assumptions used to develop the warranty reserves, subsequent changes in the reserves will be recorded in cost of sales and may affect our operating results in future periods.

In addition, in the ordinary course of its business, the Company experiences various types of claims that sometimes result in litigation or other legal proceedings. The Company does not anticipate that any of these current proceedings will have a material adverse effect on the Company.

Note Q Acquisitions

On July 2, 2007 the Company purchased all of the outstanding shares of Perouse Plastie SAS (Perouse). Perouse is an international breast implant manufacturer based in France that currently supplies a complete range of products for the European and Latin American markets. The Company paid $53.4 million in cash (net of cash acquired) in the second quarter of fiscal 2008. In addition, the Company incurred approximately $0.5 million in acquisition costs and paid a net working capital adjustment of $0.2 million (in the first quarter of fiscal 2009), bringing the total purchase price to $54.1 million.

The acquisition was accounted for using the purchase method of accounting and, accordingly, the purchase price was allocated to the tangible and intangible net assets acquired on the basis of their respective values on the acquisition date. The results of Perouse operations are included in the Company s consolidated results since acquisition date. Pro forma results of operations for the first quarter of fiscal year 2008 as though the acquisition had taken place at the beginning of the period, would not differ significantly from the actual results for the period.

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The following table summarizes the Company s determination of the fair values of the assets acquired and liabilities assumed at July 2, 2007.

(In thousands)		
Cash	$	436
Accounts receivable		3,508
Inventory		8,953
Prepaid expenses and other current assets		980
Total current assets		13,877
Property, plant and equipment		4,934
Intangible assets		18,423
Goodwill		32,268
Other assets		39
Total assets acquired	$	69,541
Liabilities associated with acquisition:		
Accounts payable and accrued liabilities	$	7,049
Other long-term liabilities		8,424
Total liabilities assumed	$	15,473
Net assets acquired	$	54,068

Of the $18.4 million of acquired intangible assets, $8.7 million was assigned to developed technology with a useful life of seven years (based on the excess earnings method under the income approach), $5.4 million was assigned to customer relationships with a four year life for distributors (based on the with and without method under the income approach) and an eight year life for physicians and hospitals (based on the excess earnings method under the income approach), $0.3 million was assigned to a covenant not to compete with a useful life of three years (based on the with and without method under the income approach), and $4.0 million was assigned to trade names (based on the royalty relief method), which has an indefinite life and is therefore not subject to amortization. The weighted average amortization period for the intangible assets with definite lives is 6.5 years.

Of the $8.4 million in other long-term liabilities, $5.5 million is the long-term portion of deferred taxes related to the intangibles acquired. The remaining $2.9 million is the long-term portion of capital lease obligations and outstanding bank loans assumed.

Note R Capital Lease Obligations

The Company s manufacturing, warehousing and administrative offices in Bornel, France are leased under a non-cancelable lease classified as a capital lease. Leased property under the capital lease as of June 27 and March 31, 2008, net of $0.1 million of accumulated amortization, totals $1.3 million and is included as part of Property and equipment, net in the Company s consolidated balance sheets.

As of June 27, 2008, approximately $0.1 million and $1.0 million of capital lease obligations are included in Other current liabilities and Long-term accrued liabilities , respectively, in the Company s consolidated balance sheets. As of March 31, 2008, approximately $0.1 million and $1.1 million of capital lease obligations are included in Other current liabilities and Long-term accrued liabilities , respectively, in the Company s consolidated balance sheets. As of June 27, 2008, the lease obligation has a remaining term of 8.2 years and a weighted average interest rate of 6.1%.

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Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations

The following discussion and analysis should be read in conjunction with our Unaudited Consolidated Financial Statements and related Notes thereto contained elsewhere in this Report. The information contained in this Quarterly Report on Form 10-Q is not a complete description of our business or the risks associated with an investment in our securities. We urge you to carefully review and consider the various disclosures made by us in this Report and in our other reports filed with the Securities and Exchange Commission (SEC), including our Annual Report on Form 10-K for the year ended March 31, 2008, and subsequent reports on Form 8-K, both of which discuss our business in greater detail.

The section entitled Risk Factors set forth in Item 1A under Part II Other Information, and similar discussions in our other SEC filings, discuss some of the important risk factors that may affect our business, results of operations and financial condition. These risks, in addition to the other information in this Report and in our other filings with the SEC, should be carefully considered before deciding to purchase, hold or sell our securities.

Various statements in this Report, in future filings by us with the SEC, in our press releases and in our oral statements made by or with the approval of authorized personnel, constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Forward-looking statements are based on current expectations and are indicated by words or phrases such as anticipate, estimate, expect, intend, project, plan, believe, will, seek, and similar words or phrases and involve known and unknown risks, uncertainties and other factors which may cause actual results, performance or achievements to be materially different from any future results, performance or achievements expressed or implied by such forward-looking statements. Some of the factors that could affect our financial performance or cause actual results to differ from our estimates in, or underlying, such forward-looking statements are set forth in Part II under Item 1A Risk Factors or elsewhere in this Report.

Forward-looking statements include statements regarding, among other things:

- *our anticipated operating results for fiscal year 2009;*
- *our expectations regarding future developments in the markets in which we compete and intend to compete;*
- *our anticipated growth strategies;*
- *our intention to introduce or seek approval for new products;*
- *our ability to continue to meet United States Food and Drug Administration (FDA) and other regulatory requirements;*
- *our anticipated outcomes of regulatory reviews;*
- *our anticipated outcomes of litigation; and*
- *our ability to replace sources of supply without disruption and regulatory delay.*

These forward-looking statements are based on our expectations and are subject to a number of risks and uncertainties, many of which are beyond our control. Actual results could differ materially from these forward-looking statements as a result of the facts described in Part II under Item 1A - Risk Factors or elsewhere including, among others, problems with suppliers, changes in the competitive marketplace, significant product liability or other claims, product recalls, difficulties with new product development, the introduction of new products by our competitors, changes in the economy, FDA or other regulatory delay in approval or rejection of new or existing products, changes in Medicare, Medicaid or third-party reimbursement policies, changes in government regulations, use of hazardous or environmentally sensitive materials, inability to implement new information technology systems, inability to integrate new acquisitions, and other events. We undertake no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise. In light of these risks and uncertainties, we cannot assure you that the forward-looking information contained in this Form 10-Q will, in fact, transpire.

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Company Overview

We develop, manufacture, license and market a range of products serving the aesthetic market, including plastic and reconstructive surgery. Our products include breast implants for plastic and reconstructive surgery, capital equipment and consumables used for soft tissue aspiration for body contouring (liposuction), and facial aesthetics products.

We are headquartered in Santa Barbara, California, with manufacturing and research operations in the United States, the Netherlands, France and Mauritius and employ approximately 1,240 people around the world as of June 27, 2008.

We purchase finished products and certain raw material components from third party manufacturers and suppliers. Our cost of goods sold represents raw materials, labor and overhead, the cost of third party finished products, freight expense, royalties, amortization of certain intangibles, and the cost associated with our product warranty programs. Gross margins may fluctuate from period to period due to a variety of factors, including changes in the selling prices of our products, the mix of products sold, changes in the cost of third party finished products, raw materials, labor and overhead, fluctuations in foreign currency exchange rates, changes in warranty costs and warranty reserves, the purchase accounting treatment of acquired inventory, amortization and changes in manufacturing processes and yields.

In addition to our U.S. sales, we also sell most of our product lines outside the U.S., principally to Canada, Europe, Central and South America, and the Pacific Rim. Products are sold through our direct international sales offices in Canada, France, United Kingdom, Germany, Spain, Italy and Australia, as well as through independent distributors in other countries. Our manufactured products are mainly supplied by our plants in the U.S., the Netherlands, France and Mauritius. Our Netherlands, France and Mauritius plants serve our international branches and distributors. Our U.S. plant also serves these markets in addition to the U.S. market.

We employ a direct sales force domestically for our aesthetic surgery and facial product lines, and specialists to support our body contouring business. The sales force provides product information, training and data support and related services to physicians, nurses and other health care professionals. We promote our products through participation in and sponsorship of medical conferences and educational seminars, specialized websites, journal advertising, direct mail programs, and a variety of marketing support programs. In addition, we contribute to organizations that provide counseling and education for persons suffering from certain conditions, and we provide patient education materials for most of our products to physicians for use with their patients.

Our selling, general and administrative expenses incorporate the expenses of our sales and marketing organization and the general and administrative expenses necessary to support the global organization. Our selling expenses consist primarily of salaries, commissions, and marketing program costs. General and administrative expenses incorporate the costs of accounting, human resources, information services, equity compensation expense, certain intangible amortization, business development, legal and insurance costs.

Our research and development expenses are comprised of the following types of costs incurred in performing clinical development and research and development activities: salaries and benefits, allocated overhead, clinical trial and related clinical manufacturing costs, regulatory submission costs, contract services, other outside costs and costs related to our post-approval conditions. We also conduct research on materials technology, manufacturing processes, product design and product improvement options.

Our quarterly results reflect seasonality, as the second fiscal quarter ending in September tends to historically have the lowest revenue and profitability of all of the quarters. This is primarily due to lower levels of sales of breast implants for augmentation, an elective procedure, as many surgeons and patients take vacations during this quarter.

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Perouse Acquisition

On July 2, 2007 we purchased all of the outstanding shares of Perouse Plastie SAS (Perouse). Perouse is an international breast implant manufacturer based in France that currently supplies a complete range of breast aesthetics products, primarily for the European and Latin American markets. We paid $53.4 million in cash (net of cash acquired) in the second quarter of fiscal 2008. In addition, we incurred approximately $0.5 million in acquisition costs and paid a net working capital adjustment of $0.2 million in the first quarter of fiscal 2009, bringing the total purchase price to $54.1 million.

