

ADVANCED MEDICAL OPTICS INC  
Form 10-Q  
November 07, 2007  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

WASHINGTON, D.C. 20549

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**FORM 10-Q**

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(Mark One)

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

For the quarterly period ended September 28, 2007

or

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

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

COMMISSION FILE NUMBER 001-31257

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**ADVANCED MEDICAL OPTICS, INC.**

(Exact name of registrant as specified in its charter)

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**DELAWARE**  
(State or other jurisdiction of  
incorporation or organization)

1700 E. St. Andrew Place

**33-0986820**  
(I.R.S. Employer  
Identification No.)

92705

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**Santa Ana, California**  
(Address of principal executive offices) (Zip Code)  
Registrant's telephone number, including area code: 714/247-8200

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

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

Large accelerated filer  Accelerated filer  Non-accelerated filer

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

As of October 31, 2007, there were 60,517,542 shares of common stock outstanding.

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**FORM 10-Q FOR THE QUARTER ENDED SEPTEMBER 28, 2007**

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Advanced Medical Optics, Inc.

Unaudited Consolidated Statements of Operations

(In thousands, except per share data)

	Three Months Ended		Nine Months Ended	
	September 28, 2007	September 29, 2006	September 28, 2007	September 29, 2006
Net sales	\$ 273,194	\$ 258,602	\$ 786,264	\$ 753,871
Cost of sales (Note 4)	121,030	95,474	348,683	274,682
Gross profit	152,164	163,128	437,581	479,189
Selling, general and administrative	137,916	96,297	397,136	291,125
Research and development	20,975	16,105	60,819	49,643
Business repositioning (credits) costs, net (Note 4)		(547)		46,427
In-process research and development			86,980	
Net gain on legal contingencies		(102,896)		(96,896)
Operating (loss) income	(6,727)	154,169	(107,354)	188,890
Non-operating expense (income):				
Interest expense	20,588	9,783	48,792	22,318
Unrealized loss (gain) on derivative instruments, net	2,433	(2,252)	2,738	650
Loss due to early retirement of Convertible Senior Subordinated Notes		2,985		18,783
Other, net	1,517	1,521	4,254	3,069
	24,538	12,037	55,784	44,820
(Loss) earnings before income taxes	(31,265)	142,132	(163,138)	144,070
(Benefit) provision for income taxes	(5,328)	54,978	17,484	56,990
Net (loss) earnings	\$ (25,937)	\$ 87,154	\$ (180,622)	\$ 87,080
Net (loss) earnings per share:				
Basic	\$ (0.43)	\$ 1.47	\$ (3.02)	\$ 1.34
Diluted	\$ (0.43)	\$ 1.42	\$ (3.02)	\$ 1.30
Weighted average number of shares outstanding:				
Basic	60,242	59,166	59,856	64,841
Diluted	60,242	61,531	59,856	67,228

See accompanying notes to unaudited consolidated financial statements.

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Advanced Medical Optics, Inc.

Unaudited Consolidated Balance Sheets

(In thousands, except share data)

	September 28, 2007	December 31, 2006
<b>ASSETS</b>		
Current assets:		
Cash and equivalents	\$ 36,549	\$ 34,522
Trade receivables, net	240,749	232,408
Inventories	155,531	127,532
Deferred income taxes	50,536	41,698
Income tax receivable	13,766	15,045
Other current assets	30,243	26,938
<b>Total current assets</b>	<b>527,374</b>	<b>478,143</b>
Property, plant and equipment, net	161,993	132,756
Deferred income taxes	14,303	13,260
Other assets	99,019	69,365
Intangible assets, net	665,984	471,664
Goodwill	1,282,234	848,709
<b>Total assets</b>	<b>\$ 2,750,907</b>	<b>\$ 2,013,897</b>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current liabilities:		
Short-term borrowings	\$ 51,000	\$
Accounts payable	74,967	53,897
Accrued compensation	51,161	41,896
Other accrued expenses	147,616	120,384
Deferred income taxes	1,302	1,276
<b>Total current liabilities</b>	<b>326,046</b>	<b>217,453</b>
Long-term debt	1,544,355	851,105
Deferred income taxes	218,384	185,844
Other liabilities	57,591	43,504
Commitments and contingencies		
Stockholders' equity:		
Preferred stock, \$.01 par value; 5,000,000 shares authorized; none issued		
Common stock, \$.01 par value; 240,000,000 shares authorized; 60,492,700 and 59,512,106 shares issued	605	595
Additional paid-in capital	1,441,590	1,409,475
Accumulated deficit	(911,142)	(730,800)
Accumulated other comprehensive income	73,566	36,745
Treasury stock, at cost (2,999 and 1,397 shares)	(88)	(24)
<b>Total stockholders' equity</b>	<b>604,531</b>	<b>715,991</b>
<b>Total liabilities and stockholders' equity</b>	<b>\$ 2,750,907</b>	<b>\$ 2,013,897</b>

See accompanying notes to unaudited consolidated financial statements.



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Advanced Medical Optics, Inc.

Unaudited Consolidated Statements of Cash Flows

(In thousands)

	Nine Months Ended	
	September 28, 2007	September 29, 2006
<b>Cash flows from operating activities:</b>		
Net (loss) earnings	\$ (180,622)	\$ 87,080
Adjustments to reconcile net (loss) earnings to net cash provided by operating activities:		
Amortization of debt issuance costs	4,941	6,104
Depreciation and amortization	70,821	52,609
Deferred income taxes	(4,958)	
In-process research and development	86,980	
Loss due to early retirement of convertible subordinated notes		18,783
Loss on investments and long-lived assets	1,558	1,409
Unrealized loss on derivatives	2,738	650
Share-based compensation	15,504	14,782
Changes in assets and liabilities (net of effect of businesses acquired):		
Trade receivables, net	30,828	9,749
Inventories	3,326	(20,386)
Other current assets	1,558	(7,632)
Accounts payable	4,325	(7,861)
Accrued expenses and other liabilities	(6,628)	(4,806)
Income taxes	8,469	43,946
Other non-current assets and liabilities	(7,133)	(6,183)
<b>Net cash provided by operating activities</b>	<b>31,707</b>	<b>188,244</b>
<b>Cash flows from investing activities:</b>		
Acquisition of businesses, net of cash acquired	(737,773)	
Purchases of property, plant and equipment	(24,241)	(20,204)
Proceeds from sale of property, plant and equipment	751	2,780
Purchases of software and other long-lived assets	(5,391)	(2,146)
Purchases of demonstration and bundled equipment	(6,328)	(7,714)
<b>Net cash used in investing activities</b>	<b>(772,982)</b>	<b>(27,284)</b>
<b>Cash flows from financing activities:</b>		
Short-term debt borrowings (repayments), net	51,000	(28,300)
Repayment of long-term debt	(2,250)	(167,678)
Financing related costs	(15,386)	(10,401)
Proceeds from issuance of long-term debt	695,500	500,000
Proceeds from issuance of common stock	18,651	34,642
Repurchase and retirement of common stock		(500,000)
Purchase of treasury stock	(64)	
Excess tax benefits from share-based compensation		5,729
<b>Net cash provided by (used in) financing activities</b>	<b>747,451</b>	<b>(166,008)</b>
Effect of exchange rates on cash and equivalents	(4,149)	2,999
<b>Net increase (decrease) in cash and equivalents</b>	<b>2,027</b>	<b>(2,049)</b>

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Cash and equivalents at beginning of period	34,522	40,826
Cash and equivalents at end of period	\$ 36,549	\$ 38,777

See accompanying notes to unaudited consolidated financial statements.



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Advanced Medical Optics, Inc.

Notes to Unaudited Consolidated Financial Statements

**Note 1: Basis of Presentation**

In the opinion of management, the accompanying unaudited consolidated financial statements contain all adjustments necessary (consisting only of normal, recurring adjustments) for a fair statement of the financial information contained therein. These statements do not include all disclosures required by accounting principles generally accepted in the United States of America for annual financial statements and should be read in conjunction with the audited consolidated financial statements of Advanced Medical Optics, Inc. (the Company or AMO) for the year ended December 31, 2006. The results of operations for the three and nine months ended September 28, 2007 are not necessarily indicative of the results to be expected for the year ending December 31, 2007.

All material intercompany balances have been eliminated.

*Reclassification*

Certain prior period amounts have been reclassified to conform to the current period presentation.

*Recently Adopted and Issued Accounting Standards*

The Company adopted the provisions of Financial Accounting Standards Board (FASB) Interpretation No. 48, Accounting for Uncertainty in Income Taxes (FIN 48), on January 1, 2007 and recorded an increase in accumulated deficit of \$0.3 million related to the cumulative effect of adoption. The components of the cumulative effect of adoption included an increase of \$1.8 million in the gross liability for unrecognized tax benefits, an increase in gross deferred tax assets of \$3.5 million and a decrease in goodwill of \$1.4 million.

As of the adoption date, the Company had unrecognized tax benefits of \$30.1 million of which \$20.2 million, if recognized, would affect the effective tax rate. As of September 28, 2007, the Company had unrecognized tax benefits of \$37.5 million of which \$24.1 million, if recognized, would affect the effective tax rate. The difference primarily relates to timing differences and amounts arising from business combinations which, if recognized, would be recorded to goodwill.

We conduct business globally and, as a result, the Company or one or more of its subsidiaries files income tax returns in the U.S. federal jurisdiction and various state and foreign jurisdictions. In the normal course of business we are subject to examination by taxing authorities throughout the world, including such major jurisdictions as the United States, Ireland, Japan, Germany, China, and Netherlands. With few exceptions, we are no longer subject to U.S. federal, state and local, or non-U.S. income tax examinations for years before 1999.

The Company anticipates that the total amount of liability for unrecognized tax benefits may change due to the settlement of audits and the expiration of statute of limitations in the next 12 months. Quantification of such change cannot be estimated at this time.

The Company recognizes potential accrued interest and penalties related to unrecognized tax benefits in income tax expense. As of the date of adoption, the Company had a liability for interest and penalties of \$1.4 million (net of tax). As of September 28, 2007, the Company had a liability for interest and penalties of \$2.1 million (net of tax).

In September 2006, the FASB issued Statement of Financial Accounting Standards (SFAS) No. 157, Fair Value Measurement. SFAS No. 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. This Statement does not require any new fair value measurements. SFAS No. 157 is effective for fiscal years beginning after November 15, 2007 and interim periods within those fiscal years. The Company is currently assessing the impact of SFAS No. 157 on its financial statements.

In February 2007, the FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities Including an amendment of FASB Statement No. 115 (SFAS No. 159). SFAS No. 159 permits entities to choose to measure many financial instruments and certain other items at fair value. This Statement is effective as of the beginning of an entity's first fiscal year that begins after November 15, 2007. The Company is currently assessing the impact (if any) of SFAS No. 159 on its financial statements.

**Note 2: Acquisitions**

*IntraLase Corp.*

On April 2, 2007, pursuant to the Agreement and Plan of Merger (the Merger Agreement ), dated as of January 5, 2007, by and among AMO, Ironman Merger Corporation, a wholly owned subsidiary of AMO, and IntraLase Corp.

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( IntraLase ), the Company completed its acquisition of IntraLase (the IntraLase acquisition ), for total consideration of approximately \$821 million in cash. IntraLase designs, develops and manufactures an ultra-fast laser for refractive and corneal surgery that creates more precise corneal incisions for laser vision correction in the first step of LASIK surgery.

The IntraLase acquisition has been accounted for as a purchase business combination. Under the purchase method of accounting, the assets acquired and liabilities assumed are recorded at the date of acquisition at their respective fair values.

The results of operations of IntraLase have been included in the accompanying consolidated statements of operations from the acquisition date. The total purchase price of the IntraLase acquisition was as follows (in thousands):

Cash consideration to IntraLase stockholders	\$ 741,652
Cash payment for vested IntraLase stock options	71,166
Estimated direct transaction fees and expenses	8,646
 Total purchase price	 \$ 821,464

The above purchase price has been allocated based on the fair values of assets acquired and liabilities assumed.

The purchase price has been allocated as follows (in thousands):

Cash and marketable securities	\$ 97,715
Inventories (includes \$7,655 step-up to fair value)	24,624
Accounts receivable, net	28,269
Other current assets	13,850
Property, plant and equipment	14,642
Other non-current assets	9,933
Intangible assets	224,200
In-process research and development	85,400
Goodwill	411,212
Accounts payable	(11,437)
Other liabilities	(41,132)
Non-current deferred tax liability, primarily related to intangible assets	(35,812)
 Net assets acquired	 \$ 821,464

The purchase price allocation is preliminary, pending completion of the valuation of acquired intangible assets and in-process research and development, resolution of outstanding legal matters and filing of final income tax returns. The final valuation will be based on the actual net assets of IntraLase that existed as of the date of the completion of the acquisition. The final valuation may change the allocation of the purchase price, which could affect the fair value assigned to the assets and liabilities and could result in a change to the unaudited pro forma information presented below. Of the \$224.2 million of acquired intangible assets, \$170.2 million was assigned to developed technology rights that have a weighted-average useful life of approximately 7 years, \$10.1 million was assigned to customer relationships with a useful life of 5 years and \$43.9 million was assigned to the IntraLase tradename with an indefinite useful life. The amounts assigned to intangible assets were based on management's preliminary estimate of the fair value.

