IRIDEX CORP
Form 10-Q
August 12, 2008

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SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 28, 2008

Or

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

For the transition period from __________ to __________

Commission file number: 0-27598

IRIDEX CORPORATION

(Exact name of registrant as specified in its charter)

Delaware	**77-0210467**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification Number)**
1212 Terra Bella Avenue Mountain View, California	**94043-1824**
(Address of principal executive offices)	**(Zip Code)**

Registrant s telephone number, including area code: (650) 940-4700

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 þ No o

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

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

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

APPLICABLE ONLY TO CORPORATE ISSUERS:

The number of shares of common stock, $.01 par value, issued and outstanding as of August 8, 2008 was 8,824,301.

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PART I FINANCIAL INFORMATION

Item 1. Condensed Consolidated Financial Statements (unaudited)

IRIDEX Corporation
Condensed Consolidated Balance Sheets
(Unaudited, in thousands except share amounts)

	June 28, 2008	Dec 29, 2007 (1)
Assets		
Current assets:		
Cash and cash equivalents	$ 4,092	$ 5,809
Restricted cash		3,800
Accounts receivable, net	9,061	8,876
Inventories, net	15,197	15,967
Prepaids and other current assets	983	1,051
Total current assets	29,333	35,503
Property and equipment, net	1,284	1,621
Goodwill	3,239	3,239
Other intangible assets, net	4,771	5,944
Other long term assets	252	347
Total assets	$ 38,879	$ 46,654
Liabilities and Stockholders Equity		
Current liabilities:		
Accounts payable	$ 3,728	$ 2,887
Bank line of credit	6,000	4,863
Accrued compensation	1,871	2,024
Accrued expenses	4,350	7,809
Accrued warranty	1,380	1,895
Deferred revenue	3,131	3,350
Bank term loan current portion		5,016
Total current liabilities	20,460	27,844
Commitments and contingencies (Note 6)		
Stockholders equity:		
Convertible preferred stock, $.01 par value: Authorized: 2,000,000 shares; Issued and outstanding: 500,000 shares in 2008 and 2007	5	5
Common stock, $.01 par value: Authorized: 30,000,000 shares; Issued and outstanding: 8,824,301 shares in 2008 and 2007	89	89
Additional paid-in capital	38,922	38,695
Accumulated other comprehensive loss	(89)	(88)
Treasury stock, at cost	(430)	(430)
Accumulated deficit	(20,078)	(19,461)

Total stockholders equity	18,419	18,810
Total liabilities and stockholders equity	$ 38,879	$ 46,654

(1) Derived from the consolidated audited financial statements included in our report filed on Form 10-K with the SEC for the year ended December 29, 2007.

The accompanying notes are an integral part of these condensed consolidated financial statements.

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IRIDEX Corporation
Condensed Consolidated Statements of Operations
(Unaudited, in thousands except per share data)

	Three Months Ended		Six Months Ended	
	June 28, 2008	June 30, 2007	June 28, 2008	June 30, 2007
Revenues	$ 12,922	$ 15,249	$ 24,396	$ 27,815
Cost of revenues	7,591	8,665	14,260	16,023
Gross profit	5,331	6,584	10,136	11,792
Operating expenses:				
Research and development	998	1,588	2,023	3,317
Selling, general and administrative	4,589	7,546	9,107	15,820
Total operating expenses	5,587	9,134	11,130	19,137
Loss from operations	(256)	(2,550)	(994)	(7,345)
Legal settlement	800	2,500	800	2,500
Interest and other expense, net	(218)	(293)	(372)	(418)
Income (loss) before income taxes	326	(343)	(566)	(5,263)
Provision for income taxes	(51)		(51)	
Net income (loss)	$ 275	$ (343)	$ (617)	$ (5,263)
Net income (loss) per share basic and diluted	$ 0.03	$ (0.04)	$ (0.07)	$ (0.65)
Shares used in computing net income (loss) per share basic and diluted	8,824	8,196	8,824	8,138

Condensed Consolidated Statements of Comprehensive Income (Loss)
(Unaudited, in thousands)

	Three Months Ended		Six Months Ended	
	June 28, 2008	June 30, 2007	June 28, 2008	June 30, 2007
Net income (loss)	$ 275	$ (343)	$ (617)	$ (5,263)
Foreign currency translation adjustments	39	(13)	(1)	(22)
Comprehensive income (loss)	$ 314	$ (356)	$ (618)	$ (5,285)

The accompanying notes are an integral part of these condensed consolidated financial statements.