Important Factors

Management currently considers the following events, trends and uncertainties to be important to understanding our financial condition and operating performance:

- The performance of the U.S. economy will impact the demand for our products in the U.S. in fiscal 2009, and continued weakness in the U.S. economy could put pressure on our revenue growth and profitability;
- We are in the midst of a transition in the U.S. from saline breast implants to MemoryGel breast implants that we expect will continue over a several year period with potentially uneven rates of change that could cause revenues and profits to fluctuate quarter to quarter; and
- We are committed to investing in the i) marketing of existing products and ii) development and marketing of new aesthetics products to expand our product portfolio, which may have the effect in the short term of increasing our expenses faster than our revenues are anticipated to increase.

Our focus in fiscal year 2009 has been and will be on those activities within the aesthetics business that we can influence and control, including the following:

- competing to grow U.S. breast aesthetics market share through targeted marketing programs;
- supporting the continued transition in the U.S. from saline breast implants to MemoryGel breast implants;
- launching our entry in the U.S. dermal filler market with Prevelle Silk;
- continuing our international breast aesthetics growth strategy by leveraging the Perouse acquisition and investing in management and marketing infrastructure; and
- investing in research and development programs to expand our product portfolio and create incremental product bundling opportunities that will allow us to better serve customers.

Recent Events

In June 2008, we announced the completion of enrollment in the Phase I trial for botulinum toxin type A in patients with cervical dystonia.

APPLICATION OF CRITICAL ACCOUNTING POLICIES

Management s Discussion and Analysis of Financial Condition and Results of Operations addresses our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. On an on-going basis, we evaluate our estimates and judgments. We base our estimates and judgments on historical experience and on various other factors that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions. We believe the following critical accounting policies, among others, affect our more significant judgments and estimates used in the preparation of our consolidated financial statements.

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Revenue Recognition

We recognize product revenue, net of discounts, returns, rebates and taxes collected from customers in accordance with Statement of Financial Accounting Standards (SFAS) No. 48, Revenue Recognition When the Right of Return Exists, and Staff Accounting Bulletin (SAB) No. 104, Revenue Recognition.

As required by these standards, revenue is recorded when persuasive evidence of a sales arrangement exists, delivery has occurred, the buyer s price is fixed or determinable, contractual obligations have been satisfied, and collectibility is reasonably assured. These requirements are met, and sales and related cost of sales are recognized, upon the shipment of products, or in the case of consignment inventories, upon the notification of usage by the customer. We record estimated reductions to revenue for customer programs and other volume-based incentives. Should the actual level of customer participation in these programs differ from those estimated, additional adjustments to revenue may be required. We also allow credit for products returned within our policy terms. We record an allowance for estimated returns at the time of sale based on historical experience, recent gross sales levels and any notification of pending returns. Should the actual returns differ from those estimated, additional adjustments to revenue and cost of sales may be required.

Our current and long-term deferred revenue includes funds received in connection with sales of our Enhanced Advantage Breast Implant Limited Warranty program. The fees received in connection with a sale of such a warranty are deferred and recognized as revenue evenly over the life of the warranty term.

Accounts Receivable

We market our products to a diverse customer base, principally throughout the United States, Canada, Europe, Central and South America, and the Pacific Rim. We grant credit terms in the normal course of business to our customers, primarily hospitals, doctors and distributors. We perform ongoing credit evaluations of our customers and adjust credit limits based upon payment history and the customer s current credit worthiness, as determined through review of their current credit information. We continuously monitor collections and payments from customers and maintain allowances for doubtful accounts for estimated losses resulting from the inability of some of our customers to make required payments. Estimated losses are based on historical experience and any specifically identified customer collection issues. If the financial condition of our customers, or the economy as a whole, were to deteriorate resulting in an impairment of our customers ability to make payments, additional allowances may be required. These additional allowances for estimated losses would be included in selling, general and administrative expenses.

Inventories

We value our inventories at the lower of cost, based on the first-in first-out (FIFO) cost method, or the current estimated market value of the inventory. In the case of inventory acquired in an acquisition, inventory is valued at fair value. We write down our inventory for estimated obsolescence or unmarketable inventory equal to the difference between the cost of inventory and the estimated market value based upon assumptions about future demand and market conditions. If actual future demand or market conditions differ from those projected by us, additional inventory valuation adjustments may be required. These additional valuation adjustments would be included in cost of sales.

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Warranty Reserves

We offer two types of limited warranties relating to our breast implants in the United States and Canada: a standard limited warranty which is offered at no additional charge and an enhanced limited warranty, generally sold for an additional charge of $100 in the U.S. ($100 CAD in Canada), both of which provide limited financial assistance in the event of a deflation or rupture and free product replacement. Our standard limited warranty is also offered in certain European and other international countries for silicone gel-filled breast implants. As a competitive market response to offers made by our primary competitor as a result of the silicone gel breast implant post approval environment in the U.S., during the fourth quarter of fiscal 2007, we began a limited-time offer of free enrollment in our Enhanced Advantage Breast Implant Limited Warranty for MemoryGel implants implanted after February 15, 2007. We provide an accrual for the estimated cost of the standard and/or free limited breast implant warranties at the time revenue is recognized. The cost of the enhanced limited warranty, when sold at an additional charge to the patient, is recognized as costs are incurred. Costs related to warranties are recorded in cost of sales. The accrual for the standard and/or free limited warranty is based on estimates, which are based on relevant factors such as unit sales, historical experience, the limited warranty period, estimated costs, and information developed using actuarial techniques. The accrual is analyzed periodically for adequacy. During the first quarter of fiscal 2008, we recorded adjustments reducing our warranty reserves as a result of this periodic analysis in the amount of $2.9 million relating to pre-existing warranties. While we engage in extensive product quality programs and processes, including actively monitoring and evaluating the quality of our raw material and component suppliers, the warranty obligation is affected by reported rates of warranty claims and levels of financial assistance specified in the limited warranties. Should actual patient claim rates reported differ from our estimates and/or changes in claim rates result in revised actuarial assumptions, adjustments to the estimated warranty liability may be required. These adjustments would be included in cost of sales. Our warranty programs may be modified in the future in response to the competitive market environment. Such changes may impact the amount and timing of the associated revenue and expense for these programs.

Product Liability Reserves

We have product liability reserves for product-related claims to the extent those claims may result in litigation expenses, settlements or judgments within our self-insured retention limits. We have also established additional reserves for our continuing operations, through our wholly-owned captive insurance company, for estimated liabilities for product-related claims based on actuarially determined estimated liabilities, taking also into account our excess insurance coverages and retention levels. The actuarial valuations are based on historical information and certain assumptions about future events. Product liability costs are recorded in selling, general and administrative expenses as they are generally under the control of our General Counsel and other general and administrative staff and are directly impacted by our overall corporate risk management strategy; or in the case of products related to discontinued operations, including urology products or ophthalmic products, costs are recorded in discontinued operations. Should actual product liability experience differ from the estimates and assumptions used to develop these reserves, subsequent changes in reserves will be recorded in selling, general and administrative expenses or discontinued operations, and may affect our results in future periods.

Goodwill and Intangible Asset Impairment

We evaluate long-lived assets, including goodwill and other intangibles, for impairment whenever events or changes in circumstances indicate that the carrying value of an asset may not be recoverable. In addition, we evaluate goodwill and other intangibles annually in the fourth quarter of each fiscal year. In assessing the recoverability of goodwill and other intangibles, we must make assumptions regarding estimated future cash flows and other factors to determine the fair value of the respective assets.

Stock-Based Compensation Expense

Effective April 1, 2006 we adopted SFAS No. 123 (revised 2004), Share-Based Payment, or SFAS 123(R). SFAS 123(R) requires all share-based payments, including grants of stock options, restricted stock units and performance stock units to be recognized in our financial statements based on their respective grant date fair values. Under this standard, the fair value of each equity grant to an employee is estimated on the date of grant using an option pricing model that meets certain requirements. We currently use the Black-Scholes option pricing model to estimate the fair value of our share-based payments related to Stock Option Grants. The fair value of our restricted stock units is based

on the fair market value of our common stock on the date of grant and the fair value of our Performance Stock Units (PSUs) is estimated using a Monte Carlo simulation model.

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The Black-Scholes model used to value our stock option grants meets the requirements of SFAS 123(R), but the fair values generated by the model may not be indicative of the actual fair values of our stock-based awards as it does not consider certain factors important to stock-based awards, such as continued employment, periodic vesting requirements and limited transferability. The determination of the fair value of stock option grants utilizing the Black-Scholes model is affected by our stock price and a number of assumptions, including expected volatility, expected life, risk-free interest rate and expected dividends. We use the historical volatility for our stock as the expected volatility assumption required in the Black-Scholes model. We believe that our historical volatility is the best estimate of our future volatility. The expected life of the stock options is based on historical data. The risk-free interest rate assumption is based on observed interest rates appropriate for the terms of our stock options and stock purchase rights. The dividend yield assumption is based on our history and expectation of dividend payouts.

Stock-based compensation expense recognized in our financial statements is based on awards that are ultimately expected to vest. The amount of stock-based compensation expense has been reduced for estimated forfeitures based on historical experience. Forfeitures are required to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. We evaluate the assumptions used to value stock awards on a quarterly basis. If factors change and we employ different assumptions, stock-based compensation expense may differ significantly from what we have recorded in the past. If there are any modifications or cancellations of the underlying unvested securities, we may be required to accelerate, increase or cancel any remaining unearned stock-based compensation expense. To the extent that we grant additional equity securities to employees or we assume unvested securities in connection with any acquisitions, our stock-based compensation expense will be increased by the additional unearned compensation resulting from those additional grants or acquisitions.