Identification and allocation of value to the identified intangible assets was based on the provisions of SFAS No. 141, Business Combinations, ( SFAS No. 141 ). The fair value of the identified intangible assets was estimated by performing a discounted cash flow analysis using the income approach. This method includes a forecast of direct revenues and costs associated with the respective intangible assets and charges for economic returns on tangible and intangible assets utilized in cash flow generation. Net cash flows attributable to the identified intangible assets are discounted to their present value at a rate commensurate with the perceived risk. The projected cash flow assumptions considered contractual relationships, customer attrition, eventual development of new technologies and market competition.

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The estimates of expected useful lives were based on guidance from SFAS No. 141 and take into consideration the effects of competition, regulatory changes and possible obsolescence. The useful lives of technology rights were based on the number of years in which net cash flows have been projected. The useful lives of customer relationships were estimated based upon the length of the contracts currently in place, probability based estimates of contract renewals in the future and natural growth and diversification of other potential customers, which were considered insignificant. Management considers the IntraLase trade name to be a leading name in laser vision correction procedures. Management intends to maintain and continue to market existing and new products under the IntraLase trade name. As management intends to continue to use the IntraLase trade name indefinitely, an indefinite life was assigned.

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Assumptions used in forecasting cash flows for each of the identified intangible assets included consideration of the following:

IntraLase historical operating margins

Number of procedures and devices IntraLase has developed and were approved by the FDA

IntraLase market share

Contractual and non-contractual relationships with large groups of surgeons and

Patents and exclusive licenses held.

A history of operating margins and profitability, a strong scientific, service and manufacturing employee base and a leading presence in the laser market were among the factors that contributed to a purchase price resulting in the recognition of goodwill.

*In-process research and development (IPR&D)*

The adjustment for in-process research and development of \$85.4 million is preliminary and is based on our current estimate. The amount ultimately allocated to in-process research and development may differ from this preliminary allocation.

The fair value of these IPR&D projects was estimated by performing a discounted cash flow analysis using the income approach. Net cash flows attributable to the projects were discounted to their present values at a rate commensurate with the perceived risk, which for these projects was between 14-16%. The following assumptions underlie these estimates.

An enhanced procedure to cut corneal flaps with an advanced faster femtosecond laser is forecast to be approved for sale in the U.S. in 2011.

Further development of therapeutic applications in the IntraLase Enabled Keratoplasty (IEK) is forecast to be approved for sale in the U.S. in 2007. This procedure uses the IntraLase laser for corneal transplant surgery, which involves replacing a diseased or scarred cornea with a donor cornea.

Other ancillary femtosecond laser products and procedures are forecast to be approved for sale in the U.S. in 2008.

In addition, solely for the purposes of estimating the fair value of the IPR&D projects, the following assumptions were made:

Revenue that is reasonably likely to result from the approved and unapproved potential uses of identifiable intangible assets that includes the estimated number of units to be sold, estimated selling prices, estimated market penetration and estimated market share and year-over-year growth rates over the product cycles;

Remaining development and sustaining engineering expenses once commercialized were also estimated by management according to internal planning estimates; and

The cost structure was assumed to be similar to that for existing products.

The major risks and uncertainties associated with the timely and successful completion of the projects consist of the ability to confirm the safety and efficacy of the technology based on the data from clinical trials and obtaining necessary regulatory approvals. In addition, no assurance can be given that the underlying assumptions used to forecast the cash flows or the timely and successful completion of such projects will materialize, as estimated. For these reasons, among others, actual results may vary significantly from the estimated results.

The following unaudited pro forma information assumes the IntraLase acquisition occurred at the beginning of each period presented below. These unaudited pro forma results have been prepared for informational purposes only and do not purport to represent what the results of operations would have been had the IntraLase acquisition occurred as of the date indicated, nor of future results of operations. The unaudited pro forma results for three and nine months ended September 28, 2007 and September 29, 2006 were as follows (in thousands, except per share data):

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	Three Months Ended		Nine Months Ended	
	September 28, 2007	September 29, 2006	September 28, 2007	September 29, 2006
Net sales	\$ 273,194	\$ 290,895	\$ 825,584	\$ 848,398
Net (loss) earnings (1) (2)	(81,770)	23,588	(192,817)	2,209
(Loss) earnings per share:				
Basic	\$ (1.36)	\$ 0.40	\$ (3.22)	\$ 0.03
Diluted	\$ (1.36)	\$ 0.38	\$ (3.22)	\$ 0.03

- (1) The unaudited pro forma information for the three months ended September 28, 2007 includes the following non-recurring charges related to the IntraLase Acquisition: an \$85.4 million in-process research and development charge and a \$7.7 million inventory step-up charge. The unaudited pro forma information for the three months ended September 28, 2007 also reflects a \$37.2 million decrease reflecting the pro forma tax effect of the adjustments at an estimated combined effective tax rate of 40%. The unaudited pro forma information for the nine months ended September 28, 2007 reflects a \$6.8 million increase in amortization related to management's estimate of the fair value of intangible assets acquired as the result of the IntraLase Acquisition, a \$14.8 million increase in interest expense resulting from additional borrowings incurred to fund the cash portion of the IntraLase Acquisition and related costs and amortization of deferred financing costs, a \$1.4 million decrease representing the elimination of IntraLase's interest income relating to the marketable securities which were liquidated, and an \$9.2 million decrease reflecting the pro forma tax effect of the adjustments at an estimated combined effective tax rate of 40%.
- (2) The unaudited pro forma information for the three and nine months ended September 29, 2006 includes the following non-recurring charges related to the IntraLase Acquisition: an \$85.4 million in-process research and development charge and a \$7.7 million inventory step-up charge. The unaudited pro forma information for the three and nine months ended September 29, 2006 also reflect a \$6.8 million increase and a \$20.3 million increase in amortization related to management's estimate of the fair value of intangible assets acquired as the result of the IntraLase Acquisition, respectively, a \$14.8 million increase and a \$44.3 million increase in interest expense resulting from additional borrowings incurred to fund the cash portion of the IntraLase Acquisition and related costs and amortization of deferred financing costs, respectively, a \$1.3 million decrease and a \$3.4 million decrease representing the elimination of IntraLase's interest income relating to the marketable securities which were liquidated, respectively, and a \$46.3 million decrease and a \$64.4 million decrease reflecting the pro forma tax effect of the adjustments at an estimated combined effective tax rate of 40%.

**WaveFront Sciences, Inc. (WFSI)**

In January 2007, the Company acquired WFSI, an optical medical device research and development company, for approximately \$14 million, excluding future contingent consideration discussed below. The purchase price included \$1.6 million of IPR&D which was expensed in the quarter ended March 30, 2007, as it represented the fair value of projects that had not reached technological feasibility and had no alternative future use at the date of acquisition. The purchase agreement provides for additional future payments of approximately \$6 million that are contingent on successful achievement of certain milestones, \$1.0 million of which has been paid through September 28, 2007. The acquisition of WFSI was not material to the historical consolidated financial position, results of operations or cash flows of the Company.

**Note 3: Common Stock**

AMO has two incentive compensation plans (ICPs) that provide for the granting of stock options, restricted stock and restricted stock units to directors, employees and consultants. The Company has two Employee Stock Purchase Plans (ESPP) for United States and international employees, respectively, which allow employees to purchase AMO common stock.

**Table of Contents***Share-Based Compensation Expense*

Total share-based compensation expense included in the unaudited consolidated statements of operations for the three and nine months ended September 28, 2007 and September 29, 2006 was as follows (in thousands):

	Three Months Ended		Nine Months Ended	
	September 28, 2007	September 29, 2006	September 28, 2007	September 29, 2006
Cost of sales	\$ 607	\$ 552	\$ 1,771	\$ 1,709
Operating Expenses				
Research and development	849	542	2,148	1,599
Selling, general and administrative	4,209	3,426	11,585	11,474
	5,058	3,968	13,733	13,073
Pre-tax expense	5,665	4,520	15,504	14,782
Income tax benefit	(1,878)	(1,479)	(4,960)	(4,866)
After tax expense	\$ 3,787	\$ 3,041	\$ 10,544	\$ 9,916

*Stock Options*

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

The Company issues new shares to satisfy option exercises.

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

	Number of Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term in Years	Aggregate Intrinsic Value
Outstanding at December 31, 2006	7,628	\$ 25.16		
Granted	907	41.79		
Exercised	(901)	17.70		
Forfeitures, cancellations and expirations	(87)	38.62		
Outstanding at September 28, 2007	7,547	\$ 27.89	6.10	\$ 54,857
Vested and expected to vest at September 28, 2007	7,283	\$ 27.42	6.02	\$ 54,852
Exercisable at September 28, 2007	5,300	\$ 22.44	5.07	\$ 54,818

**Note 4: Product Rationalization and Business Repositioning Plan and Product Recalls***Product Rationalization and Business Repositioning Plan*



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On October 31, 2005, the Company's Board of Directors approved a product rationalization and repositioning plan covering the discontinuation of non-strategic cataract surgical and eye care products and the elimination or redeployment of resources that support these product lines. The plan also included organizational changes and potential reductions in force in manufacturing, sales and marketing associated with these product lines, as well as organizational changes in research and development and other corporate functions designed to align the organization with our strategy and strategic business unit organization.

The plan further called for increasing the Company's investment in key growth opportunities, specifically the Company's refractive implant product line and international laser vision correction business, and accelerating the implementation of productivity initiatives. Following an analysis of its IOL manufacturing capabilities in the second quarter of 2006, the Company consolidated certain operations. In addition, the Company expanded the scope of its eye care rationalization initiatives in order to maximize manufacturing capacity and seize growth opportunities. The plan was completed in the fourth quarter of 2006. Total cumulative charges of \$105.0 million were incurred through December 31, 2006.

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In the three months ended September 29, 2006, the Company incurred \$4.0 million of pre-tax charges, which included \$4.5 million for inventory, manufacturing related and other charges included in cost of sales and a net credit of \$0.5 million included in operating expenses. The net credit included in operating expenses comprised severance, relocation and other one-time termination benefits of \$0.2 million and productivity and brand repositioning costs of \$6.5 million, offset by net asset disposal gains of \$4.9 million and a net credit from settlement of a contractual obligation of \$2.3 million. In the nine months ended September 29, 2006, the Company incurred \$61.5 million of pre-tax charges, which included \$15.1 million for inventory, manufacturing related and other charges included in cost of sales and \$46.4 million included in operating expenses. Charges included in operating expenses comprised productivity and brand repositioning costs of \$37.6 million and severance, relocation and other one-time termination benefits of \$13.7 million, offset by net asset disposal gains of \$2.8 million and a net credit from settlement of contractual obligations of \$2.1 million.

Business repositioning charges and related activity in the accrual balances during the nine months ended September 28, 2007 were as follows (in thousands):

	Balance at December 31, 2006	Costs Incurred	Cash Payments	Balance at September 28, 2007
<b>Business Repositioning Costs:</b>				
Severance, relocation and related costs	\$ 11,399	\$	\$ (9,797)	\$ 1,602
Contractual obligations	248		(248)	
Productivity initiatives and brand repositioning costs	1,188		(447)	741
	\$ 12,835	\$	\$ (10,492)	\$ 2,343

*Product Recall*

In May 2007, the Company initiated a global recall of the MoisturePlus multipurpose formulation ( MoisturePlus Recall ) after being informed by the U.S. Food and Drug Administration of a higher association with Acanthamoeba keratitis. The recall negatively impacted sales in the third quarter of 2007 due to sales returns of \$6.3 million. The Company incurred approximately \$24.8 million in recall-related costs, of which approximately \$15.4 million was recorded in cost of goods sold, \$9.3 million was recorded in selling, general and administrative expenses and \$0.1 million was recorded in research and development. During the nine months ended September 28, 2007, sales returns from the recall were \$37.7 million. The Company incurred approximately \$51.8 million in recall-related costs, of which approximately \$34.9 million was recorded in cost of goods sold, \$16.8 million was recorded in selling, general and administrative expenses and \$0.1 million was recorded in research and development.

In November 2006, the Company voluntarily recalled certain eye care product lots caused by a production-line issue at its manufacturing plant in China ( China Recall ). The China Recall negatively impacted sales in the first quarter of 2007 due to sales returns of \$0.2 million. The Company incurred approximately \$4.5 million in China Recall costs in the first quarter of 2007, of which approximately \$2.1 million was recorded in cost of goods sold, \$2.1 million was recorded in selling, general and administrative expenses and \$0.3 million was included in non-operating expenses.

