NORTH AMERICAN PALLADIUM LTD
Form F-10/A
February 13, 2013
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As filed with the Securities and Exchange Commission on February 13, 2013

Registration No. 333-185656

U.S. SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

AMENDMENT NO. 1

TO

FORM F-10

REGISTRATION STATEMENT

UNDER

THE SECURITIES ACT OF 1933

NORTH AMERICAN PALLADIUM LTD.

(Exact name of Registrant as specified in its charter)

Canada	**1000**	**Not Applicable**
(Province or other Jurisdiction of Incorporation or Organization)	**(Primary Standard Industrial Classification Code Number)**	**(I.R.S. Employer Identification Number, if any)**

Suite 2350, Royal Bank Plaza, South Tower, 200 Bay Street, Toronto, Ontario, Canada M5J 2J2, (416) 360-7590

(Registrant s principal executive offices)

CT Corporation System, 111 Eighth Avenue, New York, New York 10011, (212) 894-8940

(Agent for service in the United States)

The Commission is requested to send copies of all communications to:

Riccardo A. Leofanti, Esq.	**Simon Romano**
Skadden, Arps, Slate, Meagher & Flom LLP	**Stikeman Elliott LLP**
222 Bay Street, Suite 1750	**5300 Commerce Court West, 199 Bay Street**
Toronto, Ontario, Canada M5K 1J5	**Toronto, Ontario, Canada M5L 1B9**
(416) 777-4700	**(416) 869-5506**

Approximate date of commencement of proposed sale to the public:

From time to time after the effective date of this Registration Statement.

Province of Ontario, Canada

(Principal jurisdiction regulating this offering)

It is proposed that this filing shall become effective (check appropriate box):

A. ¨ Upon filing with the Commission, pursuant to Rule 467(a) (if in connection with an offering being made contemporaneously in the United States and Canada).

B. x At some future date (check the appropriate box below):

1. ¨ pursuant to Rule 467(b) on ( ) at ( ).
2. ¨ pursuant to Rule 467(b) on ( ) at ( ) because the securities regulatory authority in the review jurisdiction has issued a receipt or notification of clearance on ( ).

3. x pursuant to Rule 467(b) as soon as practicable after notification of the Commission by the Registrant or the Canadian securities regulatory authority of the review jurisdiction that a receipt or notification of clearance has been issued with respect hereto.
4. ¨ after the filing of the next amendment to this Form (if preliminary material is being filed).

If any of the securities being registered on this Form are to be offered on a delayed or continuous basis pursuant to the home jurisdiction s shelf prospectus offering procedures, check the following box. þ

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PART I

INFORMATION REQUIRED TO BE DELIVERED TO OFFEREES OR PURCHASERS

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February 12, 2013

US$300,000,000

Common Shares

Debt Securities

Warrants

Subscription Receipts

North American Palladium Ltd. (**NAP** or the **Company**) may offer and issue from time to time common shares (the **Common Shares**), debt securities (the **Debt Securities**), warrants to purchase Common Shares and warrants to purchase Debt Securities (together, the **Warrants**), and subscription receipts (Subscription Receipts) (all of the foregoing, collectively, the **Securities**) or any combination thereof up to an aggregate initial offering price of US$300,000,000 during the 25-month period that this prospectus, including any amendments thereto, remains effective.

Investing in the Securities involves risk. Please carefully consider the Risk Factors section beginning on page 8 of this prospectus.

This prospectus is filed by a foreign issuer that is permitted, pursuant to a multi-jurisdictional disclosure system adopted by the United States and Canada (MJDS), to prepare this prospectus in accordance with Canadian disclosure requirements. Prospective investors should be aware that such requirements are different from those of the United States. The financial statements incorporated herein by reference have been prepared in accordance with International Financial Reporting Standards, as issued by the International Accounting Standards Board (IFRS), and thus may not be comparable to financial statements of United States companies.

Prospective investors should be aware that the acquisition of the Securities described herein may have tax consequences both in the United States and Canada. Such consequences for investors who are resident in, or citizens of, the United States or Canada may not be described fully herein. Prospective investors should read the tax discussion contained in the applicable prospectus supplement with respect to a particular offering of Securities.

The enforcement by investors of civil liabilities under the United States federal securities laws may be affected adversely by the fact that the Company is incorporated under the federal laws of Canada, that most of its officers and directors are residents of Canada, that some or all of the experts named in this prospectus are residents of a foreign country, and that all or a substantial portion of the assets of the Company and said persons are located outside the United States.

No underwriter has been involved in the preparation of, or has performed a review of, the contents of this prospectus.

NEITHER THE UNITED STATES SECURITIES AND EXCHANGE COMMISSION (SEC) NOR ANY STATE SECURITIES COMMISSION HAS APPROVED OR DISAPPROVED THE SECURITIES OFFERED HEREBY, OR PASSED ON THE ACCURACY OR ADEQUACY OF THIS PROSPECTUS. ANY REPRESENTATION TO THE CONTRARY IS A CRIMINAL OFFENSE.

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The specific terms of the Securities with respect to a particular offering will be set out in the applicable prospectus supplement and may include, where applicable: (i) in the case of Debt Securities, the specific designation, aggregate principal amount, the currency or the currency unit for which the Debt Securities may be purchased, the maturity, interest provisions, authorized denominations, offering price (in the event the offering is a fixed price distribution), the manner of determining the offering price(s) (in the event the offering is made at prices which may be changed or at market prices prevailing at the time of sale, at prices related to such prevailing market prices or at negotiated prices), covenants, events of default, any terms for redemption or retraction, any exchange or conversion terms, whether the debt is senior or subordinated and any other terms specific to the Debt Securities being offered; (ii) in the case of Common Shares, the designation of the particular class and, if applicable, series, the number of shares offered, the offering price (in the event the offering is a fixed price distribution), the manner of determining the offering price(s) (in the event the offering is made at prices which may be changed or at market prices prevailing at the time of sale, at prices related to such prevailing market prices or at negotiated prices), dividend rate, if any, and any other terms specific to the Common Shares being offered; (iii) in the case of Warrants, the offering price (in the event the offering is a fixed price distribution), the manner of determining the offering price(s) (in the event the offering is made at prices which may be changed or at market prices prevailing at the time of sale, at prices related to such prevailing market prices or at negotiated prices), the designation, number and terms of the Common Shares or Debt Securities issuable upon exercise of the Warrants, any procedures that will result in the adjustment of these numbers, the exercise price, dates and periods of exercise, the currency in which the Warrants are issued and any other specific terms; and (iv) in the case of Subscription Receipts, the number of Subscription Receipts being offered, the offering price (in the event the offering is a fixed price distribution), the manner of determining the offering price(s) (in the event the offering is made at prices which may be changed or at market prices prevailing at the time of sale, at prices related to such prevailing market prices or at negotiated prices), the procedures for the exchange of the Subscription Receipts for Common Shares, Debt Securities or Warrants, as the case may be, and any other specific terms. Where required by statute, regulation or policy, and where Securities are offered in currencies other than Canadian dollars, appropriate disclosure of foreign exchange rates applicable to the Securities will be included in the prospectus supplement describing the Securities.