Deferred Income Taxes

Our effective tax rate reflects the impact of undistributed foreign earnings for which no U.S. taxes have been provided because such earnings are intended to be invested indefinitely outside the United States based on our projected cash flow, working capital and long-term investment requirements of our U.S. and foreign operations. If future events, including material changes in estimates of cash, working capital and long-term investment requirements, necessitate that certain assets associated with these earnings be repatriated to the United States, an additional tax provision and related liability would be required which could materially impact our future effective tax rate. We recognize deferred tax assets and liabilities for temporary differences between the financial reporting basis and the tax basis of our assets and liabilities along with net operating loss and tax credit carryovers.

Effective April 1, 2007, we adopted Financial Accounting Standards Board (FASB) Interpretation No. 48, Accounting for Uncertainty in Income Taxes An Interpretation of FASB Statement No. 109 (FIN 48), which prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. Under FIN 48, the tax benefit from uncertain tax positions may be recognized only if it is more likely than not that the tax position will be sustained, based solely on its technical merits, with the taxing authority having full knowledge of all relevant information. We recognize deferred tax assets and liabilities for temporary differences between the financial reporting basis and the tax basis of our assets and liabilities along with net operating loss and tax credit carryovers only for tax positions that meet the more likely than not recognition criteria. We record a liability for unrecognized tax benefits from uncertain tax positions as discrete tax adjustments in the first interim period that the more likely than not threshold is not met. Due to the inherent risks in the estimates and assumptions used in determining the sustainability of our tax positions and in the measurement of the related tax, our provision for income taxes and our effective tax rate may vary significantly from our estimates and from amounts reported in future or prior periods. We discuss this change in accounting principle and its effect on our consolidated financial statements in Note H of the Notes to Consolidated Financial Statements.

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RESULTS OF OPERATIONS

The following table sets forth certain data from the Consolidated Statements of Income expressed as a percentage of net sales for the periods indicated:

	Three Months Ended	
	June 27, 2008	June 29, 2007
Net sales	**100.0%**	100.0%
Cost of sales	**27.9**	22.2
Gross profit	**72.1**	77.8
Selling, general and administrative expense	**40.7**	37.7
Research and development expense	**10.4**	10.8
Operating income	**21.0**	29.3
Interest expense	**(1.4)**	(1.5)
Interest income	**0.6**	5.0
Other expense, net		(0.3)
Income from continuing operations before income taxes	**20.2**	32.5
Income taxes	**5.9**	9.7
Net income from continuing operations	**14.3**	22.8
Net loss from discontinued operations	**(0.4)**	(0.1)
Gain on sale of discontinued operations		0.1
Net income	**13.9%**	22.8%

For the three month period ended June 27, 2008 compared to the three month period ended June 29, 2007

Net Sales

Net sales for the three month period ended June 27, 2008 increased 10.4% to $105.5 million, compared to $95.6 million for the comparable period in the prior year. Foreign exchange rate movements, primarily the stronger Euro and Canadian Dollar over the same quarter in the prior year had a favorable year-to-year impact on sales of $1.6 million. The increase in net sales was primarily the result of an 11.2% increase in total sales of breast aesthetic products to $93.9 million for the quarter from $84.5 million for the same period in the prior year. Increased breast aesthetic sales were driven by growth in MemoryGel silicone-gel breast implants across all markets. Increased breast aesthetics sales were also due in part to $5.5 million in incremental sales in the current period from our Perouse operations. Excluding unit volume related to Perouse, we saw overall unit growth in unit sales of breast implant products of approximately 3%. Also contributing to sales growth were NeoForm dermis sales in the U.S. and strong global sales of tissue expanders, both of which are primarily used for breast reconstruction. We anticipate that our breast aesthetic sales in the remainder of fiscal 2009 will be driven by existing products, particularly sales of our MemoryGelÔ products in all markets and Perouse products internationally. Net sales of body contouring products were $3.7 million for the current quarter, compared to $4.0 million in the first quarter of fiscal 2008. Other aesthetic products sales increased 11.6% to $7.9 million for the quarter, from $7.0 million for the same period in the prior year due in part to increased revenue from our facial aesthetics products, including sales of our dermal fillers and $0.6 million related to Perouse. We expect net sales in the range of $405 million to $425 million for the full fiscal year 2009.

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Cost of Sales and Gross Profit

Gross profit increased $1.8 million to $76.1 million for the first quarter of fiscal 2009 from $74.3 million for the first quarter of fiscal 2008. The gross profit percentage decreased to 72.1% of net sales for the first quarter of fiscal 2008 compared to 77.8% for the same period in the prior year. The current year gross margin percentage decreased primarily due to a higher proportion of international distributor sales and by sales of lower margin Perouse products. Prior year gross margin was favorably impacted by a non-recurring adjustment related to the product warranty accrual of $2.9 million, partly offset by an inventory valuation adjustment. We believe that our gross profit as a percentage of net sales will be in the range of 71% to 73% for the full fiscal year 2009.

Selling, General and Administrative

Selling, general and administrative expenses increased to $43.0 million, or 40.7% of net sales, for the first quarter of fiscal 2009, compared to $36.0 million, or 37.7% of net sales, in the comparable period in the prior year. The increase was primarily due to Perouse costs in fiscal 2009 of $2.8 million and higher costs associated with domestic and international marketing programs and international marketing infrastructure in the current year. The increase was partially offset by favorable changes in the product liability reserve of $0.4 million and an adjustment to a previously estimated compensation accrual of $0.6 million. We expect selling, general and administrative expenses to be in the range of 41% to 43% of net sales for the full fiscal year 2009.

Research and Development

Research and development expense was $11.0 million, or 10.4% of net sales, for the first quarter of fiscal 2009, compared to the $10.3 million or 10.8% of net sales reported in the comparable period last year. This change was primarily due to increases in development costs related to our botulinum toxin program partially offset by lower spending for our dermal filler development program with Genzyme. We expect research and development expense to be in the range of 10% to 12% of net sales for the full fiscal year 2009.

Interest and Other Income and Expense

Interest expense was $1.5 million for both the first quarter of fiscal 2009 and 2008. These costs included interest on our $150 million convertible subordinated notes at 2^{3}/4% issued in December 2003, commitment fees on our credit facilities and amortization of debt issuance costs.

Interest income decreased $4.2 million to $0.6 million for the first quarter of fiscal 2009, compared to $4.8 million in the comparable period in the prior year, as a result of lower cash and marketable securities balances in the current period, due mainly to our stock buyback program in fiscal 2008.

Income Taxes

Our effective tax rate for the first quarter of fiscal 2009 was 29.3%, compared with 29.9% for the comparable period last year. The decrease in our effective tax rate for the first quarter of fiscal 2009 compared to the first quarter of fiscal 2008 was primarily due to an increase in the amount of foreign earnings intended to be invested indefinitely outside of the United States relative to total pretax income, partially offset by the expiration of the federal research and experimentation tax credit on December 31, 2007.

For further details see Note H of the Notes to Consolidated Financial Statements.

Income, Net of Income Taxes and Earnings per Share from Continuing Operations

Income from continuing operations was $15.1 million and $21.7 million for the three months ended June 27, 2008 and June 29, 2007, respectively. Basic earnings per share were $0.45 and $0.54 for these same respective periods. Diluted earnings per share were $0.40 and $0.48 for these same respective periods.

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Loss from Discontinued Operations, Net of Income Taxes

Loss from discontinued operations, net of income taxes, includes the results of our former surgical urology and clinical and consumer healthcare business segments, which were sold to Coloplast A/S on June 2, 2006. For the three months ended June 27, 2008, we had a loss from discontinued operations, net of income taxes, of $0.4 million compared to a loss from discontinued operations, net of income taxes, of $60,000 for the three months ended June 29, 2007. For further details regarding discontinued operations, see Note N of the Notes to Consolidated Financial Statements.

FINANCIAL CONDITION, LIQUIDITY AND CAPITAL RESOURCES

Cash provided by operating activities and from the exercise of employee stock options have been our primary recurring sources of funds. As of June 27, 2008, we had cash, cash equivalents and short-term marketable securities of $105.8 million, a decrease of $4.1 million from $109.9 million as of March 31, 2008. The principal components of the decrease in cash, cash equivalents and marketable securities were $15.2 million used for capital expenditures and $6.7 million in dividends paid, offset by cash generated from operating activities of continuing operations of $18.0 million.

We invest excess cash in interest bearing bank deposits and marketable securities that are highly liquid, of high-quality investment grade, and which have varying maturities. Our short-term marketable securities consist primarily of money market funds, state and municipal government and government agency obligations, Federal Home Loan Bank and Mortgage Association bonds, and investment-grade corporate obligations, including commercial paper. None of our investments include auction rate securities.

The following table summarizes our cash, cash equivalents and marketable securities for the periods noted:

(in thousands)	**June 27, 2008**	March 31, 2008
Cash and cash equivalents	**$ 74,635**	$ 79,697
Marketable securities	**31,148**	30,218
Total cash, cash equivalents and marketable securities	**$ 105,783**	$ 109,915
Percentage of total assets	**24%**	25%

Cash Flow Changes

The following table summarizes our cash flow activity:

	Three Months Ended	
(in thousands)	**June 27, 2008**	June 29, 2007
Net cash provided by continuing operating activities	**$ 17,961**	$ 24,383
Net cash used for continuing investing activities	**(16,126)**	(6,025)
Net cash used for continuing financing activities	**(6,660)**	(217,672)
Net cash used for discontinued operations	**(385)**	(6)
Effect of currency exchange rates on cash and cash equivalents	**148**	544
Decrease in cash and cash equivalents	**$ (5,062)**	$ (198,776)

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Cash Provided by Operating Activities of Continuing Operations

Cash provided by operating activities of continuing operations of $18.0 million and $24.4 million for the three months ended June 27, 2008 and June 29, 2007, respectively, was due in part to the net impact of non-cash charges to income from continuing operations. Non-cash charges primarily included non-cash compensation, depreciation, amortization and deferred income taxes. For the three month periods ended June 27, 2008 and June 29, 2007, operating cash flows were negatively impacted in the amount of $4.9 million and $4.5 million, respectively, by changes in working capital balances. Our working capital was $172.5 million at June 27, 2008, and $171.9 million at March 31, 2008.