**Note 5: Composition of Certain Financial Statement Captions***Inventories:*

(In thousands)	September 28, 2007	December 31, 2006
Finished goods, including consignment inventory of \$8,089 and \$9,740 in 2007 and 2006, respectively	\$ 82,919	\$ 83,358
Work in process	21,089	13,538
Raw materials	51,523	30,636
	\$ 155,531	\$ 127,532



**Table of Contents***Intangible assets, net*

(In thousands)	Useful Life (Years)	September 28, 2007		December 31, 2006	
		Gross Amount	Accumulated Amortization	Gross Amount	Accumulated Amortization
<b>Amortizable Intangible Assets:</b>					
Patent	17	\$ 422	\$ (19)	\$	\$
Licensing	3 5	4,590	(4,340)	4,590	(4,243)
Technology rights	5 19	549,101	(102,491)	364,219	(61,997)
Trademarks	13.5	17,981	(4,763)	16,933	(3,545)
Customer relationships	5 10	32,680	(11,477)	22,400	(7,093)
		604,774	(123,090)	408,142	(76,878)
Nonamortizable Tradename (VISX)	Indefinite	140,400		140,400	
Nonamortizable Tradename (IntraLase)	Indefinite	43,900			
		\$ 789,074	\$ (123,090)	\$ 548,542	\$ (76,878)

The amortizable intangible assets balance increased due to the impact of foreign currency fluctuation and acquisitions of WFSI and IntraLase. Intangible assets increased by \$6.5 million and \$224.2 million as a result of the acquisitions of WFSI and IntraLase, respectively. Amortization expense was \$17.4 million and \$44.3 million for the three and nine months ended September 28, 2007, respectively, and \$9.7 million and \$29.6 million for the three and nine months ended September 29, 2006, respectively, and is recorded in selling, general and administrative in the accompanying unaudited consolidated statements of operations. Amortization expense is expected to be \$61.3 million in 2007, \$68.1 million in 2008, \$67.9 million in 2009, \$65.3 million in 2010 and \$63.4 million in 2011. Actual amortization expense may vary due to the impact of foreign currency fluctuations.

*Goodwill*

(In thousands)	Balance at December 31, 2006	Excess Tax Benefits Adjustments	Foreign Currency Adjustments	WaveFront Acquisition	IntraLase Acquisition	FIN 48 Adjustments	Balance at September 28, 2007
<b>Goodwill:</b>							
Eye Care	\$ 28,540	\$	\$ 925	\$	\$	\$	\$ 29,465
Cataract/Implant	349,347		16,549				365,896
Laser Vision Correction (LVC)	470,822	(2,030)		8,269	411,212	(1,400)	886,873
	\$ 848,709	\$ (2,030)	\$ 17,474	\$ 8,269	\$ 411,212	\$ (1,400)	\$ 1,282,234

The change in goodwill during the nine months ended September 28, 2007 included an adjustment of LVC goodwill of \$2.0 million as a result of excess tax benefits from the exercise of converted VISX stock options that were fully vested at the acquisition date and an increase of \$17.5 million from foreign currency fluctuations in the Eye Care and Cataract/Implant segments. On April 2, 2007, the Company recorded \$411.2 million of goodwill from the acquisition of IntraLase, which is included in the LVC segment. In addition, the Company recorded \$8.3 million from the acquisition of WFSI, also included in the LVC segment. As a result of the adoption of FIN 48, the Company decreased goodwill by \$1.4 million as a result of a reduction in the liability for unrecognized tax benefits accounted for in connection with the VISX acquisition. The Company performed its annual impairment test of goodwill during the second quarter of 2007 and determined there was no impairment.

**Table of Contents****Note 6: Debt**

(In thousands)	Average Rate of Interest	September 28, 2007	December 31, 2006
Convertible Senior Subordinated Notes due 2024 ( 2½ % Notes ), with put dates of January 15, 2010, July 15, 2014 and July 15, 2019	2.500%	\$ 246,105	\$ 246,105
Convertible Senior Subordinated Notes due 2025 ( 1.375% Notes ), with put dates of July 1, 2011, July 1, 2016 and July 1, 2021	1.375%	105,000	105,000
Convertible Senior Subordinated Notes due 2026 ( 3.25% Notes ), with put dates of August 1, 2014, August 1, 2017 and August 1, 2021	3.250%	500,000	500,000
Senior Subordinated Notes due 2017 ( 7½% Notes ), with put dates of May 1, 2010 and May 1, 2012	7.500%	250,000	
Term Loan due 2014 ( Term Loan )	7.250%	447,750	
Senior revolving credit facility	7.580%	46,500	155,000
		1,595,355	1,006,105
Less current portion		51,000	155,000
<b>Total long-term debt</b>		<b>\$ 1,544,355</b>	<b>\$ 851,105</b>

In April 2007, the Company issued \$250 million of 7½% Senior Subordinated Notes due May 1, 2017 (the 7½ Notes). Interest on the 7½ Notes is payable on May 1 and November 1 of each year, commencing on November 1, 2007. The 7½ Notes are redeemable at the option of the Company, in whole or in part, at any time on or after May 1, 2012 at various redemption prices, together with accrued and unpaid interest and additional interest, if any, to the redemption date. In addition, at any time on or before May 1, 2010, the Company may, at its option and subject to certain requirements, use the cash proceeds from one or more qualified equity offerings by the Company to redeem up to 35% of the aggregate principal amount of the 7½ Notes issued under the Indenture at a redemption price equal to 107.5% of the principal amount, together with accrued and unpaid interest, if any, thereon to the redemption date.

All of the convertible notes issued by the Company may be converted, at the option of the holders, on or prior to the final maturity date under certain circumstances, none of which had occurred as of September 28, 2007. Upon conversion of the convertible notes, the Company will satisfy in cash the conversion obligation with respect to the principal amount of the convertible notes, with any remaining amount of the conversion obligation to be satisfied in shares of common stock. As a result of this election, the Company also is required to satisfy in cash its obligations to repurchase any convertible notes that holders may put to the Company on the respective dates noted in the table above.

On April 2, 2007, the Company replaced its existing \$300 million senior revolving credit facility with a new senior credit facility. This new facility consists of a \$300 million revolving line of credit maturing April 2, 2013 and a \$450 million term loan maturing on April 2, 2014.

At September 28, 2007, approximately \$8.5 million of the Company's new credit facility was reserved to support letters of credit issued on the Company's behalf for normal operating purposes and the Company has approximately \$245.0 million undrawn and available revolving loan commitments.

Borrowings under the new credit facility, if any, bear interest at current market rates plus a margin based upon the Company's ratio of debt to EBITDA, as defined. The incremental interest margin on borrowings under the new credit facility decreases as the Company's ratio of debt to EBITDA decreases to specified levels. Under the new credit facility, certain transactions may trigger mandatory prepayment of borrowings, if any. Such transactions may include equity or debt offerings, certain asset sales and extraordinary receipts. The Company pays a quarterly fee (1.95% per annum at September 28, 2007) on the average balance of outstanding letters of credit and a quarterly commitment fee (0.50% per annum at September 28, 2007) on the average unused portion of the new credit facility.

The new credit facility provides that the Company maintain certain financial and operating covenants which include, among other provisions, maintaining specific total leverage and interest coverage ratios. On October 5, 2007, the Company entered into the First Amendment to Credit Agreement (the Amendment), by and among the Company, the Guarantors party thereto, certain of the Revolving Credit Lenders party to the Credit Agreement referred to below and Bank of America, N.A., as Administrative Agent on behalf of itself and the Lenders, which amended the Credit Agreement dated as of April 2, 2007 (the Credit Agreement) among the Company, the Guarantors, the lenders from time to time party thereto, UBS Securities LLC, as syndication agent, Goldman Sachs Credit Partners L.P., as documentation agent, and Bank of America, N.A., as

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administrative agent, swing line lender and L/C issuer. The Amendment adjusts the ratio of debt to EBITDA required as of certain quarterly determination dates during the term of the Credit Agreement. The Amendment further provides that certain charges relating to the MoisturePlus Recall may be added back to EBITDA for quarterly periods through and including the fiscal quarter ending December 31, 2007 for purposes of calculating compliance with the maintenance financial covenants set forth in the Credit Agreement.

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Certain covenants under the new credit facility may limit the incurrence of additional indebtedness. The new credit facility prohibits dividend payments. The Company was in compliance with these covenants at September 28, 2007. The new credit facility is collateralized by a first priority perfected lien on, and pledge of, all of the combined Company's present and future property and assets (subject to certain exclusions), 100% of the stock of the domestic subsidiaries, 66% of the stock of foreign subsidiaries and all present and future intercompany debts.

As of September 28, 2007, the aggregate maturities of total long-term debt are due as follows: \$1.1 million in 2008, \$4.5 million in 2009, \$4.5 million in 2010, \$4.5 million in 2011 and \$1,529.7 million thereafter.

*Guarantor Subsidiaries*

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

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

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

Condensed Consolidating Balance Sheet	September 28, 2007 (in thousands)				Consolidating	Consolidated
		Parent	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Entries and Eliminations	
<b>Assets:</b>						
Cash and equivalents	\$ 922	\$ 2,620	\$ 33,007	\$	\$	\$ 36,549
Trade receivables, net	2,591	89,229	148,929			240,749
Inventories	4,825	137,394	104,098	(90,786)		155,531
Other current assets	72,715	278,087	49,750	(306,007)		94,545
<b>Total current assets</b>	<b>81,053</b>	<b>507,330</b>	<b>335,784</b>	<b>(396,793)</b>		<b>527,374</b>
Property, plant and equipment, net	14,119	19,167	128,707			161,993
Goodwill and intangibles, net	29,673	1,439,976	522,366	(43,797)		1,948,218
Other assets	78,496	37,342	47,478	(49,994)		113,322
Investment in subsidiaries	2,475,528	1,175,411	2,264,518	(5,915,457)		
<b>Total assets</b>	<b>\$ 2,678,869</b>	<b>\$ 3,179,226</b>	<b>\$ 3,298,853</b>	<b>\$ (6,406,041)</b>		<b>\$ 2,750,907</b>

Liabilities and stockholders' equity:

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Short-term borrowings	\$ 51,000	\$	\$	\$	\$ 51,000
Accounts payable and other current liabilities	279,528	76,093	260,640	(341,215)	275,046
Total current liabilities	330,528	76,093	260,640	(341,215)	326,046
Long-term debt, net of current portion	1,544,355				1,544,355
Other liabilities	199,455	46,985	78,838	(49,303)	275,975
Total liabilities	2,074,338	123,078	339,478	(390,518)	2,146,376
Total stockholders' equity	604,531	3,056,148	2,959,375	(6,015,523)	604,531
Total liabilities and stockholders' equity	\$ 2,678,869	\$ 3,179,226	\$ 3,298,853	\$ (6,406,041)	\$ 2,750,907



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Condensed Consolidating Balance Sheet	December 31, 2006 (in thousands)	Consolidating				Consolidated
		Parent	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Entries and Eliminations	
<b>Assets:</b>						
Cash and equivalents	\$ 344	\$ 1,187	\$ 32,991	\$	\$	\$ 34,522
Trade receivables, net	723	77,906	153,779			232,408
Inventories	10,166	106,976	101,498	(91,108)		127,532
Other current assets	70,163	256,612	37,543	(280,637)		83,681
<b>Total current assets</b>	<b>81,396</b>	<b>442,681</b>	<b>325,811</b>	<b>(371,745)</b>		<b>478,143</b>
Property, plant and equipment, net	15,212	2,620	114,924			132,756
Goodwill and intangibles, net	29,673	828,849	501,851	(40,000)		1,320,373
Other assets	29,874	20,870	32,572	(691)		82,625
Investment in subsidiaries	1,638,781	1,203,100	2,162,731	(5,004,612)		
<b>Total assets</b>	<b>\$ 1,794,936</b>	<b>\$ 2,498,120</b>	<b>\$ 3,137,889</b>	<b>\$ (5,417,048)</b>		<b>\$ 2,013,897</b>
<b>Liabilities and stockholders' equity:</b>						
Accounts payable and other current liabilities	\$ 58,715	\$ 206,799	\$ 263,012	\$ (311,073)		\$ 217,453
<b>Total current liabilities</b>	<b>58,715</b>	<b>206,799</b>	<b>263,012</b>	<b>(311,073)</b>		<b>217,453</b>
Long-term debt, net of current portion	851,105					851,105
Other liabilities	169,125	783	59,440			229,348
<b>Total liabilities</b>	<b>1,078,945</b>	<b>207,582</b>	<b>322,452</b>	<b>(311,073)</b>		<b>1,297,906</b>
Total stockholders' equity	715,991	2,290,538	2,815,437	(5,105,975)		715,991
<b>Total liabilities and stockholders' equity</b>	<b>\$ 1,794,936</b>	<b>\$ 2,498,120</b>	<b>\$ 3,137,889</b>	<b>\$ (5,417,048)</b>		<b>\$ 2,013,897</b>

Condensed Consolidating Statement of Operations	Three months ended	Consolidating				Consolidated
		Parent	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Entries and Eliminations	
<b>September 28, 2007 (in thousands)</b>						
Net sales	\$ 64,660	\$ 187,402	\$ 208,564	\$ (187,432)		\$ 273,194
<b>Operating costs and expenses:</b>						
Cost of sales	54,244	112,293	139,508	(185,015)		121,030
Selling, general and administrative	21,093	52,240	66,224	(1,641)		137,916
Research and development	5,439	7,467	8,069			20,975
<b>Operating (loss) income</b>	<b>(16,116)</b>	<b>15,402</b>	<b>(5,237)</b>	<b>(776)</b>		<b>(6,727)</b>
Non-operating expense (income), net	51,512	(26,875)	(405)	306		24,538
Equity in (earnings) losses of subsidiaries	(26,305)	5,469		20,836		
<b>(Loss) earnings before income taxes</b>	<b>(41,323)</b>	<b>36,808</b>	<b>(4,832)</b>	<b>(21,918)</b>		<b>(31,265)</b>
(Benefit) provision for income taxes	(15,386)	10,900	(842)			(5,328)
<b>Net (loss) earnings</b>	<b>\$ (25,937)</b>	<b>\$ 25,908</b>	<b>\$ (3,990)</b>	<b>\$ (21,918)</b>		<b>\$ (25,937)</b>