All shelf information permitted under applicable laws to be omitted from this prospectus will be contained in one or more prospectus supplements that will be delivered to purchasers together with this prospectus to the extent required by applicable securities laws. Each prospectus supplement will be incorporated by reference into this prospectus for the purposes of securities legislation as of the date of the prospectus supplement and only for the purposes of the distribution of the Securities to which the prospectus supplement pertains.

This prospectus constitutes a public offering of the Securities only in those jurisdictions where they may be lawfully offered for sale and therein only by persons permitted to sell the Securities. The Company may offer and sell Securities to, or through, underwriters or dealers and also may offer and sell certain Securities directly to other purchasers or through agents pursuant to exemptions from registration or qualification under applicable securities laws. A prospectus supplement relating to each issue of Securities offered thereby will set forth the names of any underwriters, dealers or agents involved in the offering and sale of the Securities and will set forth the terms of the offering of the Securities, the method of distribution of the Securities including, to the extent applicable, the proceeds to the Company and any fees, discounts or any other compensation payable to underwriters, dealers or agents and any other material terms of the plan of distribution.

The Company s outstanding Common Shares are listed for trading on the NYSE MKT, LLC (**NYSE MKT**) and the Toronto Stock Exchange (**TSX**) under the trading symbols PAL and PDL , respectively. On February 11, 2013, the last trading day prior to the filing of this prospectus, the closing price of the Common Shares on the NYSE MKT was US$1.79 per Common Share, and the closing price of the Common Shares on the TSX was Cdn.$1.80 per Common Share. Unless otherwise specified in the applicable prospectus supplement, Securities other than the Common Shares are not expected to be listed on any securities exchange. **Other than the listing of the Common Shares on the TSX and NYSE MKT, there is no market through which the Securities may be sold and purchasers may not be able to resell Securities purchased under this prospectus and the applicable prospectus supplement. This may affect the pricing of the Securities in the secondary market, the transparency and availability of trading prices, the liquidity of the Securities and the extent of regulation of the Company. See Risk Factors .** The offering of Securities hereunder is subject to the passing upon of certain legal matters on behalf of the Company by Stikeman Elliott LLP, with respect to Canadian legal matters, and by Skadden, Arps, Slate, Meagher & Flom LLP, with respect to United States legal matters.

The Company s head and registered office is located at Suite 2350, Royal Bank Plaza, South Tower, 200 Bay Street, Toronto, Ontario, Canada M5J 2J2, telephone (416) 360-7590 and facsimile (416) 360-7709.

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Unless otherwise indicated or the context suggests otherwise, all references in this prospectus and any prospectus supplement to the Company , we , us or our refer to North American Palladium Ltd. and its subsidiaries.

You should rely only on the information contained in or incorporated by reference into this prospectus and any prospectus supplement. The Company has not authorized anyone to provide you with different or inconsistent information. If anyone provides you with different or inconsistent information, you should not rely on it. We are not making an offer to sell the Securities in any jurisdiction where the offer or sale is not permitted. You should assume that the information contained in this prospectus, any prospectus supplement and the documents incorporated herein and therein is accurate only as of the respective dates of the documents in which such information appears. Our business, financial condition, results of operations and prospects may have changed since those dates.

This prospectus is part of a registration statement on Form F-10 relating to the Securities that we filed with the U.S. Securities and Exchange Commission (the **SEC**). We may, from time to time, sell any combination of the Securities described in this prospectus in one or more offerings up to an aggregate amount of US$300,000,000. This prospectus provides you with a general description of the Securities that we may offer. Each time we sell Securities under this prospectus, we will provide a prospectus supplement that will contain specific information about the terms of that offering. The prospectus supplement may also add, update or change information contained in this prospectus. Before you invest, you should read both this prospectus and any applicable prospectus supplement, together with additional information incorporated by reference and described under the heading Documents Incorporated By Reference . **This prospectus does not contain all of the information set forth in the registration statement, certain parts of which are omitted in accordance with the rules and regulations of the SEC. You should refer to the registration statement and the exhibits to the registration statement for further information with respect to us and the Securities.**

CAUTIONARY NOTE TO UNITED STATES INVESTORS

This prospectus has been prepared in accordance with the requirements of Canadian securities laws, which differ from the requirements of United States securities laws. Unless otherwise indicated, all reserve and resource estimates included in this prospectus, in any prospectus supplement or in any documents incorporated by reference herein or therein have been, and will be, prepared in accordance with Canadian National Instrument 43-101 Standards of Disclosure for Mineral Projects (**NI 43-101**) and the Canadian Institute of Mining, Metallurgy and Petroleum classification system. NI 43-101 is a rule developed by the Canadian Securities Administrators that establishes standards for all public disclosure an issuer makes of scientific and technical information concerning mineral projects.

Canadian standards, including NI 43-101, differ significantly from the requirements of the SEC, and reserve and resource information contained in or incorporated by reference into this prospectus and any prospectus supplement may not be comparable to similar information disclosed by U.S. companies. In particular, and without limiting the generality of the foregoing, these documents use the terms measured resources , indicated resources and inferred resources . Investors are advised that, while such terms are recognized and required by Canadian securities laws, the SEC does not recognize them. The requirements of NI 43-101 for the identification of reserves are also not the same as those of the SEC, and reserves reported by the Company in compliance with NI 43-101 may not qualify as reserves under SEC standards. Under U.S. standards, mineralization may not be classified as a reserve unless the determination has been made that the mineralization could be economically and legally produced or extracted at the time the reserve determination is made. Investors are cautioned not to assume that any part of a measured resource or indicated resource will ever be converted into a reserve . Investors should also understand that inferred resources have a great amount of uncertainty as to their existence and as to their economic and legal feasibility. It cannot be assumed that all or any part of inferred resources exist, are economically or legally mineable or will ever be upgraded to a higher category. Under Canadian rules, estimated inferred resources may not form the basis of feasibility or pre-feasibility studies except in rare cases. In addition, disclosure of contained ounces in a mineral resource is permitted disclosure under Canadian regulations. However, the SEC normally only permits issuers to report mineralization that does not constitute reserves by SEC standards as in place tonnage and grade, without reference to unit measures. Accordingly, information concerning mineral deposits set forth in this prospectus, in any prospectus supplement or in any documents incorporated by reference herein or therein may not be comparable with information made public by companies that report in accordance with U.S. standards.

See Glossary of Mining Terms in this prospectus for a description of certain of the mining terms used in this prospectus, in any prospectus supplement and in the documents incorporated by reference herein and therein.

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DOCUMENTS INCORPORATED BY REFERENCE

Information has been incorporated by reference in this prospectus from documents filed with the Ontario Securities Commission (**OSC**). Copies of the documents incorporated herein by reference may be obtained on request without charge from the Corporate Secretary of the Company at Suite 2350, Royal Bank Plaza, South Tower, 200 Bay Street, Toronto, Ontario M5J 2J2, telephone 416-360-7590 and facsimile 416-360-7709, or by accessing the disclosure documents available through the internet on the Canadian Securities Administrators System for Electronic Document Analysis and Retrieval (SEDAR) at www.sedar.com.

