STAAR SURGICAL COMPANY
Form 10-Q/A
November 20, 2003
Table of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q/A

Amendment No. 1

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

For the quarterly period ended: April 4, 2003

OR

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

For the transition period from _____ to _____

Commission file number: 0-11634

STAAR SURGICAL COMPANY

(Exact name of registrant as specified in its charter)

Delaware	**95-3797439**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**

1911 Walker Avenue

Monrovia, California

91016

(Address of principal executive offices)

(Zip Code)

(626) 303-7902

(Registrant s telephone number, including area code)

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

Indicate by a check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). YES ¨ NO x

The registrant has 18,396,123 shares of common stock, par value $0.01 per share, issued and outstanding as of November 18, 2003.

Table of Contents

EXPLANATORY NOTE

STAAR Surgical Company (the Company) is filing this Amendment No. 1 to its Quarterly Report on Form 10-Q for the period ended April 4, 2003 (the Report) to restate its financial statements for the three months ended April 4, 2003 and March 29, 2002, as more fully discussed in Note 11 of the notes to the financial statements. This Amendment No. 1 corrects the Company s first quarter financial statements to include accrued interest income on notes receivable of officers and directors.

To make these corrections and related changes, the Company is amending and restating Items 1 and 2 of the Report. Pursuant to Rule 12b-15, the Company is also including currently dated certifications of the Chief Executive Officer and Chief Financial Officer. While the remainder of the Report is unchanged, the Company is reproducing the Report in its entirety to provide a complete presentation to the reader. This Amendment No. 1 speaks as of the original date of the filing date of the Report, except for certifications, which speak as of their respective dates and the filing date of this Amendment No. 1. Except as specifically indicated, the Report has not been updated to reflect events occurring subsequently to the original filing date.

Table of Contents

STAAR SURGICAL COMPANY

INDEX

Table of Contents

PART I FINANCIAL INFORMATION

ITEM 1 FINANCIAL STATEMENTS

STAAR SURGICAL COMPANY AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands, except par value)

	April 4, 2003 Restated	January 3, 2003 Restated
	(Unaudited)	
ASSETS		
Current assets:		
Cash and cash equivalents	$ 399	$ 1,009
Accounts receivable, net	6,634	5,823
Inventories	11,602	11,761
Prepaids, deposits, and other current assets	2,838	3,127
Total current assets	21,473	21,720
Investment in joint venture	568	462
Property, plant and equipment, net	7,090	7,438
Patents and licenses, net	8,804	9,038
Goodwill	6,427	6,427
Other assets	365	393
Total assets	$ 44,727	$ 45,365
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Notes payable	$ 5,246	$ 5,845
Accounts payable	4,918	4,394
Other current liabilities	4,773	4,386
Total current liabilities	14,937	14,625
Other long-term liabilities	89	89
Total liabilities	15,026	14,714
Minority interest	124	100

Commitments and contingencies		
Stockholders equity:		
Preferred stock, $.01 par value; 10,000 shares authorized; none issued		
Common stock, $.01 par value; 30,000 shares authorized; issued and outstanding 16,962 at April 4, 2003 and January 3, 2003	169	169
Additional paid-in capital	75,027	74,977
Accumulated other comprehensive loss	(35)	(111)
Accumulated deficit	(41,747)	(40,789)
	33,414	34,246
Notes receivable from officers and directors	(3,837)	(3,695)
Total stockholders equity	29,577	30,551
Total liabilities and stockholders equity	$ 44,727	$ 45,365

Note: The amounts presented in the January 3, 2003 balance sheet are derived from the restated audited financial statements for the year ended January 3, 2003. See accompanying notes to the condensed consolidated financial statements.

Table of Contents

STAAR SURGICAL COMPANY AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands, except per share amounts)

(Unaudited)

	Three Months Ended	
	April 4, 2003	March 29, 2002
		Restated
Sales	$ 12,779	$ 11,631
Royalty and other income	47	100
Total revenues	12,826	11,731
Cost of sales	5,847	6,019
Gross profit	6,979	5,712
Selling, general, and administrative expenses:		
General and administrative	2,287	2,402
Marketing and selling	4,161	4,002
Research and development	1,176	1,076
Total selling, general, and administrative expenses	7,624	7,480
Operating loss	(645)	(1,768)
Other income (expense):		
Equity in earnings of joint venture	106	12
Interest income	125	53
Interest expense	(143)	(127)
Other expense	(54)	(23)
Total other income (expense)	34	(85)
Loss before income taxes and minority interest	(611)	(1,853)
Income tax expense (benefit)	329	(932)
Minority interest	18	41
Net loss	$ (958)	$ (962)

Basic and diluted net loss per share	$ (.06)	$ (.06)
Weighted average shares outstanding Basic and diluted	16,962	17,159

See accompanying notes to the condensed consolidated financial statements.

Table of Contents

STAAR SURGICAL COMPANY AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

(Unaudited)

	Three Months Ended	
	April 4, 2003	March 29, 2002
		Restated
Cash flows from operating activities:		
Net loss	$ (958)	$ (962)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Depreciation of property and equipment	488	521
Amortization of intangibles	240	227
Equity in earnings of joint venture	(106)	(12)
Stock-based compensation expense	50	51
Notes receivable reserve	(83)	
Other	(69)	(35)
Minority interest	24	47
Changes in working capital:		
Accounts receivable	(642)	270
Inventories	159	1,250
Prepaids, deposits, and other current assets	7	(267)
Accounts payable	530	(215)
Other current liabilities	387	(374)
Net cash provided by operating activities	27	501
Cash flows from investing activities:		
Acquisition of property and equipment	(140)	(165)
Increase in patents and licenses	(6)	
Decrease (increase) in other assets	28	(50)
Proceeds from notes receivable and other	4	
Net cash used in investing activities	(114)	(215)
Cash flows from financing activities:		
Decrease in borrowings under notes payable	(599)	(489)
Proceeds from stock options		6
Net cash used in financing activities	(599)	(483)

Effect of exchange rate changes on cash and cash equivalents	76	108
Decrease in cash and cash equivalents	(610)	(89)
Cash and cash equivalents, at the beginning of the period	1,009	853
Cash and cash equivalents, at the end of the period	$ 399	$ 764

See accompanying notes to the condensed consolidated financial statements.