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Condensed Consolidating Statement of Operations Three months ended September 29, 2006 (in thousands)	Consolidating				
	Parent	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Entries and Eliminations	Consolidated
Net sales	\$ 69,821	\$ 151,583	\$ 236,323	\$ (199,125)	\$ 258,602
Operating costs and expenses:					
Cost of sales	42,801	95,085	148,647	(191,059)	95,474
Selling, general and administrative	17,965	33,240	47,856	(2,764)	96,297
Research and development	2,492	4,422	9,191		16,105
Business repositioning	(4,144)	3,062	535		(547)
Net gain on legal contingencies	(97,756)		(5,140)		(102,896)
Operating income	108,463	15,774	35,234	(5,302)	154,169
Non-operating (income) expense, net	(3,104)	(961)	(16,742)	32,844	12,037
Equity in losses (earnings) of subsidiaries	4,476	(44,225)		39,749	
Earnings before income taxes	107,091	60,960	51,976	(77,895)	142,132
Provision for income taxes	19,937	28,288	6,753		54,978
Net earnings	\$ 87,154	\$ 32,672	\$ 45,223	\$ (77,895)	\$ 87,154

Condensed Consolidating Statement of Operations Nine months ended September 28, 2007 (in thousands)	Consolidating				
	Parent	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Entries and Eliminations	Consolidated
Net sales	\$ 175,504	\$ 530,909	\$ 595,360	\$ (515,509)	\$ 786,264
Operating costs and expenses:					
Cost of sales	127,167	336,836	397,966	(513,286)	348,683
Selling, general and administrative	61,069	143,989	197,465	(5,387)	397,136
Research and development	14,106	18,072	28,641		60,819
In-process research & development		86,980			86,980
Operating loss	(26,838)	(54,968)	(28,712)	3,164	(107,354)
Non-operating expense (income), net	81,790	(75,951)	47,765	2,180	55,784
Equity in losses of subsidiaries	128,007	94,614		(222,621)	
Loss before income taxes	(236,635)	(73,631)	(76,477)	223,605	(163,138)
(Benefit) provision for income taxes	(56,013)	55,150	18,347		17,484
Net loss	\$ (180,622)	\$ (128,781)	\$ (94,824)	\$ 223,605	\$ (180,622)

Condensed Consolidating Statement of Operations Nine months ended September 29, 2006 (in thousands)	Consolidating				
	Parent	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Entries and Eliminations	Consolidated
Net sales	\$ 216,493	\$ 462,999	\$ 670,824	\$ (596,445)	\$ 753,871
Operating costs and expenses:					
Cost of sales	142,825	278,054	437,703	(583,900)	274,682
Selling, general and administrative	60,337	98,836	139,847	(7,895)	291,125
Research and development	8,966	13,188	27,489		49,643
Business repositioning	11,245	9,474	25,708		46,427
Net gain on legal contingencies	(91,756)		(5,140)		(96,896)
Operating income	84,876	63,447	45,217	(4,650)	188,890
Non-operating expense (income), net	390	(2,805)	(4,446)	51,681	44,820
Equity in earnings of subsidiaries	(21,659)	(52,282)		73,941	
Earnings before income taxes	106,145	118,534	49,663	(130,272)	144,070

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Provision for income taxes	19,065	30,486	7,439		56,990
Net earnings	\$ 87,080	\$ 88,048	\$ 42,224	\$ (130,272)	\$ 87,080

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<b>Condensed Consolidating Statement of Cash Flows</b>	<b>Nine months ended</b>				
<b>September 28, 2007 (in thousands)</b>	<b>Parent</b>	<b>Guarantor Subsidiaries</b>	<b>Non-Guarantor Subsidiaries</b>	<b>Consolidating Entries and Eliminations</b>	<b>Consolidated</b>
Net cash provided by (used in) operating activities	\$ 95,274	\$ (23,214)	\$ (40,353)	\$	\$ 31,707
Cash flows from investing activities:					
Capital contribution	(838,742)	(66,925)		905,667	
Acquisition of business, net of cash acquired		(737,773)			(737,773)
Purchases of property, plant and equipment	(1,200)	(4,827)	(18,214)		(24,241)
Proceeds from sale of property, plant and equipment		2	749		751
Purchases of software and other long-lived assets	(2,204)	(3,149)	(38)		(5,391)
Purchases of demonstration and bundled equipment		(1,424)	(4,904)		(6,328)
Net cash used in investing activities	(842,146)	(814,096)	(22,407)	905,667	(772,982)
Cash flows from financing activities:					
Capital contribution		838,742	66,925	(905,667)	
Short-term borrowings, net	51,000				51,000
Repayment of long-term debt	(2,250)				(2,250)
Financing related cost	(15,386)				(15,386)
Proceeds from issuance of long-term debt	695,500				695,500
Proceeds from issuance of common stock	18,651				18,651
Repurchase of treasury stock	(64)				(64)
Net cash provided by financing activities	747,451	838,742	66,925	(905,667)	747,451
Effect of exchange rates on cash and equivalents			(4,149)		(4,149)
Net increase in cash and equivalents	579	1,432	16		2,027
Cash and equivalents at beginning of period	344	1,187	32,991		34,522
Cash and equivalents at end of period	\$ 923	\$ 2,619	\$ 33,007	\$	\$ 36,549

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Condensed Consolidating Statement of Cash Flows September 29, 2006 (in thousands)	Nine months ended				
	Parent	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Consolidating Entries and Eliminations	Consolidated
Net cash provided by (used in) operating activities	\$ 151,737	\$ 211,203	\$ (174,696)	\$	\$ 188,244
Cash flows from investing activities:					
Capital contribution		(1,400)		1,400	
Purchases of property, plant and equipment	(990)	(381)	(18,833)		(20,204)
Proceeds from sale of property, plant and equipment			2,780		2,780
Purchases of software and other long-lived assets	(1,971)	(172)	(3)		(2,146)
Purchases of demonstration and bundled equipment		(1,627)	(6,087)		(7,714)
Net cash used in investing activities	(2,961)	(3,580)	(22,143)	1,400	(27,284)
Cash flows from financing activities:					
Capital contribution			1,400	(1,400)	
Short-term borrowings, net	(18,300)		(10,000)		(28,300)
Repayment of long-term debt	(167,678)				(167,678)
Proceeds from issuance of long-term debt	500,000				500,000
Financing related cost	(10,401)				(10,401)
Proceeds from issuance of common stock	34,642				34,642
Repurchase and retirement of common stock	(500,000)				(500,000)
Excess tax benefit from stock-based compensation	5,729				5,729
Net cash used in financing activities	(156,008)		(8,600)	(1,400)	(166,008)
Effect of exchange rates on cash and equivalents			2,999		2,999
Net (decrease) increase in cash and equivalents	(7,232)	207,623	(202,440)		(2,049)
Cash and equivalents at beginning of period	7,878	(206,599)	239,547		40,826
Cash and equivalents at end of period	\$ 646	\$ 1,024	\$ 37,107	\$	\$ 38,777

**Note 7: Related Party Transaction**

During the second quarter of 2007, an interest-free relocation loan of \$0.5 million was repaid by the chief executive officer. This relocation loan was evidenced by a promissory note dated July 3, 2002, prior to the adoption of the Sarbanes-Oxley Act of 2002.

**Note 8: Earnings (Loss) Per Share**

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

The three and nine months ended September 28, 2007 exclude the aggregate dilutive effect of approximately 1.9 million and 2.2 million shares, respectively, for stock options, ESPP and unvested restricted stock as the effect would be antidilutive due to the net loss in each of these periods. During the three and nine months ended September 29, 2006, there

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were 13,900 and 5,000 antidilutive stock options excluded from the computation of diluted shares outstanding. There were no potentially diluted common shares associated with the 2 1/2% Notes, 1.375% Notes and the 3.25% Notes as the Company's quarter-end stock price was less than the conversion prices of the notes.

**Note 9: Other Comprehensive Income (Loss)**

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

	Three Months Ended					
	September 28, 2007			September 29, 2006		
	Before-tax amount	Income tax	Net-of-tax amount	Before-tax amount	Income Tax	Net-of-tax amount
Foreign currency translation adjustments	\$ 30,378	\$	\$ 30,378	\$ (9,497)	\$	\$ (9,497)
Net (loss) earnings			(25,937)			87,154
<b>Total comprehensive income</b>			<b>\$ 4,441</b>			<b>\$ 77,657</b>

	Nine Months Ended					
	September 28, 2007			September 29, 2006		
	Before-tax amount	Income tax	Net-of-tax amount	Before-tax amount	Income Tax	Net-of-tax amount
Foreign currency translation adjustments	\$ 36,822	\$	\$ 36,822	\$ 35,106	\$	\$ 35,106
Net (loss) earnings			(180,622)			87,080
<b>Total comprehensive (loss) income</b>			<b>\$ (143,800)</b>			<b>\$ 122,186</b>

**Note 10: Business Segment Information**

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

The Company's reportable segments are represented by three business units: Cataract/Implant, Laser Vision Correction and Eye Care. The cataract/implant segment markets four key products required for cataract surgery—foldable intraocular lenses, or IOLs, implantation systems, phacoemulsification systems and viscoelastics. The laser vision correction segment markets laser systems, diagnostic devices, treatment cards and disposable patient interfaces. The eye care segment provides a full range of contact lens care products for use with most types of contact lenses. These products include single-bottle, multi-purpose cleaning and disinfecting solutions, hydrogen peroxide-based disinfecting solutions, daily cleaners, enzymatic cleaners and contact lens rewetting drops.

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

**Table of Contents****Business Segments**

(In thousands)	Net Sales Three Months Ended		Operating Income (Loss) Three Months Ended	
	September 28, 2007	September 29, 2006	September 28, 2007	September 29, 2006
Operating segments:				
Cataract/Implant	\$ 131,715	\$ 125,207	\$ 70,277	\$ 61,758
Laser Vision Correction	99,322	50,827	59,723	31,674
Eye Care	42,157	82,568	715	41,610
Total segments	273,194	258,602	130,715	135,042
Manufacturing operations			(24,280)	(4,372)
Research and development			(20,975)	(15,550)
Business repositioning				(3,994)
Global supply chain			(14,610)	(16,648)
General corporate			(77,577)	59,691
Total	\$ 273,194	\$ 258,602	\$ (6,727)	\$ 154,169

(In thousands)	Net Sales Nine Months Ended		Operating Income (Loss) Nine Months Ended	
	September 28, 2007	September 29, 2006	September 28, 2007	September 29, 2006
Operating segments:				
Cataract/Implant	\$ 399,713	\$ 380,072	\$ 216,684	\$ 185,015
Laser Vision Correction	266,047	165,183	159,616	111,699
Eye Care	120,504	208,616	(4,448)	91,174
Total segments	786,264	753,871	371,852	387,888
Manufacturing operations			(49,084)	(6,245)
Research and development			(60,819)	(48,511)
In-process research and development			(86,980)	
Business repositioning				(61,481)
Global supply chain			(57,107)	(46,430)
General corporate			(225,216)	(36,331)
Total	\$ 786,264	\$ 753,871	\$ (107,354)	\$ 188,890

**Table of Contents****Geographic Area Information**

(In thousands)	Net Sales			
	Three Months Ended September 28, 2007	September 29, 2006	September 28, 2007	September 29, 2006
<b>United States:</b>				
Cataract/Implant	\$ 45,215	\$ 45,984	\$ 132,312	\$ 128,401
Laser Vision Correction	61,306	37,890	179,516	128,549
Eye Care	8,991	22,040	31,347	61,118
<b>Total United States</b>	<b>115,512</b>	<b>105,914</b>	<b>343,175</b>	<b>318,068</b>
<b>Americas, excluding United States:</b>				
Cataract/Implant	9,888	7,646	29,357	24,726
Laser Vision Correction	4,767	2,355	11,558	6,821
Eye Care	(77)	3,477	2,815	9,502
<b>Total Americas, excluding United States</b>	<b>14,578</b>	<b>13,478</b>	<b>43,730</b>	<b>41,049</b>
<b>Europe/Africa/Middle East:</b>				
Cataract/Implant	45,544	41,607	151,079	138,507
Laser Vision Correction	15,060	4,264	37,925	12,244
Eye Care	14,224	22,382	44,930	58,082
<b>Total Europe/Africa/Middle East</b>	<b>74,828</b>	<b>68,253</b>	<b>233,934</b>	<b>208,833</b>
<b>Japan:</b>				
Cataract/Implant	17,518	18,226	48,018	50,940
Laser Vision Correction	9,072	1,153	16,614	2,964
Eye Care	14,562	21,678	34,863	49,463
<b>Total Japan</b>	<b>41,152</b>	<b>41,057</b>	<b>99,495</b>	<b>103,367</b>
<b>Asia Pacific:</b>				
Cataract/Implant	13,550	11,744	38,947	37,498
Laser Vision Correction	9,117	5,165	20,434	14,605
Eye Care	4,457	12,991	6,549	30,451
<b>Total Asia Pacific</b>	<b>27,124</b>	<b>29,900</b>	<b>65,930</b>	<b>82,554</b>
<b>Total</b>	<b>\$ 273,194</b>	<b>\$ 258,602</b>	<b>\$ 786,264</b>	<b>\$ 753,871</b>

The United States information is presented separately as it is the Company's headquarters country, and U.S. sales represented 42.3% and 43.6% of total net sales for the three and nine months ended September 28, 2007, respectively, and 41.0% and 42.2% of total net sales for the three and nine months ended September 29, 2006, respectively. Additionally, sales in Japan represented 15.1% and 12.7% of total net sales for the three and nine months ended September 28, 2007, respectively, and 15.9% and 13.7% of total net sales for the three and nine months ended September 29, 2006, respectively. No other country, or single customer, generated over 10% of total net sales in the periods presented.