The following documents are specifically incorporated by reference and form an integral part of this prospectus:

- the management information circular dated March 28, 2012 in connection with the May 11, 2012 annual meeting of the shareholders of NAP;
- the annual information form of NAP dated March 30, 2012 (the **AIF**) for the financial year ended December 31, 2011;
- the audited consolidated financial statements of NAP and the notes thereto for the financial year ended December 31, 2011 comprised of the consolidated balance sheets as at December 31, 2011, December 31, 2010 and January 1, 2010, and the consolidated statements of operations and comprehensive loss, shareholders equity and cash flows for the years ended December 31, 2011 and December 31, 2010 (the **Annual Financial Statements**), together with the independent auditors report thereon, as filed on March 7, 2012;
- the amended management s discussion and analysis relating to the Annual Financial Statements, as filed on March 7, 2012;
- the unaudited condensed interim consolidated financial statements of NAP and the notes thereto for the nine months ended September 30, 2012 and September 30, 2011 (the **Interim Financial Statements**);
- management s discussion and analysis relating to the Interim Financial Statements;
- the material change report dated January 23, 2012 regarding NAP s decision to cease mining operations at the Sleeping Giant mine;
- the material change report dated May 7, 2012 regarding the completion of NAP s $35 million flow-through financing;
- the material change report dated July 12, 2012 regarding NAP s $43,000,000 convertible unsecured subordinated debentures bought deal offering;
- the section entitled Clarification of Certain Information in the AIF at pages 17 through 19 of the final short form prospectus of NAP dated July 24, 2012; and
- the material change report dated December 19, 2012 regarding the resignation of the Company s Vice President Finance and Chief Financial Officer, Jeff Swinoga.

Any material change reports (excluding confidential material change reports, if any), annual information forms, interim consolidated financial statements of the Company (including the related management s discussion and analysis), annual audited consolidated financial statements of the Company (including the auditors report thereon and the related management s discussion and analysis), business acquisition reports, information circulars, and any other disclosure documents required to be incorporated by reference herein under National Instrument 44-101 *Short Form Prospectus Distributions* that are filed by the Company with the securities commissions or similar authorities in each of the provinces of Canada after the date of this prospectus and prior to the termination of the offering of Securities hereunder shall be deemed to be incorporated by reference into this prospectus. In addition, any document filed by the Company with, or furnished by the Company to, the SEC pursuant to the *U.S. Securities Exchange Act of 1934*, as amended (the U.S. Exchange Act), subsequent to the date of this prospectus and prior to the termination of the offering of Securities hereunder shall be deemed to be incorporated by reference into the registration statement of which this prospectus forms a part (in the case of any Report on Form 6-K, if and to the extent expressly provided in such report).

Any statement contained in this prospectus or in a document (or part thereof) incorporated by reference herein, or deemed to be incorporated by reference herein, shall be deemed to be modified or superseded, for

purposes of this prospectus, to the extent that a statement contained in this prospectus or in any subsequently filed document (or part thereof) that also is, or is deemed to be, incorporated by reference in this prospectus modifies or supersedes such statement. Any statement so modified or superseded shall not be deemed, except as so modified or superseded, to constitute part of this prospectus. The modifying or superseding statement need not state that it has modified or superseded a prior statement or include any other information set forth in the document which it modifies or supersedes. The making of a modifying or superseding statement shall not be deemed an admission for any purpose that the modified or superseded statement, when made, constituted a misrepresentation, an untrue statement of a material fact or an omission to state a material fact that is required to be stated or that is necessary to make a statement not misleading in light of the circumstances in which it was made.

Upon a new annual information form and corresponding annual financial statements and related management s discussion and analysis being filed by us with securities commissions or similar authorities in each of the provinces of Canada during the currency of this prospectus, the previous annual information form and corresponding annual financial statements and related management s discussion and analysis all interim financial statements and management s discussion and analysis, and all material change reports filed prior to the commencement of the then current financial year will be deemed no longer to be incorporated into this prospectus for purposes of future offers and sales of Securities hereunder.

Upon each new filing of interim financial statements and related management s discussion and analysis filed with securities commissions or similar authorities in each of the provinces of Canada during the currency of this prospectus, the previous interim financial statements and management s discussion and analysis filed prior to the commencement of the then current interim period will be deemed no longer to be incorporated into this prospectus for purposes of future offers and sales of Securities hereunder.

A prospectus supplement or prospectus supplements containing the specific terms for an issue of Securities will be delivered to purchasers of the Securities together with this prospectus to the extent required by applicable securities laws, and will be deemed to be incorporated by reference into this prospectus as of the date of such prospectus supplement but only for the purposes of the Securities issued thereunder.

CURRENCY AND FINANCIAL STATEMENT PRESENTATION

Unless otherwise specified or the context otherwise requires, all references to dollar amounts in this prospectus, in any prospectus supplement or in any documents incorporated by reference herein or therein are references to Canadian dollars. References to $ or Cdn.$ are to Canadian dollars and references to US$ are to U.S. dollars.

Unless otherwise indicated, all financial information included or incorporated by reference in this prospectus and the documents incorporated by reference herein and therein has been prepared in accordance with IFRS.

The following table sets forth, for the Canadian dollar, expressed in United States dollars: (i) the high and low exchange rates during each period; (ii) the average of the exchange rates on the last day of each month during each period; and (iii) the exchange rate at the end of each period. These rates are based on the noon buying rate published by the Bank of Canada.

	Year Ended December 31,		Nine months ended September 30
	2010	2011	2012
Highest rate during period	1.0054	1.0583	1.0299
Lowest rate during period	0.9278	0.9430	0.9599
Average rate during period	0.9709	1.0110	1.0004
Rate at the end of period	1.0054	0.9833	0.9949

On February 11, 2013 the noon buying rate for one Canadian dollar expressed in United States dollars, as quoted by the Bank of Canada, was $1.00=US$0.9935 (or US$1.00=$1,0065). The Canadian dollar/U.S. dollar exchange rate has varied significantly over the last several years and investors are cautioned that the exchange rates presented here are historical and are not indicative of future exchange rates.

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CAUTIONARY NOTE REGARDING FORWARD LOOKING STATEMENTS

This prospectus and the documents incorporated by reference herein contain forward looking statements and/or forward looking information, which include future oriented financial information, within the meaning of the safe harbor provisions of the United States Private Securities Litigation Reform Act of 1995 and Canadian securities laws. All statements other than statements of historical fact are forward looking statements. The words expect, believe, anticipate, contemplate, target, plan, may, will, intend, estimate, and similar expressi looking statements, although these words may not be present in all forward looking statements. Forward looking statements included in this prospectus include, without limitation, statements in respect of an offering of Securities, information as to the Company s strategy, plans or future financial or operating performance, such as the Company s expansion plans, project timelines, production plans, projected production cash flows or expenditures, operating cost estimates, mining or milling methods, projected exploration results and other statements that express management s expectations or estimates of future performance.