Table of Contents

STAAR SURGICAL COMPANY AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

April 4, 2003

1. Basis of Presentation

The accompanying condensed consolidated financial statements include the accounts of the Company, its wholly and its majority owned subsidiaries. All significant intercompany balances and transactions have been eliminated in consolidation. Assets and liabilities of foreign subsidiaries are translated at rates of exchange in effect at the close of the period. Revenues and expenses are translated at the weighted average of exchange rates in effect during the period. The resulting translation gains and losses are deferred and are shown as a separate component of stockholders equity as accumulated other comprehensive loss. During the three months ended April 4, 2003 and March 29, 2002, the net foreign currency translation gain was $76,000 and $108,000, respectively. Net foreign currency transaction loss for the three months ended April 4, 2003 and March 29, 2002 was $56,000 and $3,000, respectively.

Investment in the Company s Japanese joint venture is accounted for using the equity method of accounting.

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all the information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements. The financial statements for the three months ended April 4, 2003 and March 29, 2002, in the opinion of management, include all adjustments consisting only of normal recurring adjustments, necessary for a fair presentation of the financial condition and results of operations. These financial statements should be read in conjunction with the audited financial statements and notes thereto included in the Company s Annual Report on Form 10-K for the year ended January 3, 2003. The results of operations for the three months ended April 4, 2003 and March 29, 2002 are not necessarily indicative of the results to be expected for any other interim period or the entire year.

The Company has restated its previously issued consolidated financial statements for the three months ended April 4, 2003 and March 29, 2002 to correct interest income on notes receivable from officers and directors on an accrual basis consistent with accounting principles generally accepted in the United States of America. The impact of the restatement on interest income and loss per share for the periods is as follows (in thousands):

	Three Months Ended April 4, 2003		
	Previously Reported	Inc (Dec)	Restated
Interest income	$ 336	$ (211)	$ 125

Loss per share	$ (0.04)	$ (0.02)	$ (0.06)

	Three Months Ended March 29, 2002		
	Previously Reported	Inc (Dec)	Restated
Interest income	$ 18	$ 35	$ 53
Loss per share	$ (0.06)	$ 0.00	$ (0.06)

There is no income tax effect of the restatement on earnings for the periods presented in 2003 and 2002 since the Company reported losses and did not record income tax benefits thereon.

Table of Contents

STAAR SURGICAL COMPANY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The impact of the restatement on the consolidated balance sheet is as follows (in thousands):

	As Previously Reported April 4, 2003	As Revised April 4, 2003	As Previously Reported March 29, 2002	As Revised March 29, 2002
Prepaids, deposits, and other current assets(1)	$ 3,118	$ 2,838	$ 2,753	No Change
Deferred tax asset non-current(2)		No Change	$ 3,982	$ 3,828
Accumulated deficit	$ 42,168	$ 41,747	$ 25,260	$ 24,973
Notes receivable from officers and directors	$ 3,137	$ 3,837	$ 3,308	$ 3,749

(1) The revised consolidated balance sheet as of April 4, 2003 includes a reclass of $280,000 of accrued interest on officer s notes from prepaids, deposits, and other current assets to notes receivable from officers and directors.

(2) The revised consolidated balance sheet as of March 29, 2002 includes a reduction to the Company s net deferred tax assets by $154,000 related to a decrease in net operating losses as a result of accrued interest income.

Each of the Company s reporting periods ends on the Friday nearest to the quarter ending date and generally consists of 13 weeks.

2. Geographic and Product Data

The Company develops, manufactures and distributes medical devices used in minimally invasive ophthalmic surgery. Substantially all of the Company s revenues result from the sale of the Company s medical devices. The Company distributes its medical devices in the cataract, refractive and glaucoma segments within ophthalmology. During the periods presented, revenues from the refractive and glaucoma segments were less than 10% of total revenue, which is not significant enough for the Company to account for these products separately or to justify segmented reporting by product type.

The Company markets and sells its products in over 39 countries and has manufacturing sites in the United States and Switzerland. Other than the United States and Germany, the Company does not conduct business in any country in which its sales in that country exceed 5% of the Company s consolidated sales. Sales are attributed to countries based on the location of customers. The composition of the Company s sales to unaffiliated customers between those in the United States, Germany, and other locations for each period is set forth below (in thousands):

Three Months Ended

	April 4, 2003	March 29, 2002
Sales to unaffiliated customers		
United States	$ 5,760	$ 6,156
Germany	5,028	3,692
Other	1,991	1,783
Total	$ 12,779	$ 11,631

Table of Contents

STAAR SURGICAL COMPANY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

3. Inventories

Inventories are stated at the lower of cost, determined on a first-in, first-out basis, or market and consisted of the following at April 4, 2003 and January 3, 2003 (in thousands):

	April 4, 2003	January 3, 2003
Raw materials and purchased parts	$ 842	$ 710
Work-in-process	1,162	798
Finished goods	9,598	10,253
	$ 11,602	$ 11,761

4. Intangible Assets

The Company also has other intangible assets consisting of patents and licenses, with a gross book value of $14.0 million and accumulated amortization of $5.2 million as of April 4, 2003. The Company capitalizes the costs of acquiring patents and licenses as well as the legal costs of successfully defending its rights to these patents. Amortization is computed on the straight-line basis over the estimated useful lives, which are based on legal and contractual provisions, and range from 10 to 20 years. Amortization expense for the quarters ended April 4, 2003 and March 29, 2002, was $241,000, and $227,000, respectively.

The weighted average amortization period for other intangible assets is approximately 15 years. The following table shows the estimated amortization expense for these assets for each of the five succeeding years (in thousands):

Fiscal Year

2003	$ 676
2004	676
2005	676
2006	676
2007	676
Total	$ 3,380

5. Notes Payable

On March 26, 2003, the Company and its domestic lender executed an agreement to extend the maturity date of the Company s $3.0 million line of credit for one year to March 31, 2004. The line of credit bears interest at a rate equal to the prime rate (4.25% at April 4, 2003) plus an interest margin of 5%. In addition, the Company is required to pay a commitment fee of 1.25% per annum of the unused amount of the line of credit. The line of credit is secured by a first priority lien on substantially all of the Company s assets. It also requires the Company to comply with certain financial covenants including the maintenance of specified levels of liquidity, tangible net worth, operating cash flow and operating income. The operating cash flow and operating income covenants

Table of Contents

STAAR SURGICAL COMPANY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

commence in the third quarter of 2003. As of April 4, 2003, the Company was in compliance with the covenants of the agreement. Borrowings outstanding under the note as of April 4, 2003 and January 3, 2003, were approximately $2.1 million and $2.8 million, respectively.