**Note 11: Commitments and Contingencies**

On August 24, 2007 and September 13, 2007, two purported class action complaints were filed by Scott Kairalla and Barry Galison, respectively, in the U.S. District Court of the Central District of California on behalf of purchasers of Company securities between January 4 and May 25, 2007 (the "Actions"). The Actions allege claims under the Securities Exchange Act of 1934 against the Company and certain of its officers and directors. The Actions allege that the Company made material misrepresentations concerning its Complete MoisturePlus product.

The Company does not believe that the Actions have merit and intends to defend them vigorously. The Company may incur substantial expenses in defending against the Actions. In the event of a determination adverse to the Company or its officers and directors, the Company may incur



substantial monetary liability which could have a material adverse effect on the Company's financial position, results of operations or cash flows.

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

**Note 12: Pension Benefit Plans**

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

	Three Months Ended		Nine months Ended	
	September 28, 2007	September 29, 2006	September 28, 2007	September 29, 2006
Service cost	\$ 551	\$ 569	\$ 1,653	\$ 1,707
Interest cost	174	137	522	411
Expected return on plan assets	(80)	(61)	(240)	(183)
Amortization of prior service cost	11	15	33	45
Amortization of net actuarial loss	26	10	78	30
Net periodic benefit cost	\$ 682	\$ 670	\$ 2,046	\$ 2,010

ADVANCED MEDICAL OPTICS, INC.

**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations for the Quarter Ended September 28, 2007**

*The following discussion and analysis presents the factors that had a material effect on AMO's cash flows and results of operations during the three and nine months ended September 28, 2007, and the Company's financial position at that date. Except for the historical information contained herein, the following discussion contains forward-looking statements that involve risk and uncertainties. Our actual results may differ significantly from the results discussed in the forward-looking statements. Factors that might cause such differences include, but are not limited to, those discussed in the subsection entitled "Certain Factors and Trends Affecting AMO and Its Businesses." The following discussion should be read in conjunction with the 2006 Form 10-K and the unaudited consolidated financial statements and notes thereto included elsewhere in this Form 10-Q.*

**OVERVIEW**

We are a global leader in the development, manufacture and marketing of medical devices for the eye. We have three major product lines: cataract / implant, laser vision correction, and eye care. In the cataract / implant market, we focus on the four key products required for cataract surgery—foldable intraocular lenses, or IOLs, implantation systems, phacoemulsification systems and viscoelastics. In the laser vision correction market, we market excimer and femtosecond laser systems, related treatment cards and disposable patient interfaces, and diagnostic devices. Our eye care product line provides a full range of contact lens care products for use with most types of contact lenses. These products include single-bottle, multi-purpose cleaning and disinfecting solutions, hydrogen peroxide-based disinfecting solutions, daily cleaners, enzymatic cleaners and contact lens rewetting drops.

We have operations in approximately 20 countries and sell our products in approximately 60 countries in the following four regions:

Americas (North and South America);

Europe, Africa and Middle East;

Japan; and

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

### *IntraLase Acquisition*

On April 2, 2007, pursuant to the Agreement and Plan of Merger (the Merger Agreement), dated as of January 5, 2007, by and among AMO, Ironman Merger Corporation, a wholly owned subsidiary of AMO, and IntraLase Corp. (IntraLase), we completed the acquisition of IntraLase (the IntraLase acquisition), for total consideration of approximately \$821 million in cash. IntraLase designs, develops and manufactures an ultra-fast laser for refractive and corneal surgery that creates more precise corneal incisions for laser vision correction in the first step of LASIK surgery.

The IntraLase acquisition has been accounted for as a purchase business combination. Under the purchase method of accounting, the assets acquired and liabilities assumed are recorded at the date of acquisition at their respective fair values. The results of operations of IntraLase have been included in the accompanying consolidated statements of operations from the acquisition date. The impact of purchase accounting resulted in non-cash charges of \$85.4 million for in-process research and development and \$7.7 million for step-up of inventory to fair value in the second quarter of 2007. We incurred other acquisition and integration related charges of \$6.5 million in the second quarter and \$5.1 million in the third quarter of 2007.

### *Eye Care Recall*

In May 2007, we initiated a global recall of our MoisturePlus multipurpose formulation (MoisturePlus Recall) after being informed by the U.S. Food and Drug Administration of a higher association with Acanthamoeba keratitis. We re-entered the multipurpose market with an existing formulation and began shipping in August 2007. The recall negatively impacted sales in the third quarter due to returns of \$6.3 million. We incurred approximately \$24.8 million in recall-related costs, of which approximately \$15.4 million was recorded in cost of goods sold, \$9.3 million was recorded in selling, general and administrative expenses and \$0.1 million was recorded in research and development. During the nine months ended September 28, 2007, sales returns from the recall were \$37.7 million. We incurred approximately \$51.8 million in recall-related costs, of which approximately \$34.9 million was recorded in cost of goods sold, \$16.8 million was recorded in selling, general and administrative expenses and \$0.1 million was recorded in research and development.

In the fourth quarter of 2007, we expect to incur approximately \$18 million in costs in connection with the MoisturePlus Recall. These costs are due to manufacturing start-up related expenses and unabsorbed overhead as production continues to ramp up in the fourth quarter of 2007, ongoing incremental administrative costs and spending on marketing programs to re-launch products and recapture market share.

In November 2006, we voluntarily recalled certain eye care product lots caused by a production-line issue at our manufacturing plant in China (China Recall). The China Recall negatively impacted sales in the first quarter of 2007 due to returns of \$0.2 million. We also estimated approximately \$16.9 million in lost sales during the first quarter as a result of the China Recall. We incurred approximately \$4.5 million in China Recall costs in the first quarter of 2007, of which approximately \$2.1 million was recorded in cost of goods sold, \$2.1 million was recorded in selling, general and administrative expenses and \$0.3 million was included in non-operating expenses.

## **CRITICAL ACCOUNTING POLICIES AND ESTIMATES**

The preparation of consolidated financial statements and related disclosures in conformity with accounting principles generally accepted in the United States of America requires management to make judgments, assumptions and estimates that affect the amounts reported. Actual results could differ from those estimates. Certain of these significant accounting policies are considered to be critical accounting policies as more fully described in Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations, of the Company's Annual Report on Form 10-K for the year ended December 31, 2006. Management believes that at September 28, 2007 there has been no material change to this information, with the exception of income taxes as described below.

### *Income Taxes*

We account for income taxes under the asset and liability method, whereby deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. We evaluate the need to establish a valuation allowance for deferred tax assets based upon the amount of existing temporary differences, the period in which they are expected to be recovered and expected levels of taxable income. A valuation allowance to reduce deferred tax assets is established when it is more likely than not that some or all of the deferred tax assets will not be realized.



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Effective January 1, 2007, we adopted Interpretation No. 48, *Accounting for Uncertainty in Income Taxes – An Interpretation of FASB Statement No. 109* (FIN 48), which requires income tax positions to meet a more-likely-than-not recognition threshold to be recognized in the financial statements. Under FIN 48, tax positions that previously failed to meet the more-likely-than-not threshold should be recognized in the first subsequent financial reporting period in which that threshold is met. Previously recognized tax positions that no longer meet the more-likely-than-not threshold should be derecognized in the first subsequent financial reporting period in which that threshold is no longer met. As a multinational corporation, we are subject to taxation in many jurisdictions, our income tax returns in several locations are being examined by the local taxation authorities and the calculation of our tax liabilities involves dealing with uncertainties in the application of complex tax laws and regulations in various tax jurisdictions. The application of tax laws and regulations is subject to legal and factual interpretation, judgment and uncertainty. Tax laws and regulations themselves are subject to change as a result of changes in fiscal policy, changes in legislation, evolution of regulations and court rulings. Therefore, the actual liability for U.S. or foreign taxes may be materially different from our estimates, which could result in the need to record additional tax liabilities or potentially to reverse previously recorded tax liabilities.

**RESULTS OF OPERATIONS**

The following tables present net sales and operating income (loss) by operating segment for the three and nine months ended September 28, 2007 and September 29, 2006, respectively:

(In thousands)	Net Sales Three Months Ended		Operating Income Three Months Ended	
	September 28, 2007	September 29, 2006	September 28, 2007	September 29, 2006
	Cataract/Implant	\$ 131,715	\$ 125,207	\$ 70,277
Laser Vision Correction	99,322	50,827	59,723	31,674
Eye Care	42,157	82,568	715	41,610
Total operating segments	\$ 273,194	\$ 258,602	\$ 130,715	\$ 135,042

(In thousands)	Net Sales Nine Months Ended		Operating Income (Loss) Nine Months Ended	
	September 28, 2007	September 29, 2006	September 28, 2007	September 29, 2006
	Cataract/Implant	\$ 399,713	\$ 380,072	\$ 216,684
Laser Vision Correction	266,047	165,183	159,616	111,699
Eye Care	120,504	208,616	(4,448)	91,174
Total operating segments	\$ 786,264	\$ 753,871	\$ 371,852	\$ 387,888

*Net sales.* Total net sales increased 5.6% and 4.3% in the three and nine months ended September 28, 2007, respectively, compared to the same periods last year. The increases in net sales from the IntraLase acquisition in the three and nine months ended September 28, 2007 and organic growth in the current quarter were offset by the negative impact of the MoisturePlus Recall. Net sales include a favorable foreign currency impact of 2.1% in the three and nine months ended September 28, 2007. Our sales and earnings may be favorably impacted during times of a weakening U.S. dollar. Sales in the U.S. represented 42.3% and 43.6% of total net sales for the three and nine months ended September 28, 2007, respectively. Additionally, sales in Japan represented 15.1% and 12.7% of total net sales in the three and nine months ended September 28, 2007, respectively. No other country, or single customer, generated over 10% of total net sales in the periods presented.

Net sales from our Cataract/Implant business increased by 5.2% in the three and nine months ended September 28, 2007, compared with the same periods last year. The increases in net sales were primarily the result of increased sales of intraocular lenses (IOLs) and phacoemulsification systems, partially offset by a decrease in sales of viscoelastics. In the current quarter, viscoelastics sales were negatively impacted by the lack of a dispersive product in the U.S. Continued reimbursement and competitive pressures in certain European markets and in Japan also negatively impacted viscoelastic products. Total IOL sales increased by 6.5% and 9.3% to \$74.3 million and \$231.5 million in the three and nine months ended September 28, 2007, respectively, compared with the same periods last year, driven by our proprietary *Tecnis* aspheric monofocal IOL and our refractive implant portfolio. Monofocal IOL sales increased 7.6% and 8.1% to \$61.4 million and \$191.3 million in the three and nine months ended September 28, 2007, respectively, compared with the same periods last year, reflecting continued strong growth of the *Tecnis* IOL franchise. Our refractive IOL sales were relatively flat in the current quarter at \$12.8 million compared to a year ago,

reflecting continued demand in international markets, while domestic

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sales slowed. In the nine months ended September 28, 2007, refractive IOL sales increased 15.3% to \$40.2 million, compared with the same period last year, reflecting demand for our *ReZoom*, *Tecnis Multifocal*, *Verisyse* and *Veriflex* IOLs. In the three months ended September 28, 2007, net sales from phacoemulsification systems were up 11.4% to \$22.4 million due to surgical pack sales and system sales driven by sales from strong growth in our established phacoemulsification franchise and the recently launched *WhiteStar Signature* system. Net sales from phacoemulsification systems were relatively flat at \$64.2 million in the nine months ended September 28, 2007, compared with the same period last year, due to lower demand earlier in the year ahead of the planned introduction of the new *WhiteStar Signature* phacoemulsification system in the current quarter, partially offset by growth in surgical pack sales.

Cataract/Implant net sales in the U.S. decreased slightly in the three months ended September 28, 2007 compared with the same period a year ago. Sales in the U.S. increased by 3.1% in the nine months ended September 28, 2007, reflecting strong growth in our *Tecnis* IOL franchise, partially offset by a decline in viscoelastics. Sales growth in the Other Americas of 29.3% and 18.7% in the three and nine months ended September 28, 2007, respectively, was due to strong demand for our core products, partially offset by decreases in sales of older-technology intraocular lenses and viscoelastics. Sales in Europe/Africa/Middle East increased by 9.5% and 9.1% and in Asia Pacific by 15.4% and 3.9% in the three and nine months ended September 28, 2007, respectively, primarily due to continued strong IOL sales driven by our proprietary *Tecnis* aspheric monofocal IOL and our refractive implant portfolio. Sales in Japan declined by 3.9% and 5.7% in the three and nine months ended September 28, 2007, respectively, reflecting competitive pricing for acrylic intraocular lenses and decreases in sales of phacoemulsification systems and older-technology intraocular lenses. Net sales in our Cataract/Implant business reflect a favorable foreign currency impact of 3.3% and 3.1% in the three and nine months ended September 28, 2007, respectively, largely from fluctuations of the euro versus the U.S. dollar.