The Company cautions the reader that such forward looking statements involve known and unknown risks that may cause actual results to be materially different from those expressed or implied by the forward looking statements. Such risks include, but are not limited to: the possibility that commodity prices and foreign exchange rates may fluctuate; the possibility that general economic conditions may deteriorate; the inability to meet production level and operating cost estimates; inaccuracy of mineral resource and reserve estimates; the demand for, and cost of, exploration, development and construction services; the risks related to future exploration programs, including the risk that future exploration will not replace mineral resources and mineral reserves that become depleted; inherent risks associated with mining and processing including environmental hazards; the failure to achieve or maintain projected production levels; the increased uncertainty as to the Company s ability to achieve or maintain projected production levels at the Lac des Iles mine due to the fact that the Company s production decisions are not based on feasibility studies of mineral reserves demonstrating economic and technical viability; the pursuit of any particular transaction or strategic alternative in connection with the strategic review process being undertaken in respect of the sale of the Company s Quebec-based gold division; the potential uncertainty related to title to the Company s mineral properties; the risk that the Company may not be able to obtain external financing necessary to continue its expansion and productions plans; the Company s dependence on a third party for smelting and refining the concentrate that is produced at the Lac des Iles mill; employment disruptions, including in connection with collective agreements between the Company and unions; environmental and other regulatory requirements; the costs of complying with environmental legislation and government regulations; the risk that permits and regulatory approvals necessary to conduct operations will not be available on a timely basis, on reasonable terms or at all; loss of key personnel; competition from other producers of platinum group metals (**PGMs**) and gold and from potential new producers; risks involved in current or future litigation (including class actions) or regulatory proceedings; the development of new technology or new alloys that could reduce the demand for palladium; the ability of the Company to comply with the terms of its credit facility, senior secured notes or future credit facilities; risks related to the Company s hedging strategies; lack of infrastructure necessary to develop the Company s projects; and the ability of the Company to maintain adequate internal control over financial reporting and disclosure controls and procedures.

Forward looking statements, including future oriented financial information, are necessarily based on a number of factors and assumptions that, while considered reasonable by management, are inherently subject to significant business, economic and competitive uncertainties and contingencies. The factors and assumptions contained in this prospectus, which may prove to be incorrect, include, but are not limited to the following:

- that the Lac des Iles mine, the Sleeping Giant mill complex and the Vezza gold mine will be and remain viable operationally and economically;
- expectations for mill feed head grade, recovery rates and mill performance will be as expected at the Lac des Iles mine;
- the plans for mine production, mine development, mill production and exploration will proceed as expected and on budget;
- market fundamentals will result in reasonable demand and prices for palladium, gold and by-product metals in the future;
- the Company will not be subject to any environmental incidents, significant regulatory changes or material labour disruptions;

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- the advice the Company has received from its employees, consultants and advisors relating to matters such as mineral resource and mineral reserve estimates, engineering, mine planning, metallurgy, permitting and environmental matters is reliable and correct and, in particular, that the models used to calculate mineral resources and mineral reserves are appropriate and accurate and remain so;
- the Company and its contractors will be able to attract and retain sufficient qualified employees; and
- financing for the Company s expansion and production plans will be available on reasonable terms.

The forward looking statements are not guarantees of future performance.

All of the forward looking statements made in this prospectus are qualified by these cautionary statements and other cautionary statements or factors contained herein, and there can be no assurance that the projected results or developments will be realized or, even if substantially realized, that they will have the expected consequences to, or effects on, the Company. Readers are cautioned not to put undue reliance on these forward looking statements. All forward looking statements in this prospectus are made as of the date hereof and the Company disclaims any obligation to update or revise any forward looking statements, whether as a result of new information, events or otherwise, except as expressly required by law.

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THE COMPANY

This summary highlights information contained elsewhere in this prospectus and the documents incorporated by reference herein. It does not contain all the information that may be important to you. You should carefully read the entire prospectus, including the documents incorporated by reference herein. See Documents Incorporated by Reference and Available Information in this prospectus. You should also carefully consider the matters discussed under Risk Factors in this prospectus.

Corporate Structure

The Company is the successor to Madeleine Mines Ltd., a company incorporated under the *Mining Companies Act* (Québec) by letters patent in 1968. In January 1992, Madeleine Mines Ltd. was amalgamated with 2945-2521 Québec Inc. and the amalgamated company was wound up into the federally incorporated parent company, 2750538 Canada Inc. This entity changed its name to Madeleine Mines Ltd. and, in June 1993, the name was changed to North American Palladium Ltd. The Company continues to exist under the *Canada Business Corporations Act* (**CBCA**).

The Company has two wholly owned subsidiaries: Lac des Iles Mines Ltd. (**LDI**), and NAP Québec Mines Ltd. (**NAP Québec**).

The following chart describes the Company s subsidiaries as at the date hereof. The percentage ownership is indicated for each entity. Each of the option agreements referenced below has not been fully exercised.

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Description of the Business

The Company s material property is the Lac des Iles property (including the Lac des Iles palladium mine). The Company also owns, but does not consider to be material properties of the Company, the Sleeping Giant gold mine and mill complex and the Vezza gold mine located in the Abitibi region of Quebec, north of Val d Or. Other advanced projects include the Flordin property, the Discovery project and the Shebandowan West project. As previously disclosed, the Company is exploring divestiture opportunities with respect to its gold assets.

The Lac des Iles mine, the Company s flagship mine, is one of the world s two primary palladium producers. Located approximately 85 kilometres northwest of Thunder Bay, Ontario, the Lac des Iles mine started producing palladium in 1993. The property consists of an open pit, a ramp-accessed underground mine, a shaft accessed underground mine (under construction), and a mill with a nominal capacity of approximately 15,000 tonnes per day. The primary deposits on the property are the Roby Zone and the Offset Zone, both disseminated magmatic nickel copper-PGM deposits. The Company has also identified other mineralized areas close to or on the Lac des Iles mine, including the Cowboy Zone, the Outlaw Zone, the Sheriff Zone and the North VT Rim. Infill drilling at the Offset Zone (completed to the end of March 2012) was successful in converting a certain amount of the Company s indicated resources to measured resources, thereby increasing the confidence in the grade distribution for mine planning purposes. With a minimum cut-off of 3.5 grams per tonne palladium, results indicated a total of 14.2 million tonnes of measured and indicated resources (2.38 million contained palladium ounces) grading 5.22 grams per tonne palladium. Inferred resources also increased to 6.3 million tonnes (0.89 million contained palladium ounces) grading 4.40 grams per tonne palladium. The Lac des Iles underground mine is being expanded to transition from mining via ramp access to mining via shaft while utilizing a high volume bulk mining method. The mine expansion is currently underway**.**

The AIF contains additional information on the business and properties of the Company. See Documents Incorporated by Reference .

Recent Developments

As previously disclosed, the Company continues to evaluate opportunities for the divestiture of its gold assets and undertakings located in Quebec, which are held by NAP Quebec Mines Ltd., including the Sleeping Giant gold mine and mill complex, the Vezza gold mine and the other exploration projects including the Flordin property and the Discovery project, and all associated rights, privileges, agreements, permits and associated infrastructure and equipment. As part of the Company s ongoing consideration of opportunities for divestiture, which provided an indication of the value of these assets in late 2012, the Company believes that the current value of such assets is likely less than their book value. A material write-down of the book value of such assets will be considered by the Company in due course.

On January 22, 2013 the Company announced the appointment of David Langille as its new Chief Financial Officer, replacing Jeff Swinoga who resigned January 4, 2013. Mr. Langille has over 26 years of experience as a finance executive with public companies and has been a member of the Institute of Chartered Accountants of Ontario and the Society of Management Accountants of Ontario since 1987.