Cash Used for Investing Activities of Continuing Operations

Historically, cash used for investing activities of continuing operations has been primarily attributable to purchases and sales of marketable debt and equity securities, as well as capital expenditures on property and equipment and intangibles. For the three months ended June 27, 2008, total cash used for investing activities of continuing operations was $16.1 million, primarily related to capital expenditures of $15.2 million and net purchases of marketable securities of $0.8 million. For the three months ended June 29, 2007, total cash used in investing activities of continuing operations was $6.0 million, primarily related to capital expenditures of $3.7 million and net purchases of marketable securities of $2.3 million. We anticipate our capital expenditures to total approximately $30 million to $40 million in fiscal 2009, as we will continue to invest in our new botulinum toxin manufacturing plant, facility improvements, software to support our manufacturing processes, production equipment and milestone payments.

Cash Used for Discontinued Operations

Cash used for discontinued operations was $0.4 million for the three months ended June 27, 2008 and $6,000 for the three months ended June 29, 2007.

Cash Used for Financing Activities of Continuing Operations

Net cash used for financing activities is primarily a result of our stock repurchase program, cash used in payments of dividends, and the net impact of our debt financing activities offset by cash provided by employee stock option exercises.

We have a share repurchase program, primarily to reduce the overall number of shares outstanding and to offset the dilutive effect of our employee equity compensation and dilution related to our convertible notes from the inclusion of contingently convertible debt in fully diluted earnings per share calculations. All shares repurchased under the program are retired and are no longer deemed to be outstanding. The timing of our repurchases is subject to market conditions, cash availability and terms of our stock purchase plans, if any. There is no guarantee that shares authorized for repurchase by the Board will ultimately be repurchased.

On June 16, 2006, we entered into a stock purchase plan with Citigroup Global Markets Inc. for the purpose of repurchasing up to 5 million shares of our common stock, up to a cumulative purchase price of $166 million, under a Rule 10b5-1 Plan (the 2006 10b5 Plan) compliant with Rule 10b-18. In connection with the entry into the 2006 10b5 Plan, our Board of Directors increased the authorized number of shares available for repurchase pursuant to our stock repurchase program from 3.3 million to 5.0 million shares. In the quarter ended June 29, 2007, we repurchased 3.9 million shares for a total purchase price of $157.8 million under the 2006 10b5 Plan. The 2006 10b5 Plan terminated on June 15, 2007.

On June 18, 2007, we entered into a second stock purchase plan (the 2007 10b5 Plan) with Citigroup Global Markets Inc. for the purpose of repurchasing our common stock, up to a cumulative purchase price of $200 million, under another Rule 10b5-1 Plan compliant with Rule 10b-18. In connection with the entry into the 2007 10b5 Plan, our Board of Directors increased the authorized number of shares available for repurchase pursuant to our stock repurchase program by 5.0 million shares. In the quarter ended June 29, 2007, we repurchased 1.3 million shares of our common stock under the 2007 10b5 Plan for a total purchase price of $52.7 million. The 2007 10b5 Plan terminated on June 17, 2008.

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No purchases were made under the 2007 10b5 Plan in the quarter ended June 27, 2008. We acquired 7,617 shares for the payment of minimum required withholding taxes related to the lapsing of restrictions on certain outstanding restricted stock grants during the quarter ended June 27, 2008.

On May 28, 2008, the Board of Directors declared a quarterly cash dividend payable on our common stock of $0.20 per share. It is our intent to continue to pay dividends for the foreseeable future subject to, among other things, Board approval, cash availability, debt and line of credit restrictions and alternative cash needs. At the current annual dividend rate of $0.80 per share, the aggregate annual dividend, based on 33.8 million shares outstanding, would be approximately $27.0 million.

We receive cash from the exercise of employee stock options and purchases under our employee stock purchase plan (ESPP). Employee stock option exercises and ESPP purchases provided $0.6 million and $1.2 million of cash in the three months ended June 27, 2008 and June 29, 2007, respectively. Proceeds from the exercise of employee stock options vary from period to period based upon, among other factors, fluctuations in the market value of our common stock relative to the exercise price of such options.

Financing Arrangements

Senior Credit Facility

On May 26, 2005, we entered into a three-year Credit Agreement (Credit Agreement) that provides us with a $200 million senior revolving credit facility, subject to a $20 million sublimit for the issuance of standby and commercial letters of credit, a $10 million sublimit for swing line loans, and a $50 million alternative currency sublimit. At our election and subject to lender approval, the amount available for borrowings under the Credit Agreement may be increased by an additional $50 million. Funds are available under the Credit Agreement to finance permitted acquisitions, stock repurchases up to certain dollar limitations, and for other general corporate purposes. We have one standby letter of credit for $750,000 outstanding under the Credit Agreement. Accordingly, although there were no borrowings outstanding under the Credit Agreement at June 27, 2008, only $199 million was available for borrowings.

On May 31, 2006, we amended the Credit Agreement to permit the consummation of the sale of our Urology Business. Additionally, the amendment modified the minimum Adjusted Consolidated EBITDA covenant that we are required to comply with under the terms of the Credit Agreement. The amendment also amended certain negative covenants contained in the Credit Agreement, including amendments to the covenants restricting our ability to make investments and incur indebtedness and an amendment increasing the amount of our equity securities that we are permitted to repurchase. On March 30, 2007, we entered into a second amendment to the credit agreement to set the maximum amount of cash dividends per share that we can declare or pay in any four consecutive quarters. The second amendment also increased the amount of our common shares and other equity interests we could repurchase. As of August 1, 2008, there were no borrowings outstanding under the Credit Agreement.

Interest on borrowings (other than swing line loans and alternative currency loans) under the Credit Agreement is at a variable rate that is calculated, at our option, at the prime rate, or a Eurocurrency rate for deposits denominated in U.S. dollars plus an additional percentage that varies between 1.00% and 1.65%, depending on our senior leverage ratio at the time of the borrowing. Swing line loans bear interest at the prime rate. Alternative currency loans bear interest at the Eurocurrency rate for deposits denominated in the applicable currency plus the same additional percentage. In addition, we paid certain fees to the lenders to initiate the Credit Agreement and pay an unused commitment fee based on our senior leverage ratio and unborrowed lender commitments.

Borrowings under the Credit Agreement are guaranteed by certain of our domestic subsidiaries and are also secured by a pledge of 100% of the outstanding capital stock of certain of our other domestic subsidiaries. In addition, if the ratio of total funded debt to adjusted earnings before interest, taxes, depreciation and amortization (or adjusted EBITDA), exceeds 2.50 to 1.00, then we are obligated to grant to the lenders a first priority perfected security interest in essentially all of our and our material domestic subsidiaries assets.

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The Credit Agreement imposes certain financial and operational restrictions, including financial covenants that require us to maintain a maximum consolidated funded debt leverage ratio of not greater than 4.00 to 1.00, a senior funded debt ratio of not greater than 2.50 to 1.00, a minimum quarterly adjusted EBITDA, and a minimum fixed charge ratio of greater than 1.25 to 1.00. The covenants also restrict our ability, among other things, to make certain investments, incur certain types of indebtedness or liens, make acquisitions in excess of $20 million except in compliance with certain criteria, and repurchase shares of common stock, pay dividends or dispose of assets above specified thresholds. The Credit Agreement also contains customary events of default, including payment defaults, material inaccuracies in our representations and warranties, covenant defaults, bankruptcy and involuntary proceedings, monetary judgment defaults in excess of specified amounts, cross-defaults to certain other agreements, change of control, and ERISA defaults.

Other Financing

In October 2005, Mentor Medical Systems B.V. (Mentor BV), a wholly-owned subsidiary of Mentor Corporation entered into a Loan and Overdraft Facility (the Facility) with Cooperative RaboBank Leiden, Leiderdorp en Oestgstgeest U.A. (RaboBank).

The Facility provides Mentor BV with an initial 15 million loan and overdraft facility, which began decreasing by 375,000 quarterly in September 2006. Under the Facility, Mentor BV may borrow up to 12.5 million in fixed amount advances, with terms of three to six months, and a further sublimit of up to 5 million of loans in fixed amount advances with a term of up to 5 years. Up to 10 million of the Facility may be drawn in the form of U.S. dollars. Funds under the Facility are available to Mentor BV to finance certain dividend payments to Mentor Corporation and for other normal business purposes. Accordingly, $18.9 million was available under this facility at June 27, 2008. Interest on borrowings under the Facility is at a rate equal to 0.55% over the RaboBank base lending rate, Euribor, or LIBOR depending upon the currency and term of each borrowing. Interest rates on borrowings other than overdrafts are fixed for the term of the advance.

Borrowings by Mentor BV under the Facility are guaranteed by Mentor s wholly-owned subsidiary, Mentor Medical Systems C.V., through a Joint and Several Debtorship Agreement. In addition, borrowings under the Facility are secured by a mortgage on certain real estate owned by Mentor BV.