Net sales from our Laser Vision Correction (LVC) business increased by 95.4% and 61.1% to \$99.3 million and \$266.0 million in the three and nine months ended September 28, 2007, compared with the same periods last year, primarily due to the IntraLase acquisition. Sales of acquired IntraLase products were \$43.0 million and \$85.1 million in the three and nine months ended September 28, 2007. The increase also reflects higher demand for our *CustomVue* procedures and strong international system sales. Net sales increased in the U.S. and Other Americas in the three and nine months ended September 28, 2007, compared with the same periods last year, due to the IntraLase acquisition, higher excimer laser procedural volume and a favorable shift toward *CustomVue* procedures. Net sales increased in Europe/Africa/Middle East, Japan and Asia Pacific, due to the IntraLase acquisition and as a result of our international expansion strategy for the LVC business. The foreign currency impact on LVC sales in the three and nine months ended September 28, 2007 was negligible.

Net sales from our Eye Care business decreased by 48.9% and 42.1% in the three and nine months ended September 28, 2007, respectively, compared with the same periods last year. The sales decreases of \$40.4 million and \$88.1 million in the current quarter and year to date, respectively, primarily reflect the impact of the MoisturePlus Recall, which includes returns of \$6.3 million in the current quarter and \$37.7 million year to date. We also saw decreased sales of hydrogen peroxide-based products, principally in Europe and Japan, where the migration to single-bottle cleaning regimens continues. Net sales decreased significantly in every region in the three months and nine months ended September 28, 2007, compared with the same periods last year, primarily as a result of the MoisturePlus Recall. Net sales in our Eye Care business included a favorable foreign currency impact of 0.9% and 1.3% in the three and nine months ended September 28, 2007, largely resulting from fluctuations of the euro versus the U.S. dollar.

*Gross margin and gross profit.* Our gross margin percentage was 55.7% in the three and nine months ended September 28, 2007, compared with 63.1% and 63.6% in the same periods last year. These decreases were driven primarily by the negative impact of the MoisturePlus Recall, partially offset by the favorable impact of the IntraLase acquisition. Gross profit for the three months ended September 28, 2007 included a \$21.7 million negative impact from the MoisturePlus Recall associated with sales returns and product-related costs. Gross profit for the nine months ended September 28, 2007 included a \$72.6 million negative impact from the MoisturePlus Recall associated with sales returns and product-related costs. Gross profit for the nine months ended September 28, 2007 also included a \$2.3 million negative impact from the China Recall, a \$7.7 million non-cash charge for the step-up of inventory to fair value in connection with the IntraLase acquisition and a \$4.7 million charge to discontinue the Amadeus microkeratome distributor agreement in the first quarter of 2007. Gross profit for the three months ended September 29, 2006 included approximately \$4.5 million, or 1.7 percentage points, for inventory, manufacturing related and other charges incurred in connection with our business repositioning plan. Gross profit for the nine months ended September 29, 2006 included \$15.1 million in charges that were incurred in connection with the business repositioning plan.

*Selling, general and administrative.* Selling, general and administrative ( SG&A ) expenses increased as a percent of net sales by 13.3 percentage points and by 11.9 percentage points to 50.5% in the three and nine months ended September 28, 2007, respectively, compared with the same periods last year. These increases include a \$9.3 million charge in MoisturePlus Recall and product re-launch expenses in the current quarter. SG&A expenses in 2007 also include ongoing operating costs



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from the acquisitions of IntraLase and WaveFront Sciences, Inc. ( WFSI ). Incremental amortization expense from the IntraLase acquisition in the three and nine months ended September 28, 2007 were \$6.8 million and \$13.6 million, respectively. Integration-related costs associated with the IntraLase acquisition in the three and nine months ended September 28, 2007 were \$4.9 million and \$11.5 million, respectively. The nine months ended September 28, 2007 included a \$8.2 million in expenses for costs incurred in connection with a proposed acquisition of another company in the ophthalmic segment which we withdrew in August 2007, \$2.1 million in China Recall-related costs in the first quarter of 2007 and a \$16.8 million charge in MoisturePlus Recall and product re-launch expenses. The overall increases also reflect our focus on being the Complete Refractive Solution to differentiate us from other market participants as we combine our refractive offering, expertise and service capabilities, as well as continuing our LVC international expansion. Selling, general and administrative expenses for the nine months ended September 29, 2006 includes \$3.3 million of charges primarily associated with assets acquired in the termination of a distributor agreement in India and acquisition and integration-related charges.

*Research and development.* Research and development expenditures increased as a percent of net sales by 1.5 percentage points to 7.7%, and by 1.1 percentage point to 7.7% in the three and nine months ended September 28, 2007, respectively, compared with the same periods last year. The increases primarily reflect incremental operating expenses from the IntraLase Acquisition. We recognized an impairment charge of \$1.0 million in the first quarter of 2007 in connection with a research and development licensing arrangement. We expect our research and development costs as a percentage of sales to be approximately 7.5% for 2007. Our research and development strategy is to develop proprietary products for vision correction that are safe and effective and address unmet needs. We are currently focusing on new advancements that build on our *Tecnis*, *Healon* and phacoemulsification technologies, corneal and lens-based solutions to presbyopia, projects from the acquisitions of WFSI and IntraLase and dry eye products.

*In-process research and development.* These charges represented the estimated fair value of projects that, as of the acquisition dates, had not reached technological feasibility and had no alternative future use. In the second quarter, we recorded \$1.6 million and \$85.4 million in-process research and development (IPR&D) charges related to the WFSI acquisition and IntraLase acquisition, respectively.

The fair value of these IPR&D projects was estimated by performing a discounted cash flow analysis using the income approach. Net cash flows attributable to the projects were discounted to their present values at a rate commensurate with the perceived risk, which for these projects was between 14-16%. The following assumptions underlie these estimates.

An enhanced procedure to cut corneal flaps with an advanced faster femtosecond laser is forecast to be approved for sale in the U.S. in 2011.

Further development of therapeutic applications in the IntraLase Enabled Keratoplasty (IEK) is forecast to be approved for sale in the U.S. in 2007. This procedure uses the IntraLase laser for corneal transplant surgery, which involves replacing a diseased or scarred cornea with a donor cornea.

Other ancillary femtosecond laser products and procedures are forecast to be approved for sale in the U.S. in 2008. Additional research and development expenses for these procedures are expected to range from \$35 million to \$40 million. This range represents management's best estimate as to the additional research and development expenses required to bring these products to market in the U.S.

*Business repositioning.* In the three months ended September 29, 2006, we incurred \$4.0 million of pre-tax charges, which included \$4.5 million for inventory, manufacturing related and other charges included in cost of sales and net credit of \$0.5 million included in operating expenses. The net credit included in operating expenses comprised severance, relocation and other one-time termination benefits of \$0.2 million and productivity and brand repositioning costs of \$6.5 million, offset by net asset disposal gains of \$4.9 million and a net credit from settlement of a contractual obligation of \$2.3 million. In the nine months ended September 29, 2006, we incurred \$61.5 million of pre-tax charges, which included \$15.1 million for inventory, manufacturing related and other charges included in cost of sales and \$46.4 million included in operating expenses. Charges included in operating expenses comprised productivity and brand repositioning costs of \$37.6 million and severance, relocation and other one-time termination benefits of \$13.7 million, offset by net asset disposal gains of \$2.8 million and a net credit from settlement of contractual obligations of \$2.1 million. The business repositioning and product rationalization plan was completed in the fourth quarter of 2006.

*Operating Income (Loss).* Operating loss as a percentage of net sales, or operating margin, was (2.5%) and (13.7%) in the three and nine months ended September 28, 2007, respectively, compared with operating income as a percentage of net sales of 59.6% and 25.1% in the three and nine

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months ended September 29, 2006, respectively. These decreases primarily reflect the negative impact of the MoisturePlus Recall and charges from the IntraLase and WFSI acquisitions, partially offset by the favorable impact from sales of acquired IntraLase products in 2007. Operating loss of \$6.7 million in the three months

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ended September 28, 2007 includes \$5.1 million for IntraLase integration-related costs, \$6.8 million from incremental amortization of acquired IntraLase intangible assets and \$5.7 million in share-based compensation expense under SFAS 123R. The negative impact on operating loss from the MoisturePlus Recall was \$31.1 million in the current quarter associated with sales returns and product-related costs. The net impact from these items reduced operating margin by 17.8 percentage points in addition to the net effect of the decline in Eye Care sales in the three months ended September 28, 2007. Operating loss of \$107.4 million in the nine months ended September 28, 2007 includes \$120.0 million of IntraLase acquisition-related charges (including amortization expense of \$13.6 million), \$4.4 million from the China Recall in the first quarter, \$15.5 million in share-based compensation expense under SFAS 123R, \$8.2 million in connection with the proposal to acquire another company in the ophthalmic segment, \$4.7 million related to the discontinuation of a distributor contract, \$1.0 million impairment related to a R&D licensing agreement and \$1.6 million for IPR&D related to the WFSI acquisition. The negative impact on operating loss from the MoisturePlus Recall was \$89.5 million year to date associated with sales returns and product-related costs. These charges reduced operating margin by 31.2 percentage points in addition to the net effect of the decline in Eye Care sales in the nine months ended September 28, 2007.

Operating income of \$154.2 million in the three months ended September 29, 2006 includes a net gain on legal contingencies of \$102.9 million offset by charges of \$4.0 million for business repositioning costs and \$4.5 million in stock-based compensation expense under SFAS 123R. The net impact from these items improved operating margin by 36.5% in the three months ended September 29, 2006. Operating income of \$188.9 million in the nine months ended September 29, 2006 includes a net gain on legal contingencies of \$96.9 million, offset by charges of \$61.5 million for business repositioning costs, \$3.3 million of charges primarily associated with assets acquired in the termination of a distributor agreement in India and acquisition and integration-related charges and \$14.8 million in stock-based compensation expense under SFAS 123R. The net impact from these items improved operating margin by 2.3% in the nine months ended September 29, 2006.

Operating income from our Cataract/Implant business increased by \$8.5 million and \$31.7 million in the three and nine months ended September 28, 2007, respectively, due to the increase in net sales of IOL products discussed above. Operating income from our LVC business increased by \$28.1 million and \$47.9 million in the three and nine months ended September 28, 2007, respectively, primarily due to the IntraLase acquisition and continued penetration of our *CustomVue* technology. The increase also reflects higher demand for our *CustomVue* procedures and strong international system sales, offset by the ongoing operating costs associated with the WFSI and IntraLase acquisitions in 2007. Operating income/loss from our Eye Care business decreased by \$40.9 million and \$95.6 million in the three and nine months ended September 28, 2007, respectively, primarily due to the eye care recalls discussed above.

*Non-operating expense.* Interest expense was \$20.6 million and \$48.8 million in the three and nine months ended September 28, 2007, respectively, compared with \$9.8 million and \$22.3 million in the three and nine months ended September 29, 2006, respectively. The increase was due to the issuance of \$500 million in convertible debt in June 2006 and \$700 million in debt in April 2007 in connection with the acquisition of IntraLase. Interest expense in the nine months ended September 28, 2007 also includes a \$1.3 million deferred financing cost write-off associated with the IntraLase acquisition. Interest expense in the three and nine months ended September 29, 2006 includes a pro-rata write-off of debt issuance costs of \$0.9 million and \$3.3 million, respectively.

During the three and nine months ended September 29, 2006, we recorded charges of \$3.0 million and \$18.8 million, respectively, associated with the repurchase of \$20 million and \$148.9 million, respectively, aggregate principal amount of convertible notes.

We recorded an unrealized loss on derivative instruments of \$2.4 million and \$2.7 in the three and nine months ended September 28, 2007, respectively, compared to an unrealized gain on derivative instruments of \$2.3 in the three months ended September 29, 2006 and an unrealized loss on derivative instruments of \$0.7 million in the nine months ended September 29, 2006. We record as unrealized (gain) loss on derivative instruments, net the mark to market adjustments on the outstanding foreign currency options and forward contracts which we enter into as part of our overall risk management strategy to reduce the volatility of expected earnings in currencies other than the U.S. dollar. The net loss in the first nine months of 2007 and 2006 was largely attributable to euro and Japanese yen instruments.

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

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The MoisturePlus Recall is expected to impact our ability to utilize existing and expected deferred tax assets related to foreign tax credits and benefits that result from our repatriation policy. As such, management determined that it is no longer more likely than not that \$12.7 million of existing foreign tax benefits and \$17.4 million of foreign tax benefits previously expected to be generated are realizable. Accordingly, during the period ended June 29, 2007, management established a valuation allowance for these items and recorded the impact in the period ended June 29, 2007 and in the estimated 2007 effective tax rate. In addition, \$9.1 million of previously expected deferred tax liabilities associated with future utilization of foreign tax credits and benefits were reversed in the quarter ended June 29, 2007 as a result of the impact of the recall.