On November 30, 2012, the Company announced completion of its flow-through financing through which it sold 2,425,000 flow-through shares at a price of $1.65 per share for gross proceeds of $4,001,250. The proceeds will be used for eligible exploration activities and mine expansion expenditures at the Lac des Iles property and other greenfield properties.

On November 7, 2012, the Company announced its financial and operational results for the third quarter ending September 30, 2012. In the third quarter of 2012, the Company s Lac des Iles mine produced 39,908 ounces of payable palladium, bringing the nine month total to 119,685 ounces. The Company also disclosed the mine expansion expenditures totaled $93 million for the nine month period. The Company also indicated that the pursuit for divestiture opportunities for its gold assets is ongoing and that mine development expenditures at the Vezza gold mine totaled $22.7 million for the nine month period ended September 30, 2012.

On September 13, 2012, the Company announced that the Board of Directors appointed Andre J. Douchane as NAP s interim Chief Executive Officer, replacing William J. Biggar who retired on September 30, 2012.

On July 31, 2012, the Company completed a $43 million offering of convertible debentures (the **Debentures**) to fund the Lac des Iles mine expansion and for general corporate purposes. The Debentures mature on September 30, 2017 (unless redeemed earlier by the Company in specified circumstances), and will bear interest at a rate of 6.15% per year, payable semi-annually on March 31 and September 30 of each year. The Debentures are convertible at the holder s option into Common Shares at a conversion price of $2.90 per Common Share.

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RISK FACTORS

An investment in the Securities involves risk. In addition to the other information contained in this prospectus, the AIF and the documents incorporated by reference herein, prospective investors should carefully consider the factors set out below and in the applicable prospectus supplement in evaluating the Company and its business before making an investment in the Securities. If any event arising from these risks occurs, the Company s business, prospects, financial condition, results of operations or cash flows could be adversely affected, the trading price of the Securities could decline and all or part of any investment in the Securities may be lost. Additional risks and uncertainties not currently known to the Company or that the Company currently deems immaterial may also materially and adversely affect the Company s business, prospects, financial condition, results of operations or cash flows.

Risks Related to the Securities

Future sales or issuances of equity securities could decrease the value of the Common Shares and Debentures, dilute investors voting power and reduce the Company s earnings per share.

The Company may sell additional equity securities in subsequent offerings and may issue additional equity securities to finance future acquisitions and other projects and to satisfy its obligations pursuant to the exercise of convertible securities.

Sales or issuances of a substantial number of equity securities, or the perception that such sales could occur, may adversely affect prevailing market prices for the Common Shares and Debentures. With any additional sale or issuance of equity securities, investors will suffer dilution of their voting power and the Company may experience dilution in its earnings per share.

The Common Shares and Debentures are publicly traded and are subject to various factors that have historically made the Company s share price volatile.

The trading price of the Common Shares and Debentures have been, and may continue to be, subject to large fluctuations and, therefore, the trading price of the Company s securities convertible into, or exchangeable for, the Common Shares may also fluctuate significantly, which may result in losses to investors. The trading price of the Common Shares and Debentures may increase or decrease in response to a number of events and factors, including:

- the Company s operating performance and the performance of competitors and other similar companies;
- volatility in palladium, gold and other metal prices and expectations for future prices;
- volatility in currency exchange rates;
- the public s reaction to the Company s press releases, other public announcements and the Company s filings with the various securities regulatory authorities;
- changes in earnings estimates or recommendations by research analysts who track the Common Shares or the shares of other companies in the mineral resource sector;
- changes in general economic and/or political conditions;
- the number of Common Shares to be publicly traded after any offering;

- the arrival or departure of key personnel;
- acquisitions, strategic alliances or joint ventures involving the Company or its competitors;
- the risks listed under the heading Cautionary Note Regarding Forward Looking Statements.
- the market for all mineral resource sector securities;
- the breadth of the public market for the Securities; and
- the attractiveness of alternative investments.

In addition, the market prices of Securities may be affected by many variables not directly related to the Company s success and that are, therefore, not within the Company s control, including other developments that affect the market for all mineral resource sector securities, the breadth of the public market for the Common Shares and Debentures, and the attractiveness of alternative investments. The effect of these and other factors on the market price

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of the Common Shares on the exchanges on which the Common Shares trade has historically made the Company s share price volatile and suggests that the Company s share price (and the price of the Debentures) could continue to be volatile in the future.

The Securities may not be listed and there may not be an established trading market for those securities. You may be unable to sell the Securities at the prices you desire or at all.

There is no existing trading market for the Debt Securities, Warrants, or Subscription Receipts. As a result, there can be no assurance that a liquid market will develop or be maintained for those securities, or that you will be able to sell any of those securities at a particular time (if at all). We may not list the Debt Securities, Warrants, or Subscription Receipts on any Canadian or U.S. securities exchange, and the Common Shares may be delisted or suspended. The liquidity of the trading market in those securities, and the market price quoted for those securities, may be adversely affected by, among other things:

- changes in the overall market for those securities;
- changes in our financial performance or prospects;
- changes or perceived changes in our creditworthiness;
- the prospects for companies in our industry generally;
- the number of holders of those securities;
- the interest of securities dealers in making a market for those securities; and
- prevailing interest rates.

The Debt Securities may be unsecured debt of the Company and, if so, will rank equally in right of payment with all other existing and future unsecured debt of the Company.

The Debt Securities may be unsecured debt of the Company and, if so, will rank equally in right of payment with all other existing and future unsecured debt of the Company. Unless collateralized or guaranteed, the Debt Securities will be effectively subordinated to all existing and future secured debt of the Company to the extent of the assets securing such debt. If the Company is involved in any bankruptcy, dissolution, liquidation or reorganization, the secured debt holders would, to the extent of the value of the assets securing the secured debt, be paid before the holders of unsecured debt securities, including if applicable, the Debt Securities. In that event, a holder of Debt Securities may not be able to recover any principal or interest due to it under the Debt Securities.

Unless the Debt Securities are guaranteed or collateralized in some other way, holders of the Debt Securities will effectively be subordinated to the claims of the holders of third party indebtedness of the Company s subsidiaries.

The Company conducts its operations through subsidiaries and to the extent any such subsidiary has or incurs indebtedness with a third party, the holders of the Debt Securities will, unless the Debt Securities are guaranteed or collateralized in some other way, be effectively subordinated to the claims of the holders of such third party indebtedness, including in the event of liquidation or upon a realization of the assets of any such subsidiary.

Risks Related to the Company

Investors should also carefully consider the risks described under the heading Risk Factors in the AIF and the Company s other publicly filed documents which are incorporated herein by reference. In addition, investors in Securities should also consider the following additional risks.

Mineral resource and reserve estimates may prove inaccurate

The Company cannot be certain that its mineral resource and reserve estimates are accurate and cannot guarantee that it will recover the expected quantities of metals. Future production could differ dramatically from such estimates for the following reasons:

- actual mineralization or ore grade could be different from those predicted by drilling, sampling or technical reports;

- increases in the capital or operating costs of the mine;

- changes in the life-of-mine plan; or

- the grade of ore may vary over the life of the mine and the Company cannot give any assurances that any particular mineral reserve estimate will ultimately be recovered.

The occurrence of any of these events may cause the Company to adjust its mineral resource and reserve estimates or change its mining plans, which could negatively affect the Company s financial condition and results of operations. Moreover, short-term factors, such as the need for additional development of the ore body or the processing of new or different grades, may adversely affect the Company.