6. Reclassifications

Certain reclassifications have been made to the 2002 condensed consolidated financial statements to conform to the 2003 presentation.

7. Net Loss Per Share

For the three months ended April 4, 2003 and March 29, 2002, options to purchase 3.5 million and 3.2 million shares, respectively of the Company s common stock were outstanding. These potential common shares were excluded from the computation of diluted earnings per share for both periods, because their inclusion would have an antidilutive effect.

Pro forma net loss and loss per share for the quarters ended April 4, 2003 and March 29, 2002 had the Company accounted for stock options issued to employees and others in accordance with the fair value method of SFAS 123 are as follows (in thousands, except per share data):

		Three Months Ended	
		April 4, 2003	March 29, 2002
			Restated
Net loss	As reported	$ (958)	$ (962)
Add:	Stock-based employee compensation expense included in reported net loss, net of related tax effects		
Deduct:	Total stock-based employee compensation expense determined under fair value based methods for all awards, net of related tax effects	(397)	(389)
Net loss	Pro forma	$ (1,355)	$ (1,351)

Loss per share:	Basic and diluted		
As reported		$ (0.06)	$ (0.06)
Pro forma		$ (0.08)	$ (0.08)

8. Supply Agreement

In May 1999, the Company entered into a license and supply agreement with another manufacturer to license and re-sell one of the manufacturer s products. Under the terms of the agreement, the Company was committed to purchase the specified product for a total sum of $3.2 million over 18 months. In September 2001, the supply agreement was amended reducing the minimum contractual amount that the Company is obligated to purchase from the manufacturer to $2.5 million over a 24-month period commencing September 1, 2001. The agreement, as amended, can be cancelled at the end of the 24-month period by either party upon four months written notice. Purchases under the agreement for the quarter ended April 4, 2003 were approximately $290,000.

In December 2000, the Company entered into a minimum purchase agreement with another manufacturer for the purchase of viscoelastic solution. In addition to the minimum purchase requirement, the Company is also

Table of Contents

STAAR SURGICAL COMPANY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

obligated to pay an annual regulatory maintenance fee. The agreement contains provisions to increase the minimum annual purchases in the event that the Seller gains regulatory approval of the product in other markets, as requested by the Company. Purchases under the agreement during the quarter ended April 4, 2003 were approximately $142,000.

As of April 4, 2003, estimated annual purchase commitments under these contracts are as follows (in thousands):

Fiscal Year	
2003	$ 1,478
2004	600
2005	600
2006	200
Total	$ 2,878

9. New Accounting Pronouncements

In June 2002, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 146, Accounting for Costs Associated with Exit or Disposal Activities, which addresses accounting for restructuring and similar costs. SFAS No. 146 supersedes previous accounting guidance, principally Emerging Issues Task Force (EITF) Issue No. 94-3. The Company will adopt the provisions of SFAS No. 146 for restructuring activities initiated after December 31, 2002. SFAS No. 146 requires that the liability for costs associated with an exit or disposal activity be recognized when the liability is incurred. Under EITF No. 94-3, a liability for an exit cost was recognized at the date of a company s commitment to an exit plan. SFAS No. 146 also establishes that the liability should initially be measured and recorded at fair value. Accordingly, SFAS No. 146 may affect the timing of recognizing future restructuring costs as well as the amount recognized.

In November 2002, the FASB issued Interpretation No. 45, Guarantor s Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness to Others, an interpretation of FASB Statements No. 5, 57 and 107 and a rescission of FASB Interpretation No. 34. This interpretation elaborates on the disclosures to be made by a guarantor in its interim and annual financial statements about its obligations under guarantees issued. The interpretation also clarifies that a guarantor is required to recognize, at inception of a guarantee, a liability for the fair value of the obligation undertaken. The initial recognition and measurement provisions of the interpretation are applicable to guarantees issued or modified after December 31, 2002. The disclosure requirements are effective for financial statements of interim and annual periods ending after December 31, 2002. No guarantees were entered into or modified after December 31, 2002. Significant guarantees of the Company as of April 4, 2003 are disclosed in Note 8 of the consolidated financial statements.

In December 2002, the FASB issued SFAS No. 148, Accounting for Stock-Based Compensation Transition and Disclosure, which amends SFAS No. 123, Accounting for Stock-Based Compensation. SFAS 148 provides alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. In addition, SFAS 148 amends the disclosure requirements of SFAS 123 to require more prominent and more frequent disclosures in financial statements of the effects of stock-based compensation. The transition guidance and annual disclosure provisions of SFAS 148 are effective for fiscal years ending after December 15, 2002. The interim disclosure provisions are effective for financial reports containing condensed financial statements for interim periods beginning after December 15, 2002. The adoption of SFAS 148 did not have a material impact on the Company s financial

Table of Contents

STAAR SURGICAL COMPANY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

position or results of operations. The Company has provided the interim disclosures required by SFAS 148 in Note 7 of the consolidated financial statements.

In January 2003, the FASB issued FASB Interpretation No. 46, Consolidation of Variable Interest Entities, an interpretation of Accounting Research Bulletins (ARB) No. 51, Consolidated Financial Statements (FIN 46). FIN 46 clarifies the application of ARB No. 51 to certain entities in which equity investors do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support from other parties. The Company does not believe the adoption of FIN 46 will have a material impact on its financial position or results of operations.

10. Subsequent Event

On April 11, 2003, the Company reached an agreement with a former officer and director of the Company, for the early repayment of his loan obligations to the Company totaling $659,000 plus accrued interest of $171,000. The notes, which would have matured on September 4, 2003, were paid in full on May 6, 2003.

Table of Contents

STAAR SURGICAL COMPANY AND SUBSIDIARIES

ITEM 2 MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The matters addressed in this Item 2 that are not historical information constitute forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. Although the Company believes that the expectations reflected in these forward-looking statements are reasonable, such statements are inherently subject to risks and the Company can give no assurances that its expectations will prove to be correct. Actual results could differ from those described in this report because of numerous factors, many of which are beyond the control of the Company. These factors include, without limitation, those described below under the heading Factors That May Affect Future Results of Operations. The Company undertakes no obligation to publicly release the result of any revisions to these forward-looking statements that may be made to reflect events or circumstances after the date of this report or to reflect the occurrence of unexpected events.