The effective tax rate in 2007 reflects an estimated change in the relative mix of domestic versus international taxable income or loss. The projected change in mix includes the impact of lower international income related to the effect of the MoisturePlus Recall. Our future effective income tax rate may vary depending on our mix of domestic and international taxable income or loss and the various tax and treasury methodologies that we implement, including our policy regarding repatriation of future accumulated foreign earnings. The acquisition of IntraLase will also change the relative mix of domestic versus international taxable income or loss.

We recorded a provision for income taxes of \$55.0 million and \$57.0 million in the three and nine months ended September 29, 2006, respectively. The effective tax rates of 38.7% and 39.6% for the respective periods were significantly impacted by the net gain on legal contingencies at an effective rate of approximately 41%. Pre-tax charges on the early retirement of convertible senior subordinated notes of \$3.0 million and \$18.8 million in the three and nine months ended September 29, 2006, respectively, resulted in the recognition of partial deferred tax benefits of \$0.3 million and \$3.9 million, respectively. In addition, the effective tax rates reflect a benefit from stock-based compensation expense currently being recognized under SFAS 123R at an effective rate of approximately 33%, and a provision on all other pre-tax income at an effective rate of 32%.

**Table of Contents****LIQUIDITY AND CAPITAL RESOURCES**

Management assesses our liquidity by our ability to generate cash to fund operations. Significant factors in the management of liquidity are: funds generated by operations; levels of accounts receivable, inventories, accounts payable and capital expenditures; adequate lines of credit; and financial flexibility to attract long-term capital on satisfactory terms. As of September 28, 2007, we had cash and equivalents of \$36.5 million.

Historically, we have generated cash from operations in excess of working capital requirements, and we expect to do so in the future. Net cash provided by operating activities was \$31.7 million and \$188.2 million in the nine months ended September 28, 2007 and September 29, 2006, respectively. The positive operating cash flow impact from the IntraLase acquisition was partially offset by the negative impact from the MoisturePlus Recall. Cash outflows from the business repositioning plan were \$10.5 million in the nine months ended September 28, 2007 compared with \$48.5 million in the same period last year. The nine months ended September 29, 2006 also included net cash proceeds of \$110.9 million from settlement of litigation contingencies during the third quarter of 2006.

Net cash used in investing activities was \$773.0 million and \$27.3 million in the nine months ended September 28, 2007 and September 29, 2006, respectively. We used \$724.0 million, net of cash acquired, to purchase IntraLase and \$13.8 million to acquire WFSI. Expenditures for property, plant and equipment totaled \$24.2 million and \$20.2 million in the nine months ended September 28, 2007 and September 29, 2006, respectively. Expenditures in the nine months ended September 28, 2007 primarily comprised expenditures to upgrade and expand our eye care manufacturing facility in China and continuation of upgrades to our manufacturing facilities in Puerto Rico and Uppsala, Sweden. Expenditures in the nine months ended September 29, 2006 primarily comprised expenditures to upgrade our viscoelastics manufacturing facility in Uppsala, Sweden and eye care manufacturing facility in Spain. Expenditures for demonstration (demo) and bundled equipment, primarily phacoemulsification and microkeratome surgical equipment, were \$6.3 million and \$7.7 million in the nine months ended September 28, 2007 and September 29, 2006, respectively. We maintain demo and bundled equipment to facilitate future sales of similar equipment and related products to our customers. Expenditures for capitalized internal-use software were \$5.4 million and \$2.1 million in the nine months ended September 28, 2007 and September 29, 2006, respectively, which primarily comprised a company-wide system upgrade as part of the overall expansion of our business. We capitalize internal-use software cost after technical feasibility has been established. In 2007, we expect to invest approximately \$50.0 million to \$55.0 million in property, plant and equipment, demo and bundled equipment, and capitalized software as part of the overall expansion of our business, including the incremental impact from the IntraLase acquisition, on capital spending.

Net cash provided by financing activities was \$747.5 million in the nine months ended September 28, 2007. We had net borrowings of \$746.5 million in short-term and long-term debt that were used to finance the IntraLase Acquisition and related financing costs. Net cash used in financing activities was \$166.0 million in the nine months ended September 29, 2006. We received proceeds of \$500 million from the issuance of 3.25% convertible notes that were used to repurchase and retire 10.1 million shares of AMO common stock. We also used \$167.7 million to repay convertible notes, partially offset by short-term borrowings of \$28.3 million.

In April 2007, we issued \$250 million of 7 1/2% Senior Subordinated Notes due May 1, 2017 (the 7 1/2 Notes). Interest on the 7 1/2% Notes is payable on May 1 and November 1 of each year, commencing on November 1, 2007. The 7 1/2% Notes are redeemable at the option of us, in whole or in part, at any time on or after May 1, 2012 at various redemption prices, together with accrued and unpaid interest and additional interest, if any, to the redemption date. In addition, at any time on or before May 1, 2010, we may, at our option and subject to certain requirements, use the cash proceeds from one or more qualified equity offerings by us to redeem up to 35% of the aggregate principal amount of the 7 1/2% Notes issued under the Indenture at a redemption price equal to 107.5% of the principal amount, together with accrued and unpaid interest, if any, thereon to the redemption date.

On April 2, 2007, we replaced our existing \$300 million senior revolving credit facility with a new senior credit facility. This new facility consists of a \$300 million revolving line of credit maturing April 2, 2013 and a \$450 million term loan maturing on April 2, 2014.

At September 28, 2007, approximately \$8.5 million of the new revolving credit facility was reserved to support letters of credit issued on our behalf for normal operating purposes and we had approximately \$245.0 million undrawn and available revolving loan commitments.

Borrowings under the new credit facility, if any, bear interest at current market rates plus a margin based upon our ratio of debt to EBITDA, as defined. The incremental interest margin on borrowings under the new credit facility decreases as the our ratio of debt to EBITDA decreases to specified levels. Under the new credit facility, certain transactions may trigger mandatory prepayment of borrowings, if any. Such transactions may include equity or debt offerings, certain asset sales and extraordinary receipts. We pay a quarterly fee (1.95% per annum at September 28, 2007) on the average balance of outstanding letters of credit and a quarterly commitment fee (0.50% per annum at September 28, 2007) on the average unused portion of the new credit facility.

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The new credit facility provide that we maintain certain financial and operating covenants which include, among other provisions, maintaining specific total leverage and interest coverage ratios. On October 5, 2007, we entered into an amendment of the credit agreement for the revolving line of credit. The amendment adjusts the ratio of debt to EBITDA required as of certain quarterly determination dates during the term of the credit agreement. The amendment further provides that certain charges relating to the MoisturePlus Recall may be added back to EBITDA for quarterly periods through and including the fiscal quarter ending December 31, 2007 for purposes of calculating compliance with the maintenance financial covenants set forth in the Credit Agreement.

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Certain covenants under the senior credit facility may limit the incurrence of additional indebtedness. The senior credit facility prohibits dividend payments. We were in compliance with these covenants at September 28, 2007. The senior credit facility is collateralized by a first priority perfected lien on, and pledge of, all of the combined company's present and future property and assets (subject to certain exclusions), 100% of the stock of the domestic subsidiaries, 66% of the stock of foreign subsidiaries and all present and future intercompany debts.

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

We believe that the net cash provided by our operating activities, supplemented as necessary with borrowings available under our revolving credit facility and existing cash and equivalents, will provide sufficient resources to fund the expected 2007 capital expenditures, and to meet our working capital requirements, debt service and other cash needs over the next year.

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

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

*Foreign currency fluctuations.* Approximately 56.4% of our revenues for the nine months ended September 28, 2007 were derived from operations outside the United States and a significant portion of our cost structure is denominated in currencies other than the U.S. dollar, primarily the Japanese yen and the euro. Therefore, we are subject to fluctuations in sales and earnings reported in U.S. dollars as a result of changing currency exchange rates.

The impact of foreign currency fluctuations on sales resulted in an increase of \$15.6 million for the nine months ended September 28, 2007 and a decrease of \$8.9 million for the nine months ended September 29, 2006. These fluctuations were due primarily to fluctuations of the Japanese yen and the euro versus the U.S. dollar.

*Contractual obligations.* We have contractual obligations for long-term debt, interest on long-term debt, operating lease obligations, service contracts and other purchase obligations that were summarized in a table of Contractual Obligations in our Annual Report on Form 10-K for the year ended December 31, 2006. Since December 31, 2006, there have been no material changes to the table of Contractual Obligations of the Company, outside of the ordinary course of business, except for the issuance of the \$250 million 7 1/2% Senior Subordinated Notes due May 1, 2017 and the presentation of our liability for unrecognized tax benefits. As discussed in Note 1 in the Notes to Unaudited Consolidated Financial Statements, we adopted the provisions of Financial Accounting Standards Board (FASB) Interpretation No. 48, Accounting for Uncertainty in Income Taxes, as of January 1, 2007. As of the adoption date, we had a liability of \$28.7 million for unrecognized tax benefits, including related interest and penalties. At September 28, 2007, we had a liability of \$32.9 million for unrecognized tax benefits, including related interest and penalties, which is expected to be paid after one year. We are unable to determine when cash settlement with a taxing authority will occur.

*Off-balance sheet arrangements.* We had no off-balance sheet arrangements at September 28, 2007 as defined in Regulation S-K Item 303(a)(4).

## **Recent Accounting Standards**

In September 2006, the FASB issued Statement of Financial Accounting Standards (SFAS) No. 157, Fair Value Measurement. SFAS No. 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. This Statement does not require any new fair value measurements. SFAS No. 157 is effective for fiscal years beginning after November 15, 2007 and interim periods within those fiscal years. We are currently assessing the impact of SFAS No. 157 on our financial statements.





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In February 2007, the FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities - Including an amendment of FASB Statement No. 115 (SFAS No. 159)". SFAS No. 159 permits entities to choose to measure many financial instruments and certain other items at fair value. This Statement is effective as of the beginning of an entity's first fiscal year that begins after November 15, 2007. We are currently assessing the impact (if any) of SFAS No. 159 on our financial statements.

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

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

risks associated with our ability to realize the benefits of the IntraLase acquisition;

uncertainties associated with the research and development and regulatory processes;

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

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

foreign currency risks and fluctuation in interest rates;

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

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

our reliance on sole source suppliers for raw materials and other products;

intense competition from companies with substantially more resources and a greater marketing scale;

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

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

unexpected losses due to product liability claims, product recalls or corrections, or other litigation associated with our May 2007 MoisturePlus Recall, securities litigation or otherwise;

our ability to maintain our relationships with health care providers;

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

our ability to attract, hire and retain qualified personnel;

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

our significant debt, which contains covenants limiting our business activities;

changes in market acceptance of laser vision correction;

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

the effect of weak or uncertain general economic conditions on the ability of individuals to afford laser vision correction.

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

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We undertake no obligation to publicly update forward-looking statements, whether as a result of new information, future events or otherwise. You are advised, however, to consult any further disclosures we make on related subjects in our Forms 10-Q, 8-K and 10-K reports to the Securities and Exchange Commission. Our Form 10-K filing for the 2006 fiscal year and this Form 10-Q list various important factors that could cause actual results to differ materially from expected and historic results. We note these factors for investors as permitted by the Private Securities Litigation Reform Act of 1995. Readers can find them in Item 1A of the Form 10-K, as supplemented in Item 1A of this Form 10-Q, under the heading Risk Factors. We incorporate that section of that Form 10-K in this filing and encourage investors to refer to it. You should understand that it is not possible to predict or identify all such factors. Consequently, you should not consider any such list to be a complete set of all potential risks or uncertainties.

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

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

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

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

*Interest rate risk.* At September 28, 2007, our debt comprises solely domestic borrowings and comprises \$1.1 billion of fixed rate debt and \$494.3 million of variable rate debt.