Inability to meet production level and operating cost estimates.

Planned production levels and operating costs are estimates, with the estimates in respect of the Lac des Iles mine being based on the Company s experience in operating such mine. All of the Company s estimates are subject to numerous uncertainties, many of which are beyond the Company s control. The Company may have difficulties attracting and maintaining a sufficient amount of qualified labour to meet projected production levels. In addition, there may be increased uncertainty as to the Company s ability to achieve or maintain projected production levels at the Lac des Iles mine due to the fact that the Company s production decisions are not based on feasibility studies of mineral reserves demonstrating economic and technical viability. The Company cannot give assurances that its actual production levels will not be substantially lower than its estimates or that its operating costs will not be materially higher than anticipated. Failure to meet production levelsant to the lease, the Company pays all real estate and personal property taxes and the insurance costs on the premises. The lease expired on December 31, 2005. Since January 1, 2006, the Company has leased 16,926 square feet of space in the facility on a month to month basis at a monthly rate of $7,109 plus a $1,690 common area maintenance fee. The Company believes that these facilities are adequate and satisfy its needs for the foreseeable future. Item 3. Legal Proceedings An action was brought against the Company on September 11, 2000 by PhotoMed International, Inc. and Daniel M. Eichenbaum, M.D. in the Third District Court of Salt Lake County, State of Utah. The action involves an amount of royalties that are allegedly due and owing to PhotoMed International, Inc. and Dr. Eichenbaum under a license agreement dated July 7, 1993, with respect to the sale of certain equipment, plus costs and attorney's fees. Certain discovery has taken place and the Company has paid royalties of $15,717, which the Company believes brings all payments current as of the date of last payment on January 7, 2005. The Company has been working with PhotoMed and Dr. Eichenbaum to ensure that the calculations have been correctly made on the royalties paid as well as the proper method of calculation for the future. It is anticipated that once the parties can agree on the correct calculations on the royalties, the legal action will be dismissed. An issue in dispute concerning the method of calculating royalties is whether royalties should be paid on returned equipment. Since July 1, 2001, only one Photon(TM) laser system has been sold and no systems returned. Thus, the amount of royalties due, according to the Company's calculations, is $981. The Company made payment of this amount to Photomed and Dr. Eichenbaum on January 5, 2005 and, as a result, seeks to have the legal action dismissed. However, if the parties are unable to agree on a method for calculating royalties, there is a risk that PhotoMed and Dr. Eichenbaum might amend their complaint to request termination of the license agreement and, if successful, the Company would lose its right to manufacture and sell the Photon(TM) laser system. An action was filed on June 20, 2003, in the Third Judicial District Court, Salt Lake County, State of Utah (Civil No. 030914195) by CitiCorp Vendor Finance, Inc., formerly known as Copelco Capital, Inc. The complaint claims that $49,626 plus interest is due for the leasing of three copy machines that were delivered to the Company's Salt Lake City facilities on or about April of 2000. The action also seeks an award of attorney's fees and costs incurred in the collection. The Company filed an answer to the complaint disputing the amounts allegedly owed due to machine problems and a claimed understanding with the vendor. The Company returned two of the machines. The Company was engaged in settlement discussions with CitiCorp until counsel for CitiCorp withdrew from the case. New counsel for CitiCorp was appointed. After an initial meeting with new counsel, the Company provided initial disclosures to the new counsel. On December 27, 2007, the Company entered into a settlement agreement with Larry Hicks to settle the lawsuit Mr. Hicks brought against the Company for payments due under a consulting agreement with the Company in the Third Judicial District Court, Salt Lake County, State of Utah (Civil No. 030922220). Under the terms of the agreement, the Company agrees to pay Mr. Hicks a total of $20,000, of which $10,000 has been paid. The remaining amount owing of $10,000 is to be paid in quarterly installments of $2,500 each prior to the end of the next four consecutive quarters, with the next payment due on or before June 30, 2008. The Company is not a party to any other material legal proceedings outside the ordinary course of its business or to any other legal proceedings, which, if adversely determined, would have a material adverse effect on its financial condition or results of operations. Item 4. Submission of Matters to a Vote of Security Holders No matters were submitted to a vote of the Company's shareholders during the quarter ended December 31, 2006. PART II Item 5. Market for Common Equity and Related Stockholder Matters The Company's authorized capital stock consists of 800,000,000 shares of common stock, $.001 par value per share, and 5,000,000 shares of preferred stock, $.001 par value per share. The Company has created seven classes of 22 preferred stock, designated as Series A preferred stock, Series B preferred stock, Series C preferred stock , Series D preferred stock, Series E preferred stock, Series F preferred stock and Series G preferred stock. The Company's common stock trades on the OTC Bulletin Board under the symbol of "PMED.OB." Prior to July 22, 1996, there was no public market for the common stock. From July 22, 1996 to June 25, 2003, the Company's common stock was listed on the Nasdaq SmallCap Market. Since June 25, 2003, the common stock has traded on the OTC Bulletin Board. As of March 31, 2008, the closing sale prices of the common stock was $.001 per share. The following are the high and low sale prices for the common stock by quarter as reported by the OTC Bulletin Board since January 1, 2004. Common Stock Price Range Period (Calendar Year) High Low ---- --- 2005 First Quarter .... .10 .08 Second Quarter .... .09 .07 Third Quarter................................ .10 .001 Fourth Quarter................................ .048 .001 2006 First Quarter .... .047 .001 Second