The following discussion should be read in conjunction with the Company s financial statements and the related notes provided under Item 1 Financial Statements above.

Results of Operations

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

	Percentage of Total Revenues for Three Months		Percentage Change for Three Months
	April 4, 2003	March 29, 2002	2003 vs. 2002
		Restated	Restated
Total revenues	100.0 %	100.0 %	9.3 %
Cost of sales	45.6	51.3	(2.9)
Gross profit	54.4	48.7	22.2
Costs and expenses:			
General and administrative	17.8	20.5	(4.8)
Marketing and selling	32.4	34.1	4.0
Research and development	9.2	9.2	9.3
Total costs and expenses	59.4	63.8	1.9
Operating loss	(5.0)	(15.1)	(63.5)

Other income (expense), net	0.2	(0.7)	
Loss before income taxes	(4.8)	(15.8)	(67.0)
Income taxes	2.6	(7.9)	
Minority interest	0.1	.3	(55.1)
Net loss	(7.5)%	(8.2)%	(0.4)%

Table of Contents

STAAR SURGICAL COMPANY AND SUBSIDIARIES

MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

Revenues

Revenues for the three months ended April 4, 2003 were $12.8 million, which is $1.1 million or 9.3% greater than the $11.7 million in revenues for the three months ended March 29, 2002. Sales increases were realized across all product lines, except in silicone intraocular lenses (IOLs) and the AquaFlow device. The most significant increases were the result of a 31% increase in distributed products in Germany, such as custom surgical packs and other cataract products used in surgery, and a 37% increase in sales internationally of the Company s implantable contact lens (ICL). ICL unit volume increased 39% while average selling price (ASP) decreased 2% over the same quarter last year. Revenues in international markets also benefited from the favorable impact of exchange rate changes relative to the U.S. dollar.

Total IOL sales increased 1% over the first quarter of 2002 despite a 20% decrease in unit volume, primarily in the U.S. market, of the Company s single-piece silicone model as a result of problems with the lens delivery system. The decrease in sales of the single-piece silicone model was offset by increased sales of Collamer IOLs (9% increase in volume partially offset by a 2% decrease in ASP), and other IOL models sold in international markets (increased volume and ASP). As a result of the decreased IOL sales in the U.S., overall sales in that market declined 7%. The Company expects IOL sales to increase in the U.S. in the second half of the year as it resolves its delivery system issues.

Gross Profit Margin

Gross profit margin increased to 54.4% of revenues for the three months ended April 4, 2003 from 48.7% of revenues for the three months ended March 29, 2002. The increase in gross profit margin is principally due to the replacement of high cost IOL inventory with significantly lower cost IOL inventory. The high cost inventory resulted from low manufacturing volumes during a period of restructuring. Gross profit margin also improved due to increased sales of the higher margin ICL in international markets and due to lower costs of custom packs and other cataract products sold in the German market.

Other Income (Expense)

Other income for the quarter ended April 4, 2003 was $34,000, as compared to other expense of $85,000 for the quarter ended March 29, 2002. The increase in other income is the result of an increase in earnings in the Company s Japanese joint venture and due to an increase in accrued interest income.

Income Taxes

The Company recorded income taxes for the quarter ended April 4, 2003 of $329,000 based on the income of its German subsidiary. For the quarter ended March 29, 2002, the Company recorded a net income tax benefit of $932,000 based on legislation enacted March 9, 2002 (HR 3090), which enabled the Company to carryback portions of its federal 2000 and 2001 losses to 1996, 1997 and 1998.

Liquidity and Capital Resources

Cash and cash equivalents at April 4, 2003 decreased by approximately $610,000 relative to January 3, 2003, as a result of the Company s paying down its domestic notes payable.

During the quarter ended April 4, 2003, accounts receivable increased $642,000 relative to January 3, 2003. The increase in accounts receivable relates to extended terms given to certain international customers. Day s

Table of Contents

STAAR SURGICAL COMPANY AND SUBSIDIARIES

MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

sales outstanding (DSO) were 47 days at April 4, 2003 compared to 45 days at January 3, 2003. The Company expects to maintain DSO within a range of 45 to 50 days during the course of the 2003 fiscal year.

Accounts payable during the quarter ended April 4, 2003 increased $524,000 relative to the fiscal year ended January 3, 2003. The increase in accounts payable is due to the timing of insurance premiums and royalty payments internationally.

Other current liabilities during the quarter ended April 4, 2003 increased $387,000 relative to January 3, 2003. The increase in other current liabilities is due to an increase in accrued salaries and wages and taxes payable.

On March 26, 2003, the Company and its domestic lender executed an agreement to extend the maturity date of the Company s $3.0 million line of credit for one year to March 31, 2004. The line of credit bears interest at a rate equal to the prime rate (4.25% at April 4, 2003) plus an interest margin of 5%. In addition, the Company is required to pay a commitment fee of 1.25% per annum of the unused amount of the line of credit. The line of credit is secured by a first priority lien on substantially all of the Company s assets. It also requires the Company to comply with certain financial covenants including the maintenance of specified levels of liquidity, tangible net worth, operating cash flow and operating income. The operating cash flow and operating income covenants commence in the third quarter of 2003. As of April 4, 2003, the Company was in compliance with the covenants of the agreement. Borrowings outstanding under the note as of April 4, 2003 and January 3, 2003, were approximately $2.1 million and $2.8 million, respectively.

A subsidiary of the Company has a revolving credit facility with a Swiss bank, which, as amended in fiscal 2001, provides for borrowings of up to 4.5 million Swiss Francs CHF ($3.3 million based on the exchange rate on April 4, 2003). The credit facility is divided into two parts: Part A provides for borrowings of up to CHF 3.0 million ($2.2 million based on the exchange rate on April 4, 2003) and does not have a termination date; Part B provides for borrowings of up to CHF 1.5 million ($1.1 million based on the exchange rate on April 4, 2003). The loan amount under Part B of the agreement reduces by CHF 250,000 ($181,000 based on the exchange rate on April 4, 2003) semi-annually beginning June 30, 2002. The credit facility is secured by a general assignment of claims and includes positive and negative covenants, which among other things requires the subsidiary to maintain equity at or above CHF 15.8 million (approximately $11.5 million based on the exchange rate on April 4, 2003), prevents the subsidiary from entering into secured obligations except as already disclosed to the lender or guaranteeing the obligations of its subsidiaries or any third party. The agreement also prevents payment on loans made to the subsidiary by the Company without prior consent of the lender.