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IRIDEX Corporation
Condensed Consolidated Statements of Cash Flows
(Unaudited, in thousands)

	Six Months Ended	
	June 28, 2008	June 30, 2007
Cash flows from operating activities:		
Net loss	$ (617)	$ (5,263)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	1,629	1,803
Stock compensation recognized	227	740
Provision for doubtful accounts	47	42
Provision for inventories	1,135	432
Changes in operating assets and liabilities:		
Accounts receivable	(232)	1,147
Inventories	(365)	(2,169)
Prepaids and other current assets	68	224
Other long term assets	95	(41)
Accounts payable	841	4,243
Accrued compensation and expenses	(3,612)	(813)
Accrued warranty	(515)	(302)
Deferred revenue	(219)	938
Net cash (used in) provided by operating activities	(1,518)	981
Cash flows from investing activities:		
Purchases of property and equipment	(119)	(502)
Purchases of intangible assets		(170)
Acquisition of business		(24,131)
Net cash used in investing activities	(119)	(24,803)
Cash flows from financing activities:		
Proceeds from issuance of common stock		827
Proceeds of credit facility, net of issuance costs	1,137	11,900
Repayment of credit facility	(5,016)	(2,629)
Restricted cash balance offset against credit facility	3,800	(3,800)
Net cash (used in) provided by financing activities	(79)	6,298
Effect of foreign exchange rate changes	(1)	24
Net decrease in cash and cash equivalents	(1,717)	(17,500)

Cash and cash equivalents at beginning of period	5,809	21,051
Cash and cash equivalents at end of period	$ 4,092	$ 3,551

The accompanying notes are an integral part of these condensed consolidated financial statements.

IRIDEX Corporation
Notes to Unaudited Condensed Consolidated Financial Statements

1. Basis of Presentation

The accompanying unaudited condensed consolidated financial statements of IRIDEX Corporation (the Company) have been prepared in accordance with generally accepted accounting principles in the United States for interim financial information and pursuant to the instructions to Form 10-Q and Article 10-01 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States for complete financial statements. In the opinion of management, all adjustments, consisting of normal recurring adjustments, considered necessary for a fair statement of the financial statements have been included.

The condensed consolidated financial statements should be read in conjunction with the audited financial statements and notes thereto, together with management s discussion and analysis of financial condition and results of operations, contained in our Annual Report on Form 10-K, which was filed with the Securities and Exchange Commission on April 10, 2008. The independent accountant s report included a qualification paragraph that stated the Company s losses from operations and failure to meet certain debt covenants raised substantial doubt about the Company s ability to continue as a going concern. The results of operations for the three and six month periods ended June 28, 2008 are not necessarily indicative of the results for the year ending January 3, 2009 or any future interim period.

Management believes that the credit facility with Wells Fargo Bank provides sufficient liquidity to operate for the next 12 months and that the covenants are reasonable and management expects to be able to meet those covenants based on its operating plan for 2008. However, recent operating results indicate that there is significant risk in achieving the operating plan, particularly for the remaining period where the Company is obligated to make payments to American Medical Systems, Inc. (AMS) refer to Note 6 below. If the Company is not able to perform in accordance with its operating plan for 2008 and fails to maintain compliance with its debt covenants, Wells Fargo Bank would be entitled to exercise its remedies under this facility which include declaring all outstanding obligations due and payable, and disposing of the collateral if obligations are not paid.

These matters raise substantial doubt about the Company s ability to continue as a going concern. The accompanying financial statements do not include any adjustments that might result from the outcome of this uncertainty. The Company s financial statements have been prepared on a going concern basis which contemplates the realization of assets and the settlement of liabilities and commitments in the normal course of business.

Recent Accounting Pronouncements

In December 2007, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No 141(R) (revised 2007), Business Combinations (SFAS 141R), which replaces SFAS 141. SFAS 141R establishes principles and requirements for how an acquirer recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed and the goodwill acquired. SFAS 141R also establishes disclosure requirements that will enable users to evaluate the nature and financial effects of the business combination. SFAS 141R is effective as of the beginning of an entity s fiscal year that begins after December 15, 2008 and will be adopted by the Company in the first quarter of fiscal year 2009. While the Company expects that SFAS 141R will have an impact on accounting for business combinations once adopted, the effect is dependent upon acquisitions at that time.