Quarter .... .014 .006 Third Quarter................................ .007 .004 Fourth Quarter................................ .005 .003 2007 First Quarter .... .032 .003 Second Quarter .... .014 .006 Third Quarter................................ .007 .004 Fourth Quarter................................ .005 .003 2008 First Quarter .... .0023 .0008 The Company's Series A preferred stock, Series B preferred stock, Series C preferred stock, Series D preferred stock, Series E preferred stock, Series F preferred stock and Series G preferred stock are not publicly traded. As of March 31, 2008, there were 4,781 record holders of common stock, six record holders of Series A preferred stock, four record holders of Series B preferred stock, no record holders of Series C preferred stock, one record holder of Series D preferred stock, one record holder of Series E preferred stock, 18 record holders of Series F preferred stock, and one record holder of Series G preferred stock. The Company has never paid any cash dividends on its common stock and does not anticipate paying any cash dividends on its common stock in the foreseeable future. The Company must pay cash dividends to holders of its Series A preferred, Series B preferred, Series C preferred, Series D preferred stock, Series E preferred, Series F preferred stock and Series G preferred stock before it can pay any cash dividend to holders of its common stock. Dividends paid in cash pursuant to outstanding shares of its Series A, Series B, Series C, Series D, Series E, Series F and Series G preferred stock are only payable from its surplus earnings, and are noncumulative and therefore, no deficiencies in dividend payments from one year will be carried forward to the next. The Company currently intends to retain future earnings, if any, to fund the development and growth of its proposed business and operations. Any payment of cash dividends in the future on the common stock will be dependent upon its financial condition, results of operations, current and anticipated cash requirements, plans for expansion, restrictions, if any, under any debt obligations, as well as other factors that its board of directors deems relevant. The Company issued 6,764 shares of its Series A preferred and 6,017 shares of its Series B preferred on January 8, 1996 as a stock dividend to Series A and Series B preferred shareholders of record as of December 31, 1994. 23 Item 6. Management's Discussion and Analysis or Plan of Operation This report contains forward-looking statements and information relating to the Company that is based on beliefs of management as well as assumptions made by, and information currently available to management. These statements reflect its current view respecting future events and are subject to risks, uncertainties and assumptions, including the risks and uncertainties noted throughout the document. Although the Company has attempted to identify important factors that could cause the actual results to differ materially, there may be other factors that cause the forward-looking statements not to come true as anticipated, believed, projected, expected or intended. Should one or more of these risks or uncertainties materialize, or should underlying assumptions prove incorrect, actual results may differ materially from those described herein as anticipated, believed, projected, estimated, expected or intended. Critical Accounting Policies Revenue Recognition. The Company recognizes revenue in compliance with Staff Accounting Bulletin 101, Revenue Recognition in Financial Statements (SAB 101), as revised by Staff Accounting Bulletin No. 104, Revenue Recognition (SAB 104). SAB 101 and SAB 104 detail four criteria that must exist before revenue is recognized: 1. Persuasive evidence of an arrangement exists. Prior to shipment of product, the Company required a signed purchase order and, depending upon the customer, a down payment toward the final invoiced price or full payment in advance with certain international product distributors. 2. Delivery and performance have occurred. Unless the purchase order requires specific installation or customer acceptance, the Company recognizes revenue when the product ships. If the purchase order requires specific installation or customer acceptance, the Company recognizes revenue when such installation or acceptance has occurred. Title to the product passes to its customer upon shipment. This revenue recognition policy does not differ among its various different product lines. The Company guarantees the functionality of its product. If its product does not function as marketed when received by the customer, the Company either makes the necessary repairs on site or has the product shipped to the Company for the repair work. Once the product has been repaired and retested for functionality, it is reshipped to the customer. The Company provides warranties that generally extend for one year from the date of sale. Such warranties cover the necessary parts and labor to repair the product as well as any shipping costs that may be required. The Company maintains a reserve for estimated warranty costs based on its historical experience and management's current expectations. 3. The sales price is fixed or determinable. The purchase order received from the customer includes the agreed upon sales price. The Company does not accept customer orders, and therefore does not recognize revenue, until the sales price is fixed. 4. Collectibility is reasonably assured. With limited exceptions, the Company requires down payments on product prior to shipment. In some cases the Company requires payment in full prior to shipment. The Company also performs credit checks on new customers and ongoing credit checks on existing customers. The Company maintains an allowance for doubtful accounts receivable based on historical experience and management's current expectations. Recoverability of Inventory. Since its inception, the Company has purchased several complete lines of inventory. In some circumstances the Company has been able to utilize certain items acquired and others remain unused. On a quarterly basis, the Company attempts to identify inventory items that have shown relatively no movement or very slow movement. Generally, if an item has shown little or no movement for over a year, it is determined not to be recoverable and a reserve is established for that item. In addition, if the Company identifies products that have become obsolete due to product upgrades or enhancements, a reserve is established for such products. The Company intends to make efforts to sell these items at significantly discounted prices. If items are sold, the cash received would be recorded as revenue, but there would be no cost of sales on such items due to the reserve that has been recorded. At the time of sale, the inventory would be reduced for the item sold and the corresponding inventory reserve would also be reduced. Recoverability of Goodwill and Other Intangible Assets. The Company's intangible assets consist of goodwill, product and technology rights, engineering and design costs, and patent costs. Intangibles with a determined life are amortized on a straight-line basis over their determined useful life and are also evaluated for potential impairment if events or circumstances indicate that the carrying amount may not be recoverable. Intangibles with an indefinite life, such as goodwill, are not amortized but are tested for impairment on an annual basis or when events and circumstances indicate that the asset may be impaired. Impairment tests include comparing the fair value of a reporting unit with its carrying net book value, including goodwill. To date, the Company's determination of the fair value of the reporting unit has been based on the estimated future cash flows of that reporting unit. 24 Allowance for Doubtful Accounts. The Company records an allowance for doubtful accounts to offset estimated uncollectible accounts receivable. Bad debt expense associated with the increases in the allowance for doubtful accounts is recorded as part of general and administrative expense. The Company's accounting policy generally is to record an allowance for receivables over 90 days past due unless there is significant evidence to support that the receivable is collectible. General The following Management's Discussion and Analysis of Financial Condition and Results of Operations, contains forward-looking statements, which involve risks and uncertainty. The Company's actual results could differ materially from those anticipated in these forward-looking statements as a result of certain factors discussed in this section. The