The loan agreement provides for borrowings on a current or fixed-term basis. The interest rate on current advances is 6.5% per annum at April 4, 2003 plus a commission rate of 0.25%, payable each quarter. The base interest rate for fixed-term advances follows Euromarket conditions for loans of a corresponding term and currency plus an individual margin. The fixed-term rate at April 4, 2003 was 4.3%. There were no borrowings outstanding under the current account as of April 4, 2003. Fixed term advances at April 4, 2003 were CHF 4.1 million ($3.0 million based on the exchange rate on April 4, 2003).

A subsidiary of the Company has a revolving credit facility with a German bank which provides for borrowings of up to approximately 125,000 EUR ($134,000 at the exchange rate on April 4, 2003) at an interest rate of 8.5%. The loan, originally due February 28, 2003, was extended on October 8, 2002 to August 31, 2003. Payments in the amount of 50,000 EUR ($54,000 at the exchange rate on April 4, 2003) were due monthly beginning December 31, 2001. The amended agreement reduced the monthly payment to 25,000 EUR ($27,000

Table of Contents

STAAR SURGICAL COMPANY AND SUBSIDIARIES

MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

at the exchange rate on April 4, 2003). The bank also agreed to waive the September 2002 and October 2002 payments. There were no other changes to the original terms of the agreement. The loan is secured by an assignment of the subsidiary s accounts receivable and inventory and is personally guaranteed by the subsidiary s president. There are no financial covenants included in the agreement and no borrowings outstanding as of April 4, 2003.

The subsidiary of the Company negotiated another credit facility with a different German bank to replace the one that expires on August 31, 2003. The new agreement, effective January 13, 2003, provides for borrowings of up to 210,000 EUR ($226,000 at the exchange rate on April 4, 2003) at an interest rate of 8.5%. The note is due November 30, 2003 and is personally guaranteed by the subsidiary s president. The agreement includes a covenant which prevents the subsidiary from paying dividends. Borrowings outstanding as of April 4, 2003 were 128,000 EUR ($138,000 at the exchange rate on April 4, 2003).

The following table represents the Company s known contractual obligations at April 4, 2003.

Contractual Obligations	Total	Less Than 1 year	1-3 Years	3-5 Years	More Than 5 Years
Long-term debt obligations	$	$	$	$	$
Capital lease obligations	101	4	97		
Operating lease obligations	1,940	753	1,132	55	
Purchase obligations	2,878	1,478	1,400		
Total	$ 4,919	$ 2,235	$ 2,629	$ 55	$

As of April 4, 2003, the Company had a current ratio of 1.4:1, net working capital of $6.5 million and net equity of $29.6 million compared to January 3, 2003 when the Company s current ratio was 1.5:1, its net working capital was $7.1 million, and its net equity was $30.6 million.

The Company s liquidity requirements arise from the funding of its working capital needs, primarily inventory, work-in-process and accounts receivable. The Company s primary sources for working capital and capital expenditures are cash flow from operations and borrowings under the Company s bank credit facilities. Any withdrawal of support from its banks could have serious consequences on the Company s liquidity. The Company s liquidity is dependent, in part, on customers paying within credit terms, and any extended delays in payments or changes in credit terms given to major customers may have an impact on the Company s cash flow. In addition, any abnormal product returns or pricing adjustments may also affect the Company s short-term funding.

14

Table of Contents

STAAR SURGICAL COMPANY AND SUBSIDIARIES

Critical Accounting Policies

The preparation of financial statements in accordance with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. On an on-going basis, we evaluate our estimates, including those related to revenue recognition, allowance for doubtful accounts, inventory reserves and income taxes, among others. Our estimates are based upon historical experiences, market trends and financial forecasts and projections, and upon various other assumptions that management believes to be reasonable under the circumstances and at that certain point in time. Actual results may differ, significantly at times, from these estimates under different assumptions or conditions.

The Company believes the following represent its critical accounting policies.

Revenue Recognition. In general, the Company supplies foldable IOLs on a consignment basis to customers, primarily ophthalmologists, surgical centers, hospitals and other eye care providers and recognizes sales when the IOLs are implanted. Sales of all other products, including sales to foreign distributors, are generally recognized upon shipment, which is when title passes.

Revenue from license and technology agreements is recorded as income, when earned, according to the terms of the respective agreements.

Impairment of Long-Lived Assets. Intangible and other long lived-assets are reviewed for impairment whenever events such as product discontinuance, plant closures, product dispositions or other changes in circumstances indicate that the carrying amount may not be recoverable. In reviewing for impairment, the Company compares the carrying value of such assets to the estimated undiscounted future cash flows expected from the use of the assets and their eventual disposition. When the estimated undiscounted future cash flows are less than their carrying amount, an impairment loss is recognized equal to the difference between the assets fair value and their carrying value.

Goodwill, which has an indefinite life and was previously amortized on a straight-line basis over the periods benefited, is no longer amortized to earnings, but instead is subject to periodic testing for impairment. Intangible assets determined to have definite lives are amortized over their remaining useful lives. Goodwill of a reporting unit is tested for impairment on an annual basis or between annual tests if an event occurs or circumstances change that would reduce the fair value of a reporting unit below its carrying amount. As of April 4, 2003, the carrying value of goodwill was $6.4 million.

The Company also has other intangible assets consisting of patents and licenses, with a gross book value of $14.0 million and accumulated amortization of $5.2 million as of April 4, 2003. The Company capitalizes the costs of acquiring patents and licenses as well as the legal costs of successfully defending its rights to these patents. Amortization is computed on the straight-line basis over the estimated useful lives, which are based on legal and contractual provisions, and range from 10 to 20 years.

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

Table of Contents

STAAR SURGICAL COMPANY AND SUBSIDIARIES

In 2002, due to the Company s recent history of losses, an increase to the valuation allowance was recorded as a non-cash charge to tax expense in the amount of $9.0 million. As a result, the valuation allowance fully offsets the value of deferred tax assets on the Company s balance sheet as of April 4, 2003. If in the future, the Company determines it will be able to utilize all or part of the deferred tax assets which have a valuation allowance of $18.6 million at April 4, 2003, we would reverse the valuation allowance, which would result in an income tax benefit.