In December 2007, the FASB issued SFAS 160, Noncontrolling Interests in Consolidated Financial Statements, an amendment of ARB No. 51 (SFAS 160). The standard changes the accounting for noncontrolling (minority) interests in consolidated financial statements including the requirements to classify noncontrolling interests as a component of consolidated stockholders equity, and the elimination of minority interest accounting in results of operations with earnings attributable to noncontrolling interests reported as part of consolidated earnings. Additionally, SFAS 160 revises the accounting for both increases and decreases in a parent s controlling ownership interest. SFAS 160 is effective for fiscal years beginning after December 15, 2008, with early adoption prohibited. The Company believes it is unlikely that the adoption of SFAS 160 will have an impact on the consolidated financial statements because the Company does not hold a noncontrolling (minority) interest in another entity.

On March 19, 2008, the FASB issued SFAS 161, Disclosures about Derivative Instruments and Hedging Activities, an amendment of FASB Statement No. 133 (SFAS 161). SFAS 161 requires enhanced disclosures about an entity s derivative and hedging activities. These enhanced disclosures will discuss (a) how and why an entity uses derivative instruments, (b) how derivative instruments and related hedged items are accounted for under Statement 133 and its related interpretations, and (c) how derivative instruments and related hedged items affect an entity s financial position, financial performance, and cash flows. SFAS 161 is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008. Currently, the Company does not engage in derivative and hedging activities.

Recently Adopted Accounting Standards

In September 2006, the FASB issued SFAS 157, Fair Value Measurements (SFAS 157), which defines fair value, establishes a framework for measuring fair value in accordance with generally accepted accounting principles, and expands disclosures about fair value measurements. SFAS 157 is effective January 1, 2008. SFAS 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years, with early adoption permitted, except for the impact of FASB Staff Position (FSP) 157-2. FSP 157-2 deferred the adoption of SFAS 157 for non financial assets and liabilities until years ended after November 15, 2008. On December 30, 2007, we adopted SFAS 157 for financial assets and liabilities. Carrying amounts of our financial instruments including cash and cash equivalents, accounts receivables, accounts payables and accrued liabilities approximate fair value due to their short maturities. The fair value of bank line of credit approximates fair value due to its floating rate nature.

In February 2007, the FASB issued SFAS 159, The Fair Value Option for Financial Assets and Financial Liabilities (SFAS 159). SFAS 159 was issued to allow entities to voluntarily choose to measure certain financial assets and liabilities at fair value (fair value option). The fair value option may be elected on an instrument-by-instrument basis and is irrevocable, unless a new election date occurs. If the fair value option is elected for an instrument, SFAS 159 specifies that unrealized gains and losses for that instrument shall be reported in earnings at each subsequent reporting date. SFAS 159 is effective January 1, 2008. On January 1, 2008 we adopted SFAS 159 and have made no election under SFAS 159.

2. Summary of Significant Accounting Policies

The Company s significant accounting policies are disclosed in our Annual Report on Form 10-K for the year ended December 29, 2007 which was filed with the Securities and Exchange Commission on April 10, 2008.

Valuation of Goodwill and Intangible Assets.

The purchase method of accounting for acquisitions requires estimates and assumptions to allocate the purchase price to the fair value of net tangible and intangible assets acquired. The amounts allocated to, and the useful lives estimated for, intangible assets affect future amortization. There are a number of generally accepted valuation methods used to estimate fair value of intangible assets, and we use primarily a discounted cash flow method, which requires significant management judgment to forecast the future operating results and to estimate the discount factors used in the analysis. Purchased intangible assets were initially recorded in the first quarter of 2007 in conjunction with the acquisition of the aesthetics business of Laserscope. We review our intangible assets for impairment whenever events or changes in circumstances indicate that their carrying value may not be recoverable. An asset is considered impaired if its carrying amount exceeds the future net cash flow the asset is expected to generate. If an asset is considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the asset exceeds its fair value. In the fourth quarter of 2007 the Company determined that based on estimated future cash flows the carrying amount of specific intangible assets exceeded their fair value; accordingly an impairment loss was recognized.