The Facility imposes certain financial and operational restrictions on Mentor BV, including financial covenants that require Mentor BV and Mentor Medical Systems CV to maintain a minimum combined defined solvency ratio, a maximum combined debt leverage ratio of not greater than 4 to 1, a senior funded debt ratio of not greater than 2.5 to 1, minimum quarterly operational results, and a minimum interest coverage ratio of greater than 5 to 1. The Facility also contains customary events of default, including cross default and material or adverse change provisions. If an event of default occurs, the commitments under the Facility may be terminated and the principal amount and all accrued but unpaid interest and other amounts owed thereunder may be declared immediately due and payable. As of June 27, 2008, all covenants and restrictions had been satisfied. Mentor BV paid 15,000 in certain fees to the RaboBank upon entry into the Facility, and Mentor BV will be obligated to pay, over the 10 year term of the Facility, a commitment fee of 0.25% of the committed and unborrowed balances. Fees are payable quarterly in arrears.

On July 2, 2007 we acquired all of the outstanding shares of Perouse Plastie, SAS, including the assumption of approximately 3.0 million in net debt. Approximately 1.4 million, or $2.2 million, is currently outstanding, of which $0.8 million is current and $1.4 million is long term. The debt consists primarily of installment loans with an average term of 6 years and a weighted average interest rate of 3.8%.

At June 27, 2008, we had approximately $0.8 million in short term borrowings and $1.4 million in long term debt outstanding. The total amount of additional borrowings available to us under all lines of credit was $218.2 million at June 27, 2008 and $218.8 million at March 31, 2008.

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Convertible Subordinated Notes

On December 22, 2003, we completed an offering of $150 million of convertible subordinated notes due January 1, 2024, pursuant to Rule 144A under the Securities Act of 1933. The notes bear interest at 2 3/4% per annum and are convertible into shares of our common stock at an initial conversion price of $29.289 per share and are subordinated to all existing and future senior debt. As a result of our dividend increase the conversion price has been adjusted to $28.8684 and each $1,000 principal amount will be convertible into 34.64 shares of common stock. If the market price of our stock remains below $28.8684 per share as of the next put date, January 1, 2009, it is likely that the bondholders will exercise their put option, requiring us to pay them in excess of $150 million in cash for the value of their bonds on that date.

The holders of the notes may redeem all or part of the notes for cash on January 1, 2009 at a price equal to 100.25% of the principle amount of the notes being redeemed, plus accrued interest. Based on a commitment we have received from our bank to extend our Credit Agreement in the amount of $150 million through October 31, 2009 (see further discussion of our Credit Agreement in Note M Short Term Bank Borrowings) and our intent to utilize the credit facility to refinance the notes if required, the notes have been classified as long term in the accompanying consolidated balance sheets.

Concurrent with the issuance of the convertible subordinated notes, we entered into convertible bond hedge and warrants transactions with respect to our common stock, the exposure for which is held by Credit Suisse First Boston LLC for a net cash payment of $18.5 million. Both the bond hedge and the warrants transactions may be settled at our option either in cash or net shares and expire January 1, 2009. The convertible bond hedge and warrants transactions combined are intended to reduce the potential dilution from conversion of the notes by effectively increasing the conversion price per share, from our perspective, to approximately $38.8613.

The warrant holder also has the right to purchase 5.2 million shares when the share price of our common stock as quoted on the NYSE exceeds the current exercise price of $38.8613 per share.

We do not have any off-balance sheet arrangements that are currently material or reasonably likely to be material to our financial position or results of operations.

We believe that funds generated from operations, our cash, cash equivalents and marketable securities, plus funds available under our line of credit agreements will be adequate to meet our working capital needs and capital expenditure investment requirements and commitments for the foreseeable future. However, it is possible that we may need to raise additional funds to finance unforeseen requirements or to consummate acquisitions of other businesses, products or technologies through the sale of equity or debt securities to the public or to selected investors, or by borrowing money from financial institutions. In addition, even though we may not need additional funds in the short-term, we may still elect to sell additional equity or debt securities or borrow for other reasons. There are no assurances that we will be able to obtain additional funds on terms that would be favorable to us, or at all. If funds are raised by issuing additional equity securities or convertible debt securities, the ownership percentage of existing shareholders would be reduced. In addition, equity or debt securities issued by us may have rights, preferences or privileges senior to those of our common stock.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

There have been no material changes in our exposure to market risk as reported in Item 7A in our Annual Report on Form 10-K for the fiscal year ended March 31, 2008.

Item 4. Controls and Procedures

We maintain disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the Exchange Act)) that are designed to ensure that information required to be disclosed in our reports filed or submitted under the Exchange Act, is recorded, processed, summarized and reported within the time periods specified in the SEC s rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure. In designing and evaluating the disclosure controls and procedures, management recognized that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and management necessarily was required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures.

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We carried out an evaluation under the supervision and with the participation of management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures as of June 27, 2008, the end of the period covered by this report. Based on that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective at the reasonable assurance level as of June 27, 2008.

Further, management has determined that there have been no changes in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) during the quarter ended June 27, 2008 that materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II OTHER INFORMATION

Item 1. Legal Proceedings

We have been served with various lawsuits filed against us in several jurisdictions related to ObTape, an implantable product used to treat female urinary incontinence that was sold by us through our discontinued urology business between 2003 and 2006. The lawsuits were filed between April 13, 2006 and July 31, 2008. These complaints, filed on behalf of patients who were implanted with ObTape, assert product liability and other claims and seek compensatory damages in unspecified amounts and, in some cases, seek punitive damages and the granting of extraordinary equitable relief. We deny the allegations and regard them as without merit, and we intend to defend the lawsuits vigorously. Management is unable to determine the financial statement impact, if any, of these legal proceedings.

In addition, in the ordinary course of our business we experience other varied types of claims that sometimes result in litigation or other legal proceedings. Although there can be no certainty, we do not anticipate that any of these proceedings will have a material adverse effect on us.

Item 1A. Risk Factors

Our business faces many risks. The risks described below may not be the only risks we face. Additional risks that we do not yet know of or that we currently think are immaterial may also impair our business operations. If any of the events or circumstances described in the following risks actually occurs, our business, financial condition or results of operations could suffer and the trading price of our common stock or our convertible notes could decline. You should consider the following risks before deciding to invest in our common stock or convertible notes.

The FDA approval of our MemoryGel breast implants in the U.S. is conditioned on our compliance with several significant post-approval conditions, including conducting a large scale, 10-year study of patients who receive the implants. These conditions may adversely affect the market acceptance and usage rates of our MemoryGel implants, may impact our ability to compete, and may cause us to incur significant unanticipated expenses. Our failure to comply with these conditions in a timely manner may cause delay in market acceptance or result in our inability to continue to sell our MemoryGel implants in the U.S.

On November 17, 2006, the U.S. Food and Drug Administration (FDA) approved for sale our MemoryGelÔ silicone gel-filled breast implants with post-approval conditions. The post-approval conditions and other requirements associated with the FDA s approval include the following: continuation of the Mentor Core Study through 10 years, physician training prior to accessing the device, a large post-approval study for 10 years, completion of additional device failure studies, focus group studies with patients on the format and content of the approved labeling, utilization of a formal informed decision process with patient labeling, cessation of new enrollment in the Mentor Adjunct Study, and implementation of device tracking.

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Our compliance with these FDA-mandated post-approval conditions, including changes to our post-approval study protocol effective April 2007, is dependent upon the cooperation of physicians and patients. If we are unable to gain that cooperation, or if patients or physicians prefer to use the competitors products as a result of our post-approval study requirements, there may be an adverse effect on our ability to comply with the post-approval conditions. In addition, the existence of the post-approval study, including administrative burden and follow-up requirements, may adversely affect the acceptance and usage rates of our products. In connection with complying with the post-approval conditions, we could incur significant unanticipated expenses, including costs to gain physician and patient cooperation and costs of post-market patient monitoring and data collection activities, which would have a material adverse effect on our market share, sales and results of operations. In addition, if we are unable to comply with these post-approval conditions, the FDA may withdraw the approval of the PMA, and we would be unable to continue selling MemoryGel breast implants in the U.S., which would also have a material adverse effect on market share, revenue and results of operations. Further, our sales and results of operations could be affected if market conversion to silicone gel-filled breast implants from saline breast implants does not occur at the rate we anticipated.

On October 20, 2006, we received the Medical Licenses for our MemoryGel and Contour Profile Gel (CPG®) breast implants in Canada. These licenses also came with conditions that are similar to those required by the FDA. If we fail to comply with these post-approval conditions, Health Canada may suspend the licenses, which would have a material adverse effect on our market share, sales and results of operations.

Significant product liability or other claims or product recalls may force us to pay substantial damage awards and other expenses that could exceed our accruals and insurance coverages. Unexpected increases in the number of limited warranty claims for our products may surpass our product warranty reserves.

The manufacture and sale of medical devices and biologics expose us to significant risk of product liability and other tort claims. Both currently and in the past, we have had a number of product liability claims relating to our products, and we will be subject to additional product liability claims in the future for both past and current products, some of which may have a negative impact on our business. Our liability with regard to products includes liability related to certain products manufactured and/or sold by us prior to our business or product line divestitures, including liabilities retained by us in connection with the sale of our urology business to Coloplast A/S. If a product liability claim or series of claims, including class action or consolidated claims, is brought against us for uninsured liabilities or in excess of our insurance coverage, our business could suffer. Some manufacturers that suffered such claims in the past have been forced to cease operations and declare bankruptcy.