Factors That May Affect Future Results of Operations

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

The Company may not be able to fund its future growth or react to competitive pressures if it lacks sufficient funds.

The Company depends on external sources (banks and capital markets) for the funding it needs to operate the business. Unexpected conditions have arisen and can continue to arise that could cause the Company to be in violation of its lender s financial covenants. The Company believes it has sufficient cash available through its bank credit facilities and cash from operations to fund existing operations and that it could obtain alternate financing, if necessary, although this is not certain. The decision of any one of the Company s lenders not to renew its line of credit could have a material adverse affect on the Company and the costs associated with obtaining alternate financing could be significant.

We have a history of losses.

We have reported losses in each of the last three fiscal years and have an accumulated deficit of $41.7 million as of April 4, 2003. If losses from operations continue, they could adversely affect the market price for our common stock, and our ability to maintain existing financing and obtain new financing. Despite our restructuring efforts, there can be no assurance that we will receive the intended benefits from these changes or that we will be successful in restoring the profitability of the Company.

We risk losses through litigation.

We are party to various claims and legal proceedings arising out of the normal course of our business. While there can be no assurance that an adverse determination of any such matters could not have a material adverse impact in any future period, we do not believe, based upon information known to us, that the final resolution of any of these matters will have a material adverse effect upon our consolidated financial position or results of operations and cash flows.

We have been in default of the terms of our domestic loans and have been required to reduce our principal balances, limiting our access to credit.

During recent periods, we have failed to comply with some of the covenants in our principal domestic loan, including covenants that we maintain minimum levels of operating income, cash flow and tangible net worth. Accordingly, we have had to seek waivers from our lender or modifications of our lending agreement. Among other things, we have agreed to monthly reductions of the balance of our principal domestic loan which reduced it from $7.0 million to $3.0 million. As of April 4, 2003, the principal balance on the loan was approximately

Table of Contents

STAAR SURGICAL COMPANY AND SUBSIDIARIES

$2.1 million. If we fail to meet the covenants in our loans in the future, we may not be able to secure further waivers or amendments from our lenders, who may instead seek payment on their loans and, if we fail to pay, to foreclose on the collateral for their loans. We have pledged substantially all of our assets as security for our existing loans. Our collateral pledge may make it more difficult for us to obtain additional financing on advantageous terms, if at all.

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

Constant development of new technologies and techniques, frequent new product introductions and strong price competition characterize the ophthalmic industry. The first company to introduce a product to market usually gains a significant competitive advantage. Our future growth depends, in part, on our ability to develop products to treat diseases and disorders of the eye that are more effective, safer, or incorporate emerging technologies better than our competitors products. In addition, we must manufacture these products economically and market them successfully by persuading a sufficient number of eye care professionals to use them. For example, glaucoma requires ongoing treatment over a long period of time; thus, many doctors are reluctant to switch a patient to a new treatment if the patient s current treatment for glaucoma remains effective. Sales of our existing products may decline rapidly if one of our competitors introduces a substantially superior product, or if we announce a new product of our own. Similarly, if we fail to make sufficient investments in research and development or if we focus on technologies that do not lead to better products, our current and planned products could be surpassed by more effective or advanced products.

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

We devote substantial resources to research and development. The research and development process is expensive, prolonged and entails considerable uncertainty. Development of new implantable technology, from discovery through testing and registration to initial product launch, typically takes between three and seven years. This period varies considerably from product to product and country to country. Because of the complexities and uncertainties associated with ophthalmic research and development, products we are currently developing may not complete the development process or obtain the regulatory approvals required for us to market such products successfully. These may take longer and cost more to develop and may be less successful than we currently anticipate. It is possible that few or none of the products in our development pipeline will become commercially successful.

Failure of users of our products to obtain adequate reimbursement from third-party payors could limit market acceptance of our products, which could impact our sales and profits.

Many of our products, in particular IOLs and products related to the treatment of glaucoma, are used in procedures that are typically covered by health insurance, HMO plans, Medicare or Medicaid. These third-party payors have recently been trying to contain costs by restricting the types of procedures they reimburse to those viewed as most cost-effective and capping or reducing reimbursement rates. These polices could adversely affect sales and prices of our products. Physicians, hospitals and other health care providers may be reluctant to purchase our products if third-party payors do not adequately reimburse them for the cost of our products and the use of our surgical equipment. For example:

Major third-party payors for hospital services, including government insurance plans, Medicare, Medicaid and private health care insurers, have substantially revised their payment methodologies during the last few years, resulting in stricter standards for reimbursement of hospital and outpatient charges for some medical procedures, including cataract procedures and IOLs;

Table of Contents

STAAR SURGICAL COMPANY AND SUBSIDIARIES

- Numerous legislative proposals have been considered that, if enacted, would result in major reforms in the United States health care system, which could have an adverse effect on our business;

- Our competitors may reduce the prices of their products, which could result in third-party payors favoring our competitors;

- There are proposed and existing laws and regulations governing product prices and the profitability of companies in the health care industry; and

- There have been recent initiatives by third-party payors to challenge the prices charged for medical products, which could affect our profitability.

Reductions in the prices for our products in response to these trends could reduce our profits. Moreover, our products may not be covered in the future by third-party payors. The failure of our products to be so covered could cause our profits to decline.

Economic conditions and price competition may cause sales of our products used in elective surgical procedures to decline and reduce our profitability.

Some of our products are used in purely elective procedures. For example, many patients with refractive errors that could be successfully treated with ICLs can also obtain satisfactory vision with eyeglasses or conventional contact lenses. Except in cases where ICLs offer the only acceptable outcome, it is likely that insurers, HMOs and government payors generally will not pay for ICL implantation and that the patient will bear the full cost of the procedure. Individuals may be less willing to incur the costs of these procedures in weak or uncertain economic conditions, which could lead to a decline in the number of these procedures.