Goodwill and intangible assets determined to have indefinite lives are not amortized, but are subject to an annual impairment test. To determine any goodwill impairment, a two-step process is performed on an annual basis, or more frequently if necessary, to determine 1) whether the fair value of the relevant reporting unit exceeds carrying value and 2) to measure the amount of an impairment loss, if any. Goodwill was initially recorded in the first quarter of 2007 in conjunction with the acquisition of the aesthetics business of Laserscope. In the fourth quarter of 2007 the Company performed an annual impairment test. We identified the Laserscope Aesthetics reporting unit as the appropriate reporting unit for this analysis. Reporting units are operating segments or components of operating segments for which discrete financial information is available. The conclusion was that the carrying value of the reporting unit exceeded the fair value. As a result, management performed the second step and determined the fair value of the assets and liabilities of the reporting unit to measure the amount of impairment loss. By establishing the fair value of the reporting unit and the fair value of assets and liabilities within the reporting unit, the Company determined the amount of impairment to goodwill.

Future changes in events or circumstances, such as an inability to achieve the cash flows determined above, may indicate that the recorded value of the intangible assets will not be recovered through future cash flows, or if the fair value of the Laserscope Aesthetics business unit is determined to be less than its carrying value, the Company may be required to record an additional impairment charge for the intangible assets or goodwill or further modify the period of expected lives for the intangible assets.

Revenue Recognition.

Our revenues arise from the sale of laser consoles, delivery devices, disposables and service and support activities. Revenue from product sales is recognized upon receipt of a purchase order and product shipment provided that no significant obligations remain and collection of the receivables is reasonably assured. Shipments are generally made with Free-On-Board (FOB) shipping point terms, whereby title passes upon shipment from our dock. Any shipments with FOB receiving point terms are recorded as revenue when the shipment arrives at the receiving point. Cost is recognized as product sales revenue is recognized. Our Company s sales may include post-sales obligations for training or other deliverables. When these obligations are fulfilled after product shipment, the Company recognizes revenue in accordance with the multiple element accounting guidance set forth in Emerging Issues Task Force No. 00-21, Revenue Arrangements with Multiple Deliverables. When the Company has objective and reliable evidence of fair value of the undelivered elements, it defers revenue attributable to the post-sale obligations and recognizes such revenue when the obligation is fulfilled. Otherwise, the Company defers all revenue related to the transaction until all elements are delivered. Revenue relating to extended warranty contracts is recognized on a straight line basis over the period of the applicable warranty contract. We recognize repair service revenue upon completion of the work.

In international regions outside of the UK and France, we utilize distributors to market and sell our products. We recognize revenue upon shipment for sales to these independent, third party distributors as we have no continuing obligations subsequent to shipment. Generally our distributors are responsible for all marketing, sales, installation, training and warranty labor coverage for our products. Our standard terms and conditions do not provide price protection or stock retention rights to any of our distributors.

Deferred Revenue

Revenue related to extended service contracts is deferred and recognized on a straight line basis over the period of the applicable service period. Costs associated with these service arrangements are recognized as incurred. A reconciliation of the changes in the Company s deferred revenue balance for the six months ending June 28, 2008 and June 30, 2007 is as follows:

	Six Months Ended	
(in thousands)	**June 28, 2008**	**June 30, 2007**
Balance, beginning of period	$ 3,350	$ 1,415
Additions to deferral through acquisition		1,870
Additions to deferral	3,365	4,153
Revenue recognized	(3,584)	(3,199)
Balance, end of period	$ 3,131	$ 4,239

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Warranty

The Company accrues for estimated warranty cost upon shipment of products. Actual warranty costs incurred have not materially differed from those accrued. The Company s warranty policy is applicable to products which are considered defective in their performance or fail to meet the product specifications. Warranty costs are reflected in the statement of operations as a cost of sales. A reconciliation of the changes in the Company s warranty liability for the six months ending June 28, 2008 and June 30, 2007 is as follows:

	Six Months Ended	
(in thousands)	**June 28, 2008**	**June 30, 2007**
Balance, beginning of period	$ 1,895	$ 866
Warranty accrual acquired through acquisition		1,771
Accrual for warranties issued during the period	111	497
Settlements made in kind during the period	(626)	(799)
Balance, end of period	$ 1,380	$ 2,335