Additionally, we offer product replacement and certain financial assistance for surgical procedures that fall within our limited warranties and coverage periods of implantation on our breast implant products, and we accrue or expense costs as incurred for those limited warranties. As a competitive market response to offers made by our primary competitor as a result of the silicone gel breast implant post-approval environment in the U.S., during the fourth quarter of fiscal 2007, we began a limited-time offer of free enrollment in our Enhanced Advantage Limited Warranty for MemoryGel implants implanted after February 15, 2007. Such accruals are based on estimates, taking into consideration relevant factors such as historical experience, warranty periods, estimated costs, existence and levels of insurance and insurance retentions, identified product quality issues, if any, and, to a limited extent, information developed by using actuarial techniques. We assess the adequacy of these accruals periodically and adjust the amounts as necessary based on actual experience and changes in future expectations. Changes to actual warranty claims incurred could have a material impact on the actuarial analysis, which in turn could materially impact our reported expenses and results of operations. In addition, from time to time, we adjust the terms of our limited warranty programs which could materially impact our reported expenses and results of operations. In addition to product liability or warranty claims, we could experience a material design or manufacturing failure, a quality system failure, other safety issues, or heightened regulatory scrutiny that would warrant a recall of products we manufacture or products we distribute that are manufactured by another company. A recall of some of our products could result in exposure to additional product liability claims, significant expense to perform the recall, and lost sales.

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We are subject to substantial government regulation, which could have a material adverse effect on our business. Any delay or failure to gain regulatory approval for our products, or the ability of our competitors to get new products, which compete with our existing products, approved before us, could also materially adversely affect our business.

The production and marketing of our products and our ongoing research and development activities, including pre-clinical testing and clinical trial activities, are subject to extensive regulation and review by numerous governmental authorities both in the U.S. and abroad. Most of the medical devices and biologics we develop must undergo rigorous pre-clinical and clinical testing and an extensive regulatory approval process before they can be marketed. Certain of our products are required to undergo review by a panel of outside experts selected by the FDA, which makes a recommendation to the FDA as to whether the product(s) should or should not be approved. This process makes it potentially longer, more difficult, and/or more costly to bring our products to market, and we cannot guarantee that any of our unapproved products will be approved or how long it may take for any one particular product to be approved. The pre-marketing approval process can be particularly expensive, uncertain and lengthy, and a number of devices, drugs and biologics for which FDA approval has been sought by other companies have never been approved for marketing. In addition to testing and approval procedures, extensive regulations also govern manufacturing, packaging, labeling, storage, distribution, record-keeping, advertising, complaint handling, and marketing procedures. If we do not comply with applicable regulatory requirements, such violations could result in non-approval, suspensions of clinical trials, suspension or withdrawal of regulatory approvals, product recalls, civil penalties and criminal fines, product seizures, operating restrictions, injunctions, and criminal prosecution.

Delays in, withdrawal of, or rejection by the FDA or other government entity of approval(s) of our products, including delay in the review of our Contour Profile Gel pre-market approval application (PMA), our Prevelle® Shape PMA, other dermal filler PMAs, and our botulinum toxin biologics license application (BLA) may also adversely affect our business. Such delays, withdrawals, or rejections may be encountered due to, among other reasons, government or regulatory delays, lack of demonstrated safety or efficacy during clinical trials, safety issues, manufacturing issues, slower than expected rate of patient recruitment for clinical trials, inability to follow patients after treatment in clinical trials, inconsistencies between early clinical trial results and results obtained in later clinical trials, varying interpretations of data generated by clinical trials, adverse publicity, or changes in regulatory policy or requirements in the U.S. and abroad. In the U.S., there has been a continuing trend toward more stringent FDA requirements in the areas of product approval and enforcement, causing medical device and biologics manufacturers to experience longer research and development timelines, longer review and approval cycles, greater risk and uncertainty, and higher expenses. Internationally, there is a risk that we may not be successful in meeting the quality standards or other certification requirements. Even if regulatory approval of a product is granted, such approval may entail limitations on uses for which the product may be labeled and promoted or stringent post-marketing requirements, or may prevent us from broadening the uses of our current products for different applications. If we incur significant unanticipated expenses (for example, in connection with post-market approval patient monitoring and data collection activities for our MemoryGel breast implants), it could have a material adverse effect on our results of operations. In addition, to the extent permissible by law, we may not receive governmental approval to export our products in the future, and countries to which products are to be exported may not approve them for import. We may also be required to withdraw or recall our products after we receive approvals and begin commercial sales if we, the FDA or a foreign government agency determines that there is a higher than average incidence of post-treatment complications with our products as a result of subsequent clinical experience and/or data. From time to time, we are subject to inquiry and audit by government agencies in this regard.

In addition, our competitors may have pending regulatory submissions for similar or superior products which may gain approval before our product applications, and any such approvals could have a material adverse effect on our business.

Our manufacturing facilities and the manufacturing facilities of our third-party suppliers are also subject to continual governmental review and inspection as part of the product approval process and after products are approved. The FDA has stated publicly that compliance with manufacturing regulations will be scrutinized strictly. A governmental authority may challenge our compliance with applicable federal, state and/or foreign regulations. In addition, any

discovery of previously unknown problems with one of our products or facilities may result in restrictions on the product or the facility, including, but not limited to, product recalls, withdrawal of the product from the market or other enforcement actions.

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From time to time, legislative or regulatory proposals are introduced that, if implemented, could alter the review and approval process relating to medical devices, combination products, biologics, or related to the sale of our products. It is possible that the FDA or other governmental authorities will issue additional regulations, which could further reduce or restrict the sales of either our presently marketed products or products under development.

Any change in legislation or regulations that govern the review and approval process relating to our current and/or future products or restrict the manner by which we may sell our products could make it more difficult and/or costly to obtain approval for new products, and/or to produce, market, and distribute existing products.

If we are unable to continue to develop and commercialize new technologies and products, we may experience a decrease in demand for our products, or our products could become obsolete.

The medical device and biologics industries are highly competitive and are subject to significant and rapid technological change. We believe that our ability to develop or acquire new technologies and products is crucial to our success. We are continually engaged in product research and development, product improvement programs, and required clinical studies to develop new technologies and products and to maintain and improve our competitive position. Any significant delays in the above or termination or failure of our clinical trials or delays in our ability to timely respond to the FDA or other regulatory authorities inquiries, requirements and requests would materially and adversely affect our research, development, and commercialization timelines. We cannot guarantee that we will be successful in enhancing existing products or in developing or acquiring new products or technologies that will timely achieve regulatory approval or success in the marketplace.

There is also a risk that our products may not gain market acceptance among physicians, patients and the medical community generally. The degree of market acceptance of any medical device or other product that we develop will depend on a number of factors, including demonstrated clinical safety and efficacy, cost-effectiveness, potential advantages over alternative products, user/patient acceptance, and our marketing and distribution capabilities. Physicians will not recommend our products if clinical and/or other data and/or other factors do not demonstrate their safety and efficacy compared to competing products, or if our products do not best meet the needs of the individual patient. If our new products do not achieve significant market acceptance, our sales and income may not grow as much as expected, or may even decline.

If we are unable to compete effectively with existing or new competitors, we could experience price reductions, reduced demand for our products, reduced margins and loss of market share, and our business, results of operations, and financial condition would be adversely affected.

Our products compete with other medical products manufactured by major companies and may face future competition from new products currently under development by others.

Competition in our industry occurs on a variety of levels, including but not limited to the following:

- developing and bringing new products to market before others or providing benefits superior to those of existing products;
- developing new technologies to improve existing products;
- developing new products at a lower cost to provide the same benefits as existing products at the same or lower price;
- creating or entering new markets with existing products;
- increasing or improving service-related programs;
- advertising in a manner that creates additional awareness and demand; and
- marketing and selling bundled products.

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The competitive environment requires an ongoing, extensive search for technological innovations and the ability to market products effectively. Consequently, we must continue to effectively execute on various competitive levels to properly position our products in the marketplace and maintain our market share, sales and gross margins.

In particular, we face competition from Allergan, Inc., which in March 2006 acquired Inamed Corporation, our then largest competitor in the U.S. and internationally for our breast aesthetics product line. As a result of Allergan s acquisition of Inamed, we are now competing against a much larger company with a larger portfolio of aesthetic medicine products, which may enable Allergan to compete more effectively with us. Outside the U.S., we compete with Allergan and various smaller competitors. Notwithstanding relative sizes, some of the smaller competitors have strong market positions in their home markets, which increases the challenges associated with maintaining and growing our international business. Within the U.S., we compete with Allergan, and another company has publicly stated that it will have FDA approval of competitive products in the near future.

If we suffer negative publicity concerning the safety of our products, our sales may be harmed and we may be forced to withdraw products.

Physicians and potential patients may have a number of concerns about the safety of our current and former products, including our breast implants, whether or not such concerns have a basis in generally accepted science or peer-reviewed scientific research. Negative publicity, whether accurate or inaccurate, concerning our products could reduce market or governmental acceptance of our products, delay product approvals, or result in decreased product demand or product withdrawal. For example, we may be required to recall or withdraw our products if we, the FDA, or a foreign government agency determine that use of our products results in a higher-than-average rate of post-treatment complications based on clinical experience and/or data. If one foreign government agency were to request or require a withdrawal or recall of one or more of our products, the safety concerns leading to that government agency s request may be investigated by regulatory bodies in other countries, which could result in additional withdrawals or recalls as well as negative publicity regarding our products. In addition, significant negative publicity could result in an increased number of product liability claims, whether or not these claims are supported by applicable law.

If changes in the economy and consumer spending reduce consumer demand for our products, our sales and profitability could suffer.

Certain elective procedures, such as breast augmentation, body contouring and facial injections, which comprise the majority of our revenues, are not covered by insurance. Adverse changes in the economy or other conditions or events may have an adverse effect on consumer spending, cause consumers to reassess their spending choices, reduce the demand for these surgeries or sway their decision to purchase lower cost saline breast implants rather than MemoryGel implants, which carry a higher selling price. Any such changes, conditions or events could have an adverse effect on our sales and results of operations. In particular, recent weakness in the U.S. economy may adversely affect discretionary consumer spending and may adversely affect our revenue.