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

Implantable medical devices must be manufactured to the highest standards and tolerances, and often incorporate newly developed technology. Despite all efforts at quality control and advance testing, from time to time defects or technical flaws in our products may not come to light until after the products are sold or consigned. In such circumstances, the Company has previously made voluntary recalls of its products. Such voluntary recalls may take place again in the future. Mandatory recalls can also take place if regulators or courts require them, even if the Company believes its products are safe and effective. Recalls result in lost sales of the recalled products themselves, and can result in further lost sales while replacement products are manufactured, especially if the replacements must be redesigned. If recalled products have already been implanted, we may bear some or all of the cost of corrective surgery. Recalls also damage our reputation. The inconvenience caused by recalls and related interruptions in supply, and the damage to our reputation, could cause some providers to discontinue using our products. The costs of recalls have severely impacted our revenues in recent periods.

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

The research, development, testing, manufacturing and marketing of our products are subject to extensive governmental regulation. Government regulation includes inspection of and controls over testing, manufacturing, safety and environmental controls, efficacy, labeling, advertising, promotion, record keeping, the sale and distribution of pharmaceutical products and samples and electronic records and electronic signatures. We are also subject to government regulation with respect to the prices we charge and the rebates we offer to customers. Government regulation substantially increases the cost of developing, manufacturing and selling our products.

In the United States, we must obtain approval from the FDA for each product that we market. The FDA approval process is typically lengthy and expensive, and approval is never certain. Products distributed outside of

Table of Contents

STAAR SURGICAL COMPANY AND SUBSIDIARIES

the United States are also subject to government regulation, which may be equally or more demanding. Our new products could take a significantly longer time than we expect to gain regulatory approval and may never gain approval. If a regulatory authority delays approval of a potentially significant product, our market value and operating results may decline. Even if the FDA or another regulatory agency approves a product, the approval may limit the indicated uses for a product, may otherwise limit our ability to promote, sell and distribute a product or may require post-marketing studies. If we are unable to obtain regulatory approval of our products, we will not be able to market these products, which would result in a decrease in our sales. Currently, we are actively pursuing approval for a number of our products from regulatory authorities in a number of countries, including, among others, the United States, Australia, Egypt, Taiwan, China, and the United Arab Emirates. Continued growth in our sales and profits will depend, in part, on the timely and successful introduction and marketing of some or all of these products.

The clinical trials required to obtain regulatory approvals are complex and expensive and their outcomes are uncertain. We incur substantial expense for, and devote significant time to, clinical trials, yet cannot be certain that the trials will ever result in the commercial sale of a product. Positive results from pre-clinical studies and early clinical trials do not ensure positive results in later clinical trials that form the basis of an application for regulatory approval. We may suffer significant setbacks in clinical trials, even after earlier clinical trials show promising results. Any of our products may produce undesirable side effects that could cause us or regulatory authorities to interrupt, delay or halt clinical trials of a pharmaceutical or medical device candidate. We, the FDA or another regulatory authority may suspend or terminate clinical trials at any time if they or we believe the trial participants face unacceptable health risks.

Noncompliance with applicable United States regulatory requirements can lead to fines, injunctions, penalties, mandatory recalls or seizures, suspensions of production, denial or withdrawal of pre-marketing approvals, recommendations by the FDA against governmental contracts and criminal prosecution. The FDA also has authority to request repair, replacement or refund of the cost of any device we manufacture or distribute. Regulatory authorities outside of the United States may impose similar sanctions for noncompliance with applicable regulatory requirements.

We face strong competition.

Our competitors, including Bausch & Lomb, AMO, Alcon, Pharmacia & Upjohn, Inc. and CIBA Vision, have much greater financial resources than we do and some of them have large international markets for a full suite of ophthalmic products. Their greater resources for research, development and marketing, and their greater capacity to offer comprehensive products and equipment to providers, make it difficult for us to compete. In recent periods, the Company has lost significant market share to some of its competitors.

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

Our products are sold in more than 39 countries. Revenues from international operations make up a significant portion of our total revenue, reaching 53% for the quarter ended April 4, 2003. The results of operations and the financial position of our offshore operations are generally reported in the relevant local currencies and then translated into United States dollars at the applicable exchange rates for inclusion in our consolidated financial statements, exposing us to translation risk. During the quarter ended April 4, 2003, our most significant currency exposures were to the Euro, the Swiss Franc, and the Australian Dollar. The exchange rates between these and other local currencies and the United States dollar may fluctuate substantially. In addition, we are exposed to transaction risk because some of our expenses are incurred in a

different currency from the currency in which our revenues are received. Fluctuations in the value of the United States dollar against other currencies have had in the past, and may have in the future, a material adverse effect on our operating margins and profitability.

Table of Contents

STAAR SURGICAL COMPANY AND SUBSIDIARIES

Economic, social and political conditions, laws, practices and local customs vary widely among the countries in which we sell our products. Our operations outside of the United States are subject to a number of risks and potential costs, including lower product margins, less stringent protection of intellectual property and economic, political and social uncertainty in some countries, especially in emerging markets. Our continued success as a global company depends, in part, on our ability to develop and implement policies and strategies that are effective in anticipating and managing these and other risks in the countries where we do business. These and other risks may have a material adverse effect on our operations in any particular country and on our business as a whole. We generally price our products in U.S. dollars, and as a result changes in exchange rates can make our products more expensive in some offshore markets and reduce our revenues. Inflation in emerging markets also makes our products more expensive there and increases the credit risks to which we are exposed. We have experienced currency fluctuations, inflation and volatile economic conditions, which have impacted our profitability in the past in several markets, including Germany, Austria, South Africa, France, Sweden, Norway, Canada and Australia, and we may experience such impacts in the future.

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

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

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

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

We obtain some of the components for our products from a single source. The loss or interruption of any of these suppliers could cause our revenue and profitability to decline and harm our customer relations.

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

The validation of a second manufacturing site is expensive both in terms of time and money and, therefore, has not been done. If there were to be a natural disaster, fire, or other serious business interruption at one of our

Table of Contents

STAAR SURGICAL COMPANY AND SUBSIDIARIES

manufacturing facilities, it could take a significant amount of time to validate a second site and replace lost product. We could lose customers to competitors, thereby reducing sales and profitability.

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

Most of our products are covered by patents that give us a degree of market exclusivity during the term of the patent. We also earn revenue by licensing some of our patented technology to other ophthalmic companies. The legal life of a patent is 20 years from application. Patents covering our products will expire within the next 1 to 15 years. Upon patent expiration, our competitors may introduce products using the same technology. As a result of this possible increase in competition, we may need to charge a lower price in order to maintain sales of our products, which could make these products less profitable. If we fail to develop and successfully launch new products prior to the expiration of patents for our existing products, our sales and profits with respect to those products could decline significantly. We may not be able to develop and successfully launch more advanced replacement products before these and other patents expire.

