ADVANCED MEDICAL OPTICS INC
Form 10-Q/A
November 08, 2007
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q/A

Amendment No. 1

(Mark One)

x **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

ADVANCED MEDICAL OPTICS, INC.

(Exact name of registrant as specified in its charter)

DELAWARE	**33-0986820**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**

1700 E. St. Andrew Place

Santa Ana, California	**92705**
(Address of principal executive offices)	**(Zip Code)**

Registrant s telephone number, including area code: 714/247-8200

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

Indicate by 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 x 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 x

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

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EXPLANATORY NOTE

This Amendment No. 1 to our Quarterly Report on Form 10-Q for the quarterly period ended September 28, 2007 reflects a correction of clerical errors in the Notes to Unaudited Consolidated Financial Statements in Item 1, Financial Statements. The condensed consolidating statement of cash flows for the nine months ended September 29, 2006, as set forth in Note 6 on page 18 of the Form 10-Q as filed on November 7, 2007 has been revised as follows: (a) the amounts presented in the line item Net cash provided by operating activities of Parent, Guarantor Subsidiaries and Non-Guarantor Subsidiaries were incorrectly stated as $151,737, $211,203 and $(174,696), respectively, when the correct amounts should be $156,509, $3,619 and $28,116, respectively, and (b) the amounts presented in the line item Cash and equivalents at beginning of period of Parent, Guarantor Subsidiaries and Non-Guarantor Subsidiaries were incorrectly stated as $7,878, $(206,599) and $239,547, respectively, when the correct amounts should be $3,106, $985 and $36,735, respectively. These errors had no impact on the consolidated financial statements in Item 1 and had no impact on Item 2, Management s Discussion and Analysis of Financial Condition and Results of Operations. Other than these changes, the remainder of the document is unchanged from the original filing.

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ADVANCED MEDICAL OPTICS, INC.

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

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PART I FINANCIAL INFORMATION

Item 1. Financial Statements

Advanced Medical Optics, Inc.

Unaudited Consolidated Statements of Operations

(In thousands, except per share data)

	Three Months Ended		Nine Months Ended	
	September 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
ASSETS		
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
Total current assets	527,374	478,143
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
Total assets	$ 2,750,907	$ 2,013,897
LIABILITIES AND STOCKHOLDERS EQUITY		
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
Total current liabilities	326,046	217,453
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)
Total stockholders equity	604,531	715,991
Total liabilities and stockholders equity	$ 2,750,907	$ 2,013,897

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**
Cash flows from operating activities:		
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)
Net cash provided by operating activities	31,707	188,244
Cash flows from investing activities:		
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)
Net cash used in investing activities	(772,982)	(27,284)
Cash flows from financing activities:		
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
Net cash provided by (used in) financing activities	747,451	(166,008)
Effect of exchange rates on cash and equivalents	(4,149)	2,999
Net increase (decrease) in cash and equivalents	2,027	(2,049)

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.

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.

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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

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):

Business Repositioning Costs:	**Balance at December 31, 2006**	**Costs Incurred**	**Cash Payments**	**Balance at September 28, 2007**
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

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Intangible assets, net

(In thousands)	Useful Life (Years)	September 28, 2007 Gross Amount	September 28, 2007 Accumulated Amortization	December 31, 2006 Gross Amount	December 31, 2006 Accumulated Amortization
Amortizable Intangible Assets:					
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
Goodwill:							
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.

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Note 6: Debt

(In thousands)	Average Rate of Interest	September 28, 2007	December 31, 2006
Convertible Senior Subordinated Notes due 2024 (2 1/2 % Notes), with put dates of January 15, 2010, July 15, 2014 and July 15, 2019	2.500%	$ 246,105	$ 246,105
Convertible Senior Subordinated Notes due 2025 (1.375% Notes), with put dates of July 1, 2011, July 1, 2016 and July 1, 2021	1.375%	105,000	105,000
Convertible Senior Subordinated Notes due 2026 (3.25% Notes), with put dates of August 1, 2014, August 1, 2017 and August 1, 2021	3.250%	500,000	500,000
Senior Subordinated Notes due 2017 (7 1/2% Notes), 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
Total long-term debt		$ 1,544,355	$ 851,105

In April 2007, the Company 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 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 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.

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 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)	**Parent**	**Guarantor Subsidiaries**	**Non-Guarantor Subsidiaries**	**Consolidating Entries and Eliminations**	**Consolidated**
Assets:					
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
Total current assets	81,053	507,330	335,784	(396,793)	527,374
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)	
Total assets	$ 2,678,869	$ 3,179,226	$ 3,298,853	$ (6,406,041)	$ 2,750,907

Liabilities and stockholders equity:

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)	**Parent**	**Guarantor Subsidiaries**	**Non-Guarantor Subsidiaries**	**Consolidating Entries and Eliminations**	**Consolidated**
Assets:					
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
Total current assets	81,396	442,681	325,811	(371,745)	478,143
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)	
Total assets	$ 1,794,936	$ 2,498,120	$ 3,137,889	$ (5,417,048)	$ 2,013,897
Liabilities and stockholders equity:					
Accounts payable and other current liabilities	$ 58,715	$ 206,799	$ 263,012	$ (311,073)	$ 217,453
Total current liabilities	58,715	206,799	263,012	(311,073)	217,453
Long-term debt, net of current portion	851,105				851,105
Other liabilities	169,125	783	59,440		229,348
Total liabilities	1,078,945	207,582	322,452	(311,073)	1,297,906
Total stockholders equity	715,991	2,290,538	2,815,437	(5,105,975)	715,991
Total liabilities and stockholders equity	$ 1,794,936	$ 2,498,120	$ 3,137,889	$ (5,417,048)	$ 2,013,897

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

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Condensed Consolidating Statement of Operations Three months ended September 29, 2006 (in thousands)	Parent	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Consolidating 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)				