If we are unable to implement new information technology systems or upgrade existing systems, our ability to manufacture and sell products, maintain regulatory compliance, and manage and report our business activities may be impaired, delayed, or diminished, which would cause substantial business interruption and loss of sales, customers, and profits.

We have implemented multiple information technology systems throughout our operations, including an enterprise resource planning system which is our primary business management system, and are constantly in the process of upgrading these systems to current version releases. We intend to continue to implement these systems, as appropriate, for all of our businesses worldwide. Many other companies have had severe problems with computer system implementations. With regard to all of our information technology system implementations and upgrades, we use controlled project plans, and we believe we have assigned adequate staffing and other resources to the projects to ensure its successful integration; however, there is no assurance that the system designs will meet our current and future business needs or that they will operate as designed. We are heavily dependent on such information technology systems, and any failure or delay in the system implementation or upgrades would cause a substantial interruption to our business, may create additional expense, and could adversely affect sales, customer relations and results of operations.

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If we are unable to acquire companies, businesses or technologies as part of our growth strategy or to successfully integrate past acquisitions, our growth, sales, and profitability could suffer.

We intend to pursue the possible acquisition of other businesses and technologies to facilitate our business strategies and future growth. There can be no assurance that we will be able to identify appropriate acquisition candidates or technologies, consummate transactions, or obtain agreements with terms favorable to us. Once a business is acquired, any inability to integrate the business, failure to retain and develop its workforce, or establish and maintain appropriate communications, performance expectations, regulatory compliance procedures, accounting controls, and reporting procedures could adversely affect our future sales and results of operations.

In July 2007, we completed the acquisition of Perouse Plastie SAS, a medical device company based in Bornel, France. Risks and uncertainties relating to the Perouse acquisition that may adversely affect our future sales and results of operations include that the businesses of Mentor and Perouse may not be integrated successfully, that anticipated synergies and international growth opportunities may not be fully realized or may take longer to be realized than expected, and possible disruption of the Perouse business, including with customers, employees, suppliers or third parties.

We depend upon our key personnel and our ability to attract, train, and retain employees.

Our success depends significantly on the continued individual and collective contributions of our senior management team. Additionally, many members of our senior management team have recently joined the company. Our future success depends on our ability to hire, train, and retain skilled employees. Competition for such employees is intense. The loss of the services of any member of our senior management or the inability to hire and retain experienced management personnel could adversely affect our ability to execute our business plan and harm our operating results.

State legislatures and taxing authorities may create new laws or change their interpretation of existing state and local tax laws that may affect future product demand or create unforeseen tax liabilities.

If any state legislature or other government authority creates new laws to assess sales taxes on medical procedures or products determined by them to be cosmetic, our physician and patient customers may have to pay more for our products and future demand may decrease. In addition, taxing authorities may determine that our products are not eligible for exemptions and are thus taxable based on their interpretations of existing tax laws. Such taxing authorities may then determine that we owe additional taxes, penalties, and interest related to product sales from prior periods. These determinations would have a negative effect on our results of operations.

If our intellectual property rights do not adequately protect our products or technologies, others could compete against us more directly, which would hurt our profitability.

Our success depends in part on our ability to obtain patents or rights to patents, protect trade secrets, operate without infringing upon the proprietary rights of others, and prevent others from infringing on our patents, trademarks, and other intellectual property rights. We will be able to protect our intellectual property from unauthorized use by third parties only to the extent that it is covered by valid and enforceable patents, trademarks, or licenses. Patent protection generally involves complex legal and factual questions and, therefore, enforceability of patent rights cannot be predicted with certainty; thus, any patents that we own or license from others may not provide us with adequate protection against competitors. Moreover, the laws of certain foreign countries do not recognize intellectual property rights or protect them to the same extent as do the laws of the United States.

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In addition to patents and trademarks, we rely on trade secrets and proprietary know-how. We seek protection of these rights, in part, through confidentiality and proprietary information agreements. These agreements may not provide sufficient protection or adequate remedies for violation of our rights in the event of unauthorized use or disclosure of confidential and proprietary information. Failure to protect our proprietary rights could seriously impair our competitive position.

If third parties claim we are infringing their intellectual property rights, we could suffer significant litigation, indemnification, or licensing expenses or be prevented from marketing our products.

Our commercial success depends significantly on our ability to operate without infringing the patents and other proprietary rights of others. However, regardless of our intent, our current or future technologies of our existing operations or those current technologies of our discontinued operations, may infringe the patents or violate other proprietary rights of third parties. In the event of such infringement or violation we may face expensive litigation, damages, or indemnification obligations and may be prevented from selling existing products and pursuing product development or commercialization.

We depend on the continued use of our manufacturing plants and on single and sole source suppliers for certain raw materials and licensed or manufactured products, and the loss of, or disruption to, any plant or supplier could adversely affect our ability to manufacture or sell many of our products.

Significant damage to or the loss of our manufacturing facilities could adversely affect our ability to manufacture and/or sell many of our products. In addition, we currently rely on single or sole source suppliers for raw materials used in many of our products, including silicone. The manufacturing of our products is complex and highly regulated, and any changes to our products may result in delays or disruptions of our manufacturing capacity or the manufacturing capacity of our third-party suppliers. In the event that our manufacturing plants or third-party suppliers cannot meet our requirements, we cannot guarantee that we would be able to produce enough manufactured goods or obtain a sufficient amount of quality raw materials from other suppliers in a timely manner or at all. We also depend on third-party manufacturers and suppliers for components and licensed products. We depend on Genzyme for the supply of dermal filler products, Tutogen Medical, Inc. for the supply of NeoForm , a human tissue product used in breast reconstruction procedures, and Niadyne, Inc. for the supply of NIA-24, and if we were no longer able to satisfy demand for these products through our relationships with Genzyme, Tutogen Medical and Niadyne, respectively, our business could be harmed. If there is a disruption in the supply of any of these single or sole source products, our future sales and results of operations would be adversely affected. We also rely on a third party contract manufacturing vendor for fill/finish of our botulinum toxin product. If that vendor fails to pass regulatory inspections or has a business interruption, there would be a significant adverse effect on our ability to commercialize the product.

Our international business exposes us to a number of risks.

Approximately one-third of our sales from our continuing operations are derived from international operations. Accordingly, any material decrease in foreign sales would have a material adverse effect on our overall sales and results of operations. Most of our international sales are denominated in Euros, British Pounds, Canadian dollars or U.S. dollars. Depreciation or devaluation of the local currencies of countries where we sell our products may result in our products becoming more expensive in local currency terms, thus reducing demand, which could have an adverse effect on our operating results. Our international operations and financial results may be adversely affected by other factors, including the following:

- foreign government regulation of medical products;
- product liability, intellectual property and other claims;
- new U.S. export or local market import license requirements;
- political or economic instability in our target markets;
- trade restrictions;
- changes in tax laws and tariffs;
- managing foreign distributors and manufacturers;
- managing foreign branch offices and staffing; and
- competition.

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Health care reimbursement or reform legislation could materially affect our business.

If any domestic or international health care reform or other legislation or regulations are passed that impose limits on the amount of reimbursement for certain types of medical procedures or products, or on the number or type of medical procedures that may be performed, or that has the effect of restricting a physician s ability to select specific products for use in patient procedures, such changes could have a material adverse effect on the demand for our products. Our revenues partially depend on U.S. and foreign government health care programs and private health insurers reimbursing patients medical expenses. Physicians, hospitals, and other health care providers may not purchase our products if they do not receive satisfactory reimbursement from these third-party payers for the cost of procedures using our products. In the U.S., there have been, and we expect that there will continue to be, a number of federal and state legislative and regulatory proposals to implement greater governmental control over the healthcare industry and its related costs. These proposals create uncertainty as to the future of our industry and may have a material adverse effect on our sales and profitability and our ability to raise capital or to form collaborations. In a number of foreign markets, the pricing and profitability of healthcare products are subject to governmental influence or control. In addition, legislation or regulations that impose restrictions on the price that may be charged for healthcare products or medical devices may adversely affect our sales and results of operations.

If our use of hazardous materials results in contamination or injury, we could suffer significant financial loss.

We are subject to federal, state, local and foreign environmental laws and regulations. Our manufacturing and research and development activities involve the controlled use and disposal of potentially hazardous materials, chemicals and biological materials, which require compliance with various laws and regulations regarding the use, storage, and disposal of such materials. We believe our continuing and discontinued operations comply in all material respects with applicable environmental laws and regulations in each country where we have a business presence. Although we continue to make expenditures for environmental protection, we do not anticipate any additional significant expenditures, in complying with such laws and regulations, that would have a material impact on our results of operations or competitive position. We are not aware of any pending litigation or significant financial obligations arising from current or past environmental practices that are likely to have a material adverse effect on our financial position. We cannot assure, however, that environmental claims or indemnification obligations relating to our continuing or discontinued operations or properties currently or previously owned or operated by us will not develop in the future, nor can we predict whether any such claims, if they were to develop, would require significant expenditures on our part. We cannot eliminate the risk of accidental contamination or injury from these materials. In the event of an accident or environmental discharge, we may be held liable for any resulting damages, which may exceed our financial resources and any applicable insurance coverage. In addition, we are unable to predict what legislation or regulations may be adopted or enacted in the future with respect to environmental protection and waste disposal.