The tables below present information about our debt obligations as of September 28, 2007 and December 31, 2006:

	September 28, 2007							Fair
	Maturing in							Market
	2007	2008	2009	2010	2011	Thereafter	Total	Value
<b>LIABILITIES</b>								
<b>Debt Obligations:</b>								
Fixed Rate	\$	\$	\$	\$	\$	\$ 246,105	\$ 246,105	\$ 233,721
Weighted Average Interest Rate						2.50%	2.50%	
Fixed Rate	\$	\$	\$	\$	\$	\$ 105,000	\$ 105,000	\$ 94,180
Weighted Average Interest Rate						1.375%	1.375%	
Fixed Rate	\$	\$	\$	\$	\$	\$ 500,000	\$ 500,000	\$ 426,665
Weighted Average Interest Rate						3.25%	3.25%	
Fixed Rate	\$	\$	\$	\$	\$	\$ 250,000	\$ 250,000	\$ 227,500
Weighted Average Interest Rate						7.50%	7.50%	
Variable Rate	\$ 46,500	\$	\$	\$	\$	\$	\$ 46,500	\$ 46,500
Weighted Average Interest Rate	7.58%						7.58%	
Variable Rate	\$ 1,125	\$ 4,500	\$ 4,500	\$ 4,500	\$ 4,500	\$ 428,625	\$ 447,750	\$ 447,750
Weighted Average Interest Rate	7.25%	7.25%	7.25%	7.25%	7.25%	7.25%	7.25%	
Total Debt Obligations	\$ 47,625	\$ 4,500	\$ 4,500	\$ 4,500	\$ 4,500	\$ 1,529,730	\$ 1,595,355	\$ 1,476,316
Weighted Average Interest Rate	7.57%	7.25%	7.25%	7.25%	7.25%	4.82%	4.93%	



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	December 31, 2006						Fair	
	2007	2008	2009	Maturing in		Total	Market Value	
				2010	2011			Thereafter
	(in thousands, except interest rates)							
<b>LIABILITIES</b>								
<b>Debt Obligations:</b>								
Fixed Rate	\$	\$	\$	\$	\$	\$ 246,105	\$ 246,105	\$ 238,722
Weighted Average Interest Rate						2.50%	2.50%	
Fixed Rate	\$	\$	\$	\$	\$	\$ 105,000	\$ 105,000	\$ 99,554
Weighted Average Interest Rate						1.375%	1.375%	
Fixed Rate	\$	\$	\$	\$	\$	\$ 500,000	\$ 500,000	\$ 455,950
Weighted Average Interest Rate						3.25%	3.25%	
Total Debt Obligations	\$	\$	\$	\$	\$	\$ 851,105	\$ 851,105	\$ 794,226
Weighted Average Interest Rate						2.80%	2.80%	

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

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

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

The following tables provide information about our foreign currency derivative financial instruments outstanding as of September 28, 2007 and December 31, 2006, respectively. The information is provided in U.S. dollar amounts, as presented in our consolidated financial statements.

	September 28, 2007		December 31, 2006	
	Notional Amount	Average Contract or Strike Rate	Notional Amount	Average Contract or Strike Rate
	(in \$millions)		(in \$millions)	
<b>Foreign currency forward contracts:</b>				
<b>Pay US\$/Receive Foreign Currency:</b>				
Swiss Franc	\$ 4.3	1.16	\$ 3.7	1.22
Danish Krone	1.1	5.22		
Norwegian Krone	0.7	5.38		
U.K. Pound	16.4	0.49		
<b>Receive US\$/Pay Foreign Currency:</b>				
Swedish Krona	29.6	6.43	8.8	6.85
Japanese Yen			7.1	118.80
Canadian Dollar	8.5	1.00	9.5	1.16



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	September 28, 2007		December 31, 2006	
	Notional	Average	Notional	Average
	Amount	Contract	Amount	Contract
	(in \$millions)	or Strike	(in \$millions)	or Strike
		Rate		Rate
Australia Dollar	3.5	1.13	7.1	1.27
<b>Total Notional</b>	<b>\$ 64.1</b>		<b>\$ 36.2</b>	
<b>Estimated Fair Value</b>	<b>\$ (0.2)</b>		<b>\$</b>	
<b>Foreign currency purchased put options:</b>				
Japanese Yen	\$ 67.2	118.54	\$ 72.0	118.00
Euro	56.5	1.28	50.8	1.24
<b>Foreign currency sold call options:</b>				
Japanese Yen	64.6	109.24	81.3	104.50
Euro	57.8	1.31	53.1	1.29
<b>Total Notional</b>	<b>\$ 246.1</b>		<b>\$ 257.2</b>	
<b>Estimated Fair Value</b>	<b>\$ (3.7)</b>		<b>\$ (0.6)</b>	

The notional principal amount provides one measure of the transaction volume outstanding as of the end of the period, and does not represent the amount of our exposure to market loss. The estimate of fair value is based on applicable and commonly used prevailing financial market information as of September 28, 2007 and December 31, 2006, respectively. The amounts ultimately realized upon settlement of these financial instruments, together with the gains and losses on the underlying exposures, will depend on actual market conditions during the remaining life of the instruments.

**Item 4. Controls and Procedures**

As of the end of the period covered by this report, we carried out an evaluation, under the supervision and with the participation of our principal executive officer and principal financial officer, of the effectiveness of the design and operation of our disclosure controls and procedures. Based on this evaluation, our principal executive officer and principal financial officer concluded that our disclosure controls and procedures (as defined in Rule 13a-15(e) and Rule 15d-15(e) under the Securities Exchange Act of 1934) are effective. In addition, our management evaluated our internal control over financial reporting and there have been no changes during the most recent fiscal quarter ended September 28, 2007 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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

On August 24, 2007 and September 13, 2007, two purported class action complaints were filed by Scott Kairalla and Barry Galison, respectively, in the U.S. District Court of the Central District of California on behalf of purchasers of our securities between January 4 and May 25, 2007 (the "Actions"). The Actions allege claims under the Securities Exchange Act of 1934 against us and certain of our officers and directors. The Actions allege that we made material misrepresentations concerning our Complete MoisturePlus product.

We do not believe that the Actions have merit and intend to defend them vigorously. We may incur substantial expenses in defending against the Actions. In the event of a determination adverse to us or our officers and directors, we may incur substantial monetary liability which could have a material adverse effect on our financial position, results of operations or cash flows.

While we are involved from time to time in litigation arising in the ordinary course of business, including product liability claims (related to our May 2007 MoisturePlus Recall or otherwise), we are not currently aware of any other actions against us or Allergan relating to the optical medical device business that we believe would have a material adverse effect on our business, financial condition, results of operations or cash

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flows. We may be subject to future litigation and infringement claims, which could cause us to incur significant expenses or prevent us from selling its products. We operate in an industry susceptible to significant product liability claims. Product liability claims may be asserted against us in the future arising out of the May 2007 MoisturePlus Recall and/or events not known to us at the present time. Under the terms of the contribution and distribution agreement affecting the spin-off, Allergan agreed to assume responsibility for, and to indemnify us against, all current and future litigation relating to its retained businesses and we agreed to assume responsibility for, and to indemnify Allergan against, all current and future litigation related to the optical medical device business.



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### **Item 1A. Risk Factors**

There have been no significant changes to the risk factors disclosed in the Company's Annual Report on Form 10-K for the year ended December 31, 2006, except for the following items:

#### **LASIK surgeons may not adopt our femtosecond laser product offering as an attractive alternative to the microkeratome for creating the corneal flap or adoption may be slower than anticipated.**

LASIK surgeons may not continue to adopt our femtosecond laser product offering, or may adopt our technology at a slower rate than we have anticipated, unless they determine, based on experience, clinical data and studies and published journal articles, including peer review articles, that our product offering provides significant benefits or an attractive alternative over the traditional method of creating the corneal flap using the microkeratome. In addition, we believe that recommendations and support of our laser by influential LASIK surgeons are essential for its market acceptance and adoption. If we do not receive support from such surgeons or from the data and experience of users, it may become difficult to have additional LASIK surgeons adopt our product offering. In such circumstances, we may not achieve expected revenues or profits. In order for the adoption rate of our technology to meet our expectations, patients must also continue to be willing to pay for LASIK surgery using our femtosecond product offering despite it being more expensive than LASIK surgery with the microkeratome. LASIK surgeons typically receive more income per eye when using our product offering instead of the traditional microkeratome.

#### **Presently unknown side effects related to the use of our femtosecond laser could emerge in the future.**

Use of the *IntraLase FS* laser to create the LASIK flap is a relatively new technique. Consequently there is no long term follow up data beyond five years that might reveal unknown side effects or complications associated specifically with this technique. The possibility of unfavorable side effects, and any concomitant adverse publicity, could seriously harm our business. In addition to the potential side effects and complications associated with LASIK generally, some LASIK surgeons have observed incidents of transient light sensitivity in patients treated with our system, although this has affected only a small percentage of patients and appears to resolve quickly with treatment. Any future reported adverse outcomes or pattern of side effects involving the use of our laser specifically, or with respect to LASIK procedures generally, could have a material adverse effect on our business, financial condition and results of operations.

#### **Measures we take to ensure collection of femtosecond laser per procedure charges may be inadequate.**

Generating per procedure revenues from our installed base of femtosecond lasers is a key aspect of our business. We charge our customers a per procedure fee for each eye treated. This fee is inclusive of a disposable patient interface, which is intended to be used on a single eye and discarded. We typically charge our customers procedure fees based on our shipments to them of per procedure disposable interfaces.

We believe that a small percentage of our customers, in an effort to avoid procedure fees, have in the past used a single patient interface to treat multiple eyes. If this practice (or other fee avoidance practices) were to continue or to proliferate, it could have a material adverse effect on our business.

Our proprietary *IntraLASIK* software contains a feature which requires the laser to periodically be reprogrammed in order to perform additional procedures. We have introduced technology which allows us to do this remotely using secure activation techniques. Over 90 percent of *IntraLase* lasers have been upgraded to new software versions that require either remote electronic activation when the customers order procedures or an *IntraLase*-generated activation code used by the customers at their sites. Secure activation capabilities allow us to align the number of procedures available on the laser with the number of patient interfaces purchased to prevent reuse. However, if these capabilities prove inadequate, or if other fee avoidance methods are devised which we are unable to detect or counter, or if we are unable to enhance all of the lasers in our worldwide installed base, this could have a material adverse effect on our business. By way of example, circumstances that could potentially hamper our enforcement efforts include: theft or disclosure of confidential passwords, improper or unauthorized tampering with laser hardware or software, lack of cooperation from international distributors, inability to obtain access to lasers in the field, legal impediments imposed by foreign jurisdictions and/or counterfeit patient interfaces.

#### **We could experience losses due to product liability claims, product recalls or corrections.**

We have in the past been, and continue to be, subject to product liability claims. In connection with our spin-off from Allergan, we assumed the defense of any litigation involving claims related to our business and agreed to indemnify Allergan for all related losses, costs and expenses. As part of our risk management policy, we have obtained third-party product



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liability insurance coverage. Product liability claims against us may exceed the coverage limits of our insurance policies or cause us to record a self-insured loss. A product liability claim in excess of applicable insurance could have a material adverse effect on our business, financial condition and results of operations. Even if any product liability loss is covered by an insurance policy, these policies have substantial retentions or deductibles that provide that we will not receive insurance proceeds until the losses incurred exceed the amount of those retentions or deductibles. To the extent that any losses are below these retentions or deductibles, we will be responsible for paying these losses. The payment of retentions or deductibles for a significant amount of claims could have a material adverse effect on our business, financial condition and results of operations.

In addition, we are subject to medical device reporting regulations that require us to report to the FDA or similar governmental authorities in other countries if our products cause or contribute to a death or serious injury or malfunction in a way that would be reasonably likely to contribute to death or serious injury if the malfunction were to recur. The FDA and similar governmental authorities in other countries have the authority to require the recall of our products in the event of material deficiencies or defects in design or manufacturing. A government mandated or voluntary recall by us could occur as a result of manufacturing errors or design defects, including defects in labeling. We have undertaken voluntary recalls of our products in the past.

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

In November 2006 and May 2007, we commenced voluntary recalls of eye care solutions, which resulted in a material decrease in eye care sales and increased costs associated with the recalls and the necessary corrective measures. We cannot assure you that we have fully anticipated the impact of these recalls on our eye care business, including litigation exposure, or that we will be able to regain our market position.

**We could experience losses and increased expenses due to legal proceedings.**

We and certain of our subsidiaries are involved in various product liability, consumer, commercial, employment and securities litigations and claims and other legal proceedings that arise from time to time. Litigation is inherently unpredictable. Although we believe we have substantial defenses in these matters, we could in the future incur significant expenses and judgments or enter into settlements of claims that could have a material adverse effect on our results of operations in any particular period.

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

Period	(a) Total Number of Shares  (or Units) Purchased(1)	(b) Average Price Paid per Share (or unit)	(c) Total Number of Shares (or Units) Purchased as Part of Publicly Announced Plans or Programs	(d) Maximum Number
				(or Approximate Dollar Value) of Shares (or Units) that May Yet Be Purchased Under the Plans or Programs
June 30, 2007 to July 27, 2007				
July 28, 2007 to August 31, 2007	1,566	\$ 42.20		
September 1, 2007 to September 28, 2007	36	\$ 35.10		
Total	1,602	\$ 38.65		

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

**Item 6. Exhibits**

- 10.1 First Amendment to Credit Agreement dated as of October 5, 2007, amending the April 2, 2007 Credit Agreement by and among Advanced Medical Optics, Inc., the guarantors party thereto, UBS Securities LLC, as syndication agent, Goldman Sachs Credit Partners L.P., as documentation agent, Bank of America N.A., as administrative agent, swing line lender and L/C issuer, and the lenders party thereto.
- 10.2 Schedule of Executive Officers Party to the 2007 Form of Change in Control Agreement.
- 10.3 Letter dated September 25, 2007 from Advanced Medical Optics, Inc. to Michael J. Lambert, offering employment as Executive Vice President and Chief Financial Officer.
- 31.1 Certification of James V. Mazzo pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2 Certification of Richard A. Meier pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32.1 Certification of James V. Mazzo and Richard A. Meier pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

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SIGNATURES

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

Date: November 6, 2007

ADVANCED MEDICAL OPTICS, INC.

/s/ Richard A. Meier  
**Richard A. Meier**  
**Chief Operating Officer**  
**(Principal Financial Officer)**

/s/ Robert F. Gallagher  
**Robert F. Gallagher**  
**Senior Vice President, Chief Accounting Officer and Controller**  
**(Principal Accounting Officer)**

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