3. Business Combination

On January 16, 2007, the Company acquired the aesthetics business of AMS and Laserscope, a wholly owned subsidiary of AMS for $28.6 million including the direct costs of acquisition for cash and 213,435 shares of common stock valued at $9.43 per share. These financial statements include the results of operations for the acquired business from the acquisition date. The Company made the acquisition due to its complementary fit with the existing IRIDEX aesthetics laser business. At the time of the acquisition the Company recorded Goodwill of $10.1 million and intangible assets of $16.4 million. At the end of 2007 the Company conducted an impairment test in accordance with SFAS 142 Goodwill and Other Intangible Assets and determined that based on operating results for 2007 and the outlook for the aesthetics business for 2008 and beyond, there was significant impairment to the intangible assets and goodwill. In addition, the Company revisited the useful lives associated with the remaining intangible assets to ensure they reflected the revised outlook for the aesthetics business. The impact of this review was to write down goodwill by $6.9 million from $10.1 million to $3.2 million and write down the gross carrying value of the intangible assets by $7.8 million from $16.4 million to $8.6 million. The net carrying value of intangible assets after impairment which includes the amortization expense for the year as of December 29, 2007 was $5.9 million and as of June 28, 2008 was $4.8 million. Amortization of intangible assets associated with the acquisition was $1.1 million and $1.4 million for the six months ended June 28, 2008 and June 30, 2007, respectively.

In June 2008, we signed an agreement which transfers the responsibility for sales and service of our aesthetics products in the UK to an independent distributor along with a transfer of associated assets.

4. Inventories

The components of the Company s inventories are as follows:

(in thousands)	**June 28, 2008**	**Dec 29, 2007**
Raw materials and work in progress	$ 8,169	$ 9,450
Finished goods	7,028	6,517
Total inventories	$ 15,197	$ 15,967

5. Bank Borrowings

In January 2007, the Company entered into a credit agreement that provided for an asset-based revolving line of credit up to $6 million revolving loan and a $6 million term loan. The Company s obligations under all loans were

secured by a lien on substantially all of the Company s assets. These credit facilities contained certain financial and other covenants. In the event of noncompliance by the Company with these covenants, the lenders would be entitled to exercise their remedies, which included declaring all obligations immediately due and payable and disposing of the collateral if the obligations were not paid. As of December 29, 2007 the Company was out of compliance with its debt covenants on its existing credit facilities with the lenders. Subsequent to the year end the Company obtained a waiver for the default.

On March 28, 2008, the Company terminated the Credit Agreement with the Lenders repaying all outstanding balances and entered into (i) a Borrowing Agreement and (ii) an Export-Import Bank Loan and Security Agreement with Wells Fargo Bank (together referred to as the Agreement). The Agreement provides for an asset-based revolving line of credit of up to $8 million (the New Revolving Loans). Of the New Revolving Loans, up to $5 million of the principal amount (the New Exim Sublimit) will be guaranteed by Exim Bank. The Company s obligations under the New Revolving Loans (including the New Exim Sublimit) are secured by a lien on substantially all of the Company s assets. Interest on the New Revolving Loans (including the New Exim Sublimit) is set at the prime rate as published in the Wall Street Journal, plus 0.75%, subject to adjustment under certain circumstances including adjustments to the prime rate, late payment or the occurrence of an event of default. All outstanding amounts under the New Revolving Loans are payable in full on March 27, 2011. If at any time the amount outstanding under the New Revolving Loans exceeds the Borrowing Base as defined in the Agreement, the Company will be required to pay the difference between the outstanding amount and the Borrowing Base. The Company may prepay New Revolving Loans without penalty. These facilities contain certain financial and other covenants, including the requirement for the Company to maintain a certain level of net income (loss) and to be able to sufficiently cover its debt service needs. Other covenants include, but are not limited to, restricting the Company s ability to incur indebtedness, incur liens, enter into mergers or consolidations, dispose of assets, make investments, pay dividends, enter into transactions with affiliates, or prepay certain indebtedness. In the event of noncompliance by the Company with the covenants under this Agreement, Wells Fargo Bank and Export-Import Bank, would be entitled to exercise their remedies, which include declaring all obligations immediately due and payable and disposing of the collateral if obligations are not paid.

As of June 28, 2008, the total amount outstanding under the New Revolving Loans was $6 million and there was eligible collateral to support an additional $0.7 million in borrowings.

6. AMS Settlement

On August 14, 2007, the Company, AMS and Laserscope (collectively the Parties), entered into a Settlement Agreement (the Settlement Agreement). The Parties entered into the Settlement Agreement to document their full and final agreement as to the amount of the adjustment contemplated by Section 1.5 of the Asset Purchase Agreement, by and among the Parties, dated November 30, 2006 (the Purchase Agreement); to amend the Product Supply Agreement, between Laserscope and the Company, dated January 16, 2007 (the Product Supply Agreement); and to set forth the Parties mutual understanding as to certain other matters.