In the U.S., each of our domestic manufacturing facilities is subject to regulation by the United States Environmental Protection Agency and other state and local environmental agencies. For example, in Texas, we are subject to regulation by the local Air Pollution Control District as a result of some of the chemicals used in our manufacturing processes. In our Wisconsin operations, we are also subject to regulation by the U.S. Department of Health and Human Services, Centers for Disease Control due to the nature of the biological agent used to manufacture our botulinum toxin product, *Clostridium botulinum* type A, which is still in the development phase. Prior to the June 2006 Coloplast transaction, we were also subject to regulation by the United States Nuclear Regulatory Commission in our Oklahoma facility due to the manufacture and distribution of brachytherapy seeds using radioactive iodine I-125 and palladium Pd-103. In addition, pursuant to the terms of our agreement with Coloplast for the sale of our Urology Business, we may have continuing direct liability or liability through our indemnification provisions, for any violations in connection with our Urology Business that arose prior to the Coloplast transaction.

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In Europe, each of our manufacturing facilities is subject to regulation by country-specific environmental protection agencies. For example, in Leiden, as a result of some of the chemicals and other materials used in our manufacturing processes, we are subject to regulation by Dutch law on environmental control and the Dutch emission guidelines that regulate the exhaust of certain chemicals and hazardous waste regulations. In France, we are subject to regulation by the Ministry of Environment. In Mauritius, we are subject to regulation by the Department of Environment.

Failure to comply with the regulations and requirements of these various agencies could affect our ability to manufacture products and may have a significant negative impact on sales and results of operations.

Changes in financial accounting standards may cause adverse unexpected revenue or expense fluctuations and affect our reported results of operations.

New or recently adopted accounting standards could have a significant effect on our reported results and may even affect our reporting of transactions completed before the change is effective. New pronouncements and varying interpretations of existing pronouncements have occurred and may occur in the future. Changes to existing rules or current practices may adversely affect our reported financial results and require restatement of previously issued results for retroactive application of the new accounting standard.

Our operating results may fluctuate substantially, and could precipitate unexpected movement in the price of our common stock and convertible notes.

Our common stock trades on the New York Stock Exchange under the symbol MNT. On June 27, 2008, the closing price of our common stock on the New York Stock Exchange was $26.60 per share. On December 22, 2003, we completed an offering of $150 million of convertible subordinated notes due January 1, 2024 pursuant to Rule 144A under the Securities Act of 1933. The notes bear interest at 2 3/4% per annum, are convertible into shares of our common stock at an adjusted conversion price of $28.8684 per share and are subordinated to all existing and future senior debt. The market prices of our stock and convertible securities are subject to significant fluctuations in response to the factors set forth above and other factors, many of which are beyond our control including such factors as changes in pricing policies or the introduction of new products by our competitors and the timing of significant orders and shipments. If the market price of our stock remains below $28.8684 per share as of the next put date, January 1, 2009, it is likely that the bondholders will exercise their put option, requiring us to pay them in excess of $150 million in cash for the value of their bonds on that date.

Such factors, as well as other economic conditions, may adversely affect the market price of our securities, including our common stock and convertible notes. There could be periods in which we experience shortfalls in revenue and/or earnings from levels expected by securities analysts and investors, which could have an immediate and significant adverse effect on the trading price of our securities, including our common stock and our convertible notes.

Hedging transactions and other transactions may affect the value of the notes.

In connection with the original issuance of our 2 3/4% convertible subordinated notes in December 2003, we entered into convertible note hedge and warrant transactions with respect to our common stock with Credit Suisse First Boston International (an affiliate of Credit Suisse First Boston LLC), the initial purchaser of the notes, to reduce the potential dilution from conversion of the notes up to a price of our common stock (approximately $38.8613 per share at the current warrant strike price). In connection with these hedging arrangements, Credit Suisse First Boston International and/or its affiliates has taken, and we expect will continue to take, positions in our common stock in secondary market transactions and/or will enter into various derivative transactions. Such hedging arrangements could adversely affect the market price of our common stock. In addition, the existence of the notes may encourage market participants to short sell our common stock because the conversion of the notes could depress the price of our common stock.

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Our Restated Articles of Incorporation provide our Board of Directors with the authority to issue blank check preferred stock. The issuance of blank check preferred stock could adversely affect the market price and the rights and powers, including voting rights, of our common stock, and decrease the amount of earnings and assets allocable to or available for distribution to holders of our common stock.

Our Restated Articles of Incorporation provide for the issuance of preferred stock in one or more series, with rights, preferences, privileges and restrictions to be determined by the Board of Directors in its discretion.

The preferred stock could be or become convertible into common stock, which may be perceived as having a protective effect on our existing shareholders and having the effect of deterring unsolicited or hostile takeover attempts. The preferred stock is designed to provide our Board of Directors with the flexibility to issue such preferred stock, should they, at some time in the future, determine that such measures are necessary or desirable.

Any future issuance of preferred stock could affect our shareholders in a number of respects. If we issue preferred stock convertible into common stock or other securities that have rights, preferences and privileges senior to those of our common stock, the holders of our common stock may suffer significant dilution. In addition, the issuance of any shares of preferred stock, including preferred stock convertible into common stock, could adversely affect the market price of our common stock.

Any preferred stock issued would have priority over the common stock upon liquidation and might have priority rights as to dividends, voting and other features. Accordingly, the issuance of preferred stock could decrease the amount of earnings and assets allocable to or available for distribution to holders of common stock and adversely affect the rights and powers, including voting rights, of the common stock.

Our Board of Directors may also issue preferred stock in connection with such activities as public or private offerings of shares for cash, acquisitions of other companies and other financing opportunities. We do not have any current plans, commitments, arrangements or agreements, written or otherwise, to issue or designate any of our blank check preferred stock.

Our Board of Directors may also choose to consider adopting a shareholder rights plan, or poison pill, as an anti-takeover defense at some future point. Shareholder rights plans involve the issuance to common shareholders of a right to purchase shares of convertible preferred stock under certain circumstances. In order to implement such a plan, the Board of Directors must have the ability to create and issue a class of preferred stock with certain terms and we must also have available sufficient shares of common stock to effect the conversion. A future issuance of blank check preferred stock and/or the subsequent adoption of a shareholder rights plan (which would then be possible) could prevent or deter the acquisition by a third party, especially if the transaction was not previously approved by our Board of Directors. Our shareholders will be solely reliant upon the business judgment of our Board of Directors regarding the various terms and conditions which may be ascribed to any series of preferred stock created in the future. Moreover, the ability to designate and issue new series of blank check preferred stock without additional shareholder action or vote deprives shareholders of notice that such actions are being considered and of providing input in the process.

As discussed in our proxy statement/prospectus filed on July 11, 2008, we expect to submit to our shareholders a proposal to reorganize our company into a holding company structure, under which our present company will become a subsidiary of a new Delaware corporation named Mentor International Holdings, Inc. Several risks associated with this proposed restructuring are described in the proxy statement/prospectus.

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Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

Issuer Purchases of Equity Securities

During the three months ended June 27, 2008, the Company repurchased 7,617 shares for the payment of withholding taxes related to the lapsing of restrictions on certain outstanding restricted stock grants.

The table below sets forth certain share repurchase information for the quarter ended June 27, 2008.

ISSUER PURCHASES OF EQUITY SECURITIES (1)

(in thousands except per share amounts)	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans	Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs(2)
April 2008		$		809
May 2008				809
June 2008	8(3)	27.32		801
Total	8	$ 27.32		801

(1) On June 18, 2007, we entered into a Rule 10b5-1 stock purchase plan compliant with Rule 10b-18 (the 2007 10b5 Plan). The 2007 10b5 Plan terminated on June 17, 2008. No shares were purchased under the 2007 10b5 Plan during the period.

(2) Reflects shares authorized for repurchase by our Board of Directors. We have not set a

date for the stock repurchase program to expire.

(3) Balance includes approximately 8,000 shares repurchased for payment of withholding taxes upon the vesting of certain restricted stock grants.

Item 3. Defaults Upon Senior Securities

None.

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

None.

Item 5. Other Information

None.

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Item 6. Exhibits

3.1 Composite Restated Articles of Incorporation of Mentor Corporation dated December 12, 2002 Incorporated by reference to Exhibit 3.1 of the Annual Report on Form 10-K for the year ended March 31, 2003.

3.2 Amendment to Restated Articles of Incorporation of Mentor Corporation Incorporated by reference to Exhibit 3.1 of the Registrant s Current Report on Form 8-K filed on October 3, 2007.

3.3 Amended and Restated Bylaws of Mentor Corporation dated September 17, 2007 Incorporated by reference to Exhibit 3.2 of the Registrant s Current Report on Form 8-K filed on September 21, 2007.

4.1 Indenture 2 3/4% Convertible Subordinated Notes Due 2024, dated December 22, 2003 Incorporated by reference to Exhibit 4.1 of the Registrant s Quarterly Report on Form 10-Q for the quarter ended December 31, 2003.

31.1 Certification of Principal Executive Officer Pursuant To Section 302 of The Sarbanes-Oxley Act of 2002.

31.2 Certification of Principal Financial Officer Pursuant To Section 302 of The Sarbanes-Oxley Act of 2002.

32.1 CEO Certification Pursuant To 18 U.S.C. Section 1350, As Adopted Pursuant To Section 906 of The Sarbanes-Oxley Act of 2002.

32.2 CFO Certification Pursuant To 18 U.S.C. Section 1350, As Adopted 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.

MENTOR CORPORATION
(Registrant)

MENTOR CORPORATION

DATE: August 6, 2008

/s/ JOSHUA H. LEVINE
Joshua H. Levine
President and Chief Executive Officer
(Principal Executive Officer)

DATE: August 6, 2008

/s/ MICHAEL O NEILL
Michael O Neill
Vice President, Chief Financial Officer and Treasurer
(Principal Financial Officer)

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