The Company depends on key employees.

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

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

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

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

Our stock price could be subject to significant fluctuations in response to factors such as quarterly variations in operating results, operating results which vary from the expectations of securities analysts and investors, changes in financial estimates, changes in market valuations of

competitors, announcements by us or our competitors of a material nature, additions or departures of key personnel, future sales of common stock and stock volume fluctuations. Also, general political and economic conditions such as recession or interest rate fluctuations may adversely affect the market price of our stock.

ITEM 3 QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

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

Table of Contents

STAAR SURGICAL COMPANY AND SUBSIDIARIES

Interest rate risk. Our $5.2 million of debt is split between domestic borrowings of $2.1 million and borrowings of our international subsidiaries of $3.1 million. Our domestic borrowings are linked to the prime interest rate and, thus, our interest rate expense will fluctuate with rate changes in the U.S. The majority of our international borrowings bear an interest rate that is linked to Euro market conditions and, thus, our interest rate expense will fluctuate with changes in those conditions. If interest rates were to increase or decrease by 1% for the year, our annual interest rate expense would increase or decrease by approximately $60,000.

Foreign currency risk. Our international subsidiaries operate in and are net recipients of currencies other than the U.S. dollar and, as such, we benefit from a weaker dollar and are adversely affected by a stronger dollar relative to major currencies worldwide (primarily, the Euro and Australian dollar). Accordingly, changes in exchange rates, and particularly the strengthening of the US dollar, may negatively affect our consolidated sales and gross profit as expressed in U.S. dollars. Additionally, approximately 60% of our debt is denominated in Swiss Francs and as such, we are subject to fluctuations of the Swiss Franc as compared to the U.S. dollar in converting the value of the debt in U.S. dollars. The U.S. dollar value of the debt is increased by a weaker dollar and decreased by a stronger dollar relative to the Swiss Franc.

ITEM 4 CONTROLS AND PROCEDURES

(a) Evaluation of disclosure controls and procedures.

Within the 90 days prior to the filing date of this report, the Chief Executive Officer and the Chief Financial Officer of the Company, with the participation of the Company s management, carried out an evaluation of the effectiveness of the Company s disclosure controls and procedures pursuant to Exchange Act Rule 13a-14. Based upon that evaluation, the Chief Executive Officer and the Chief Financial Officer believe that, as of the date of the evaluation, the Company s disclosure controls and procedures are effective in making known to them material information relating to the Company (including its consolidated subsidiaries) required to be included in this report.

Disclosure controls and procedures, no matter how well designed and implemented, can provide only reasonable assurance of achieving an entity s disclosure objectives. The likelihood of achieving such objectives is affected by limitations inherent in disclosure controls and procedures. These include the fact that human judgment in decision-making can be faulty and that breakdowns in internal control can occur because of human failures such as simple errors or mistakes or intentional circumvention of the established process.

(b) Changes in internal controls.

There were no significant changes in the Company s internal controls or in other factors that could significantly affect internal controls, known to the Chief Executive Officer or the Chief Financial Officer, subsequent to the date of the evaluation.

22

Table of Contents

STAAR SURGICAL COMPANY AND SUBSIDIARIES

PART II OTHER INFORMATION

ITEM 1 LEGAL PROCEEDINGS

Mario Pelegrina v. Andrew F. Pollet, John R. Wolf, Peter J. Utrata, Volker D. Anhaeusser, Joseph Priske, William Huddleston, Carl Manisco, individuals, Pollet & Richardson, a California corporation, and Iotech, Inc., a California corporation, Defendants, and STAAR Surgical Company, Nominal Defendant, Court of Chancery of the State of Delaware, Case No. 18556. In December 2000, Mario Pelegrina filed this shareholder derivative suit against us and certain named directors and officers. Mr. Pelegrina alleges that these directors and officers breached their fiduciary duties by engaging in self-dealing and waste of our assets. Because this is a shareholder derivative action, we are a putative plaintiff and stand to receive any damages that may be awarded. Mr. Pelegrina took no steps to prosecute the action until May 2002, when the Court of Chancery requested a status report on the litigation. On October 9, 2002, we filed a motion to dismiss the action and began preparing a brief in support of the motion. On April 24, 2003, the Court of Chancery dismissed the action without prejudice.

ITEM 2 CHANGES IN SECURITIES AND USE OF PROCEEDS

Not applicable

ITEM 3 DEFAULTS UPON SENIOR SECURITIES

Not applicable

ITEM 4 SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

Not applicable

ITEM 5 OTHER INFORMATION

Not applicable

ITEM 6 EXHIBITS AND REPORTS ON FORM 8-K

(a) ***Exhibits***

3.1	Certificate of Incorporation, as amended.(1)
3.2	By-laws, as amended.(2)
4.5	Stockholders Rights Plan, dated effective April 20, 1995.(2)
4.7	Amendment No. 1 to Stockholders Rights Plan, dated April 21, 2003.
10.95	Second Amended and Restated Revolving Line of Credit between the Company and Wells Fargo Bank, dated March 26, 2003.(3)
10.96	Second Amended and Restated Revolving Line of Credit Note, dated March 26, 2003.(3)
99.1	Certification Pursuant to 18 U.S.C. Section 1350 as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

(1) Incorporated by reference from the Company s Annual Report on Form 10-K for the year ended December 31, 1999, as filed on March 30, 2000.

Table of Contents

(2) Incorporated by reference from the Company s Annual Report on Form 10-K for the year ended December 29, 2000, as filed on March 29, 2001.
(3) Incorporated by reference to the Company s Current Report on Form 8-K filed with the Commission on March 31, 2003.

(b) ***Reports on Form 8-K***

On May 6, 2003, the Company filed a Current report on Form 8-K, furnishing under Item 12 its earnings release dated May 1, 2003 and a transcript of a conference call held May 1, 2003.

Table of Contents

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this Amendment No. 1 to Quarterly Report on Form 10-Q to be signed on its behalf by the undersigned thereunto duly authorized.

STAAR SURGICAL COMPANY

Date: November 19, 2003 By: /s/ JOHN BILY

John Bily

Chief Financial Officer