Upon execution of the Settlement Agreement, the Company also executed a Security Agreement, dated August 14, 2007 (the Security Agreement), granting AMS and Laserscope a subordinate security interest in all the Company s assets to secure all of its current and future obligations to AMS or Laserscope.

Any breach by the Company of any provision of any of its agreements with AMS or Laserscope shall constitute an immediate default and shall entitle AMS and Laserscope to any and all remedies available to them under the Security Agreement, the Product Supply Agreement, and the Settlement Agreement, including, but not limited to, the right to terminate the Product Supply Agreement immediately upon written notice to the Company with no additional notice period or opportunity to cure and the right to declare all amounts due from the Company to AMS to be immediately due and payable in full.

The total unpaid principal balance, which is included in accrued liabilities, relating to the Settlement Agreement was reduced from $4.8 million as of December 29, 2007 to $1.5 million as of June 28, 2008. In addition, as of June 28, 2008 the Company has outstanding non-cancelable purchase orders placed with AMS to purchase in aggregate an additional $0.4 million of inventory to be delivered monthly ending in September 2008.

7. Stock Based Compensation

For the six months ended June 28, 2008 the Company had one active stock plan at any given time. The 1998 Stock Plan expired in February 2008. The terms and awards granted during the six months ended June 28, 2008 were consistent with those described in our December 29, 2007 annual consolidated financial statements. On June 11, 2008, the shareholders approved the adoption of the 2008 Equity Incentive Plan, (the Incentive Plan). There are no material changes in the Incentive Plan from the 1998 Stock Plan. The maximum aggregate number of shares that may be awarded and sold under the Incentive Plan is 300,000 shares plus any shares subject to stock options or similar awards granted under the 1998 Stock Plan that expire or otherwise terminate without having been exercised in full and shares

issued pursuant to awards granted under the 1998 Stock Plan that are forfeited to the Company on or after the date the 1998 Stock Plan expires.

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The following table summarizes information regarding activity in our stock option plans during the six months ended June 28, 2008:

	Number of Shares	Weighted Average Exercise Price Per Share	Weighted Average Remaining Contractual Life (Years)	Aggregate Intrinsic Value
Outstanding at Dec 29, 2007	1,859,537	$ 6.09		
Granted	447,112	2.96		
Exercised	0			
Canceled or forfeited	(329,985)	6.40		
Outstanding at Jun 28, 2008	1,976,664	$ 5.32	4.48	$ 4,497
Exercisable at Jun 28, 2008	1,331,834	$ 5.67	3.55	$ 0

The aggregate intrinsic value in the table above represents the pre-tax intrinsic value, based on the Company s closing price as of June 28, 2008, that would have been received by option holders had all options holders exercised their stock options as of that date. During the six months ended June 28, 2008 the intrinsic value of options exercised was $0.

The weighted-average grant fair value of the options granted under the Company s stock plans was $1.91 and $4.90 per share for the six months ended June 28, 2008 and June 30, 2007, respectively.

The Company uses the Black-Scholes option-pricing model to estimate fair value of stock-based awards with the following weighted average assumptions:

	Three Months Ended		Six Months Ended	
	June 28, 2008	June 30, 2007	June 28, 2008	June 30, 2007
Average risk free interest rate	3.48%	4.50%	3.28%	4.50%
Expected life (in years)	6 years	4.5 years	6 years	4.6 years
Dividend yield	0.0%	0.0%	0.0%	0.0%
Average volatility	71.0%	63.0%	70.0%	60.0%

Option-pricing models require the input of various subjective assumptions, including the option s expected life and the price volatility of the underlying stock. The expected stock price volatility is based on analysis of the Company s stock price history over a period commensurate with the expected term of the options, trading volume of the Company s stock, look-back volatilities and Company specific events that affected volatility in a prior period. The Company has elected to use the simplified method for estimating the expected term as discussed in Staff Accounting Bulletin No. 107 and Staff Accounting Bulletin No. 110. The risk-free interest rate is based on the U.S. Treasury interest rates whose term is consistent with the expected life of the stock options. No dividend yield is included as the Company has not issued any dividends and does not anticipate issuing any dividends in the future.

The following table shows stock-based compensation expense included in the Consolidated Statements of Operations for the six months periods ended June 28, 2008 and June 30, 2007 (in thousands):

	Three Months Ended	Six Months Ended
	June 28, 2008	