Company's fiscal year is from January 1 through December 31. The Company is engaged in the design, development, manufacture and sale of high technology diagnostic and surgical eye care products. Given the "going concern" status of the Company, management has focused efforts on those products and activities that will, in its opinion, achieve the most resource efficient short-term cash flow. As seen in the results for the twelve months ended December 31, 2007, diagnostic products have been the major focus and the Photon(TM) and other extensive research and development projects have been put on hold pending future evaluation when the Company's financial position improves. The Company does not focus on a specific diagnostic product or products but, instead, on this entire diagnostic product group. During the year ended December 31, 2007, the Company recorded an increase in the warranty accrual of $72,000. This increase was a result of a comprehensive analysis by management regarding historical warranty costs. Historically, the Company has recorded a monthly warranty expense and related increase to the warranty accrual. However, in recent periods the usage of the warranty accrual has continued to increase. After reviewing the recent historical data, management determined that the warranty accrual should be increased by $72,000 to $227,000. Management will continue to closely monitor the warranty accrual usage to ensure that the proper amount has been accrued. During the twelve months ended December 31, 2007, management made certain adjustments to the financial statements, including a decrease in the reserve for obsolete or estimated non-recoverable inventory of $1,076,000. The Company also recorded a net increase in the allowance for doubtful accounts receivable of $37,000, impairment of intangibles of $-0-, and decreases in accruals to settle outstanding disputes in the amount of $91,000. The Company's ultrasound diagnostic products include a P55 pachymetric analyzer, a P2200 pachymetric analyzer, a P2000 Ultrasound A-Scan biometric analyzer, a P2500 combination A/Scan and Pachymeter, a P37 Ultrasound A/B Scan, a P37-II Ultrasound A/B Scan, a P2700 Ultrasound A/B Scan, a P3700 Ultrasound A/B Scan, a P40 Ultrasound Biomicroscope, a P45 Plus Ultrasound Biomicroscope, and a P60 Ultrasound Biomicroscope, the technology for which was acquired from Humphrey Systems in 1998. The Company introduced the P45 Plus in the fall of 2000, which combines the A/B Scan, and the biomicroscope into one instrument. The Company introduced the P60 in March 2005, which represents the fourth generation of UBM devices and has better visual clarity and image flexibility than earlier versions. In addition, the Company markets its Blood Flow Analyzer(TM) acquired in the purchase of Ocular Blood Flow Ltd. in June 2000. Other diagnostic products are the Dicon(TM) LD400 Auto Perimeter and the Dicon (TM) CT 200e Corneal Topographer, which were acquired in the acquisition of Vismed d/b/a Dicon in June 2000. Because of the "going concern" status of the Company, management has focused efforts on those products and activities that will, in its opinion, achieve the most resource efficient short-term cash flow to the Company. As reflected in the results for the fiscal year ended December 31, 2007, diagnostic products are currently the Company's major focus and the Photon(TM) and other extensive research and development projects have been put on hold pending future evaluation when the financial position of the Company improves. Due to the lack of current evidence to support recoverability, the Company has recorded an inventory reserve to offset the inventory associated with the Precisionist Thirty Thousand(TM) and the Photon(TM) as well as certain other inventory items that are estimated to be non-recoverable due to the lack of significant turnover of such items in recent periods. 25 Activities for the twelve months ended December 31, 2007 and 2006 included sales of the Company's products and related accessories and disposable products. Raymond P.L. Cannefax was named President and Chief Executive Officer on January 5, 2006. On March 20, 2006, the Company named Luis A. Mostacero as Vice President of Finance. Mr. Mostacero previously served as the Company's Controller from June 2000 to August 2005. On January 8, 2008, Mr. Mostacero was also appointed as Chief Financial Officer. On October 11, 2006, Christina O'Connor was appointed as Vice President of International Sales and Julio C. Maximo as Vice President of Operations. On April 10, 2006, the Company named Michael S. Austin as Vice President of Sales and Marketing. On November 28, 2006, Mr. Austin resigned from the Company. On January 4, 2007, Alfred B. Franklin was appointed as Vice President of Domestic Sales. Mr. Franklin resigned on May 10, 2007, to pursue other opportunities. On May 10, 2007, Stephen L. Davis was appointed as Vice President of Domestic Sales and Marketing. Mr. Davis resigned on February 14, 2008, to pursue other opportunities. On May 7, 2002, the Company received a letter from the FDA requesting further clinical information regarding the Photon(TM). The Company is in the process of generating the additional clinical information in response to the letter. The Company cannot market or sell the Photon(TM) in the United States until FDA approval is granted. On November 4, 2002, the Company received FDA approval for expanded indications of use of the Blood Flow Analyzer(TM) for pulsatile ocular blood flow, volume and pulsatility equivalence index. Also, the Company is continuing its efforts to educate the payors of Medicare claims throughout the country about the Blood Flow Analyzer(TM), its purposes and the significance of its performance in patient care in order to achieve reimbursements to the providers. These efforts should lead to a more positive effect on sales. In April 2001, the Company received written authorization from the CPT Editorial Research and Development Department of the American Medical Association to use a common procedure terminology or CPT code number 92120 for its Blood Flow Analyzer(TM), for reimbursement purposes for doctors using the device. However, certain insurance payors have elected not to reimburse doctors using the Blood Flow Analyzer(TM). The Company believes the reasons why insurance payors initially elected not to reimburse doctors using the CPT code were the relatively high volume of claims that began to be submitted under CPT code number 92120 compared to the limited volume of claims previously submitted under this code, and the time consumed by the Blood Flow Analyzer(TM) test, which some payors may have believed was less than what is allowed under CPT code number 92120. This trend began shortly after insurance payors were presented with reimbursement requests under this code, and the Company believes these reasons were the basis for the initiation of nonpayment. The impact of this nonpayment by certain payors on the Company's future operations is a lower volume of sales, particularly in those states where reimbursement is not yet approved or is delayed. Currently, there is reimbursement by insurance payors in 20 states and partial reimbursement in six other states. As insurance payors have the prerogative whether to provide reimbursement to doctors using the Blood Flow Analyzer(TM), the Company is continuing to work with insurance payors in states where there is no reimbursement to doctors using the CPT code to demonstrate the value of the instrument. However, some insurance payors are currently not providing reimbursement to doctors where a regional or state administrator of Medicare has elected not to provide Medicare coverage for the Blood Flow Analyzer(TM). The Company is continuing to work with the regional and state administrators of Medicare who have denied Medicare coverage for the Blood Flow Analyzer(TM) to demonstrate the value of the instrument. There were a number of factors that contributed to the decrease in sales of the Company's diagnostic products. The U.S. recessionary economic trend has impacted the Company's domestic sales. Additionally, the Company restructured its sales organization and sales channels by decreasing its direct sales force who are full-time employees to five direct sales employees and one independent sales organization as of December 31, 2007. The dependent sales force has been reduced because the Company does not have sufficient revenues to justify a larger direct sales force. One of the challenges for fiscal 2008 will be the judicious reestablishment of the sales force in anticipation of increased sales. 26 The Company intends to increase its efforts to sell its diagnostic products through independent sales representatives and ophthalmic equipment distributors, which are paid commissions only for their sales. As of December 31, 2007, the Company had 24 ophthalmic and medical product distributors outside the United States. The Company hopes to benefit from these recently hired sales representatives and distributors in the United States as they gain familiarity, through training, of the Company's diagnostic products. Outstanding Commitments to Issue Shares The following table identifies our outstanding commitments to issue shares, including the shares underlying the convertible notes and warrants issuable upon conversion of the notes and exercise of the warrants: Underlying Shares Security of Common Stock Notes (1) 3,637,280,000 Warrants (2) 54,034,392 Preferred Stock (3) 862,404 Stock Options (4) 11,500,000 ------------------- Total 3,703,676,796 (1) Assumes full conversion of $3,928,262 of notes issued to AJW Partners, LLC, AJW Offshore, Ltd., AJW Qualified Partners, LLC, and New Millennium Capital Partners II, LLC at a conversion price of $.00108 per share (based upon a market price of $.0018 as of January 14, 2008 with a 40% discount). (2) Consisting of warrants exerciseable at prices ranging from $.001 per share to $6.75 per share, including warrants issued to AJW Partners, LLC, AJW Offshore, Ltd., AJW Qualified Partners, LLC, and New Millennium Capital Partners II, LLC to purchase 16,534,392 shares of common stock at an exercise price of $.20 per share, exerciseable through the period from April 27, 2010 to June 30, 2010, and warrants to purchase 12,000,000 shares of common stock at an exerciseable price of $.10 per share, exerciseable through the period from February 28, 2011 to April 20, 2012, warrants to purchase 10,000,000 shares of common stock at an exercise price of $.005 per share, exerciseable through June 11, 2012, and warrants to purchase 15,000,000 shares of common stock at an exercise price of $.001 per share, exerciseable through December 24, 2012. (3) Consisting of 6,753 shares of common stock issuable upon conversion of 5,627 shares of Series A preferred stock, 10,783 shares of common stock issuable upon conversion of 8,986 shares of Series B preferred stock, 8,750 shares of common stock issuable upon conversion of 5,000 shares of Series D preferred stock, 13,333 shares of common stock issuable upon conversion of 250 shares of Series E preferred stock, 234,550 shares of common stock issuable upon conversion of 4,398.75 shares of Series F preferred stock, and 588,235 shares of common stock issuable upon conversion of 588,235 shares of Series G preferred stock. (4) Consisting of stock options granted to executive officers and employees to purchase 9,250,000 shares of common stock at exercise prices ranging from $.01 per share to $2.75 per share, and stock options granted to directors to purchase 2,250,000 shares of common stock at exercise prices ranging from $.01 per share to $2.75 per share. There are a total of 3,703,701,796 shares underlying our convertible notes, warrants, preferred stock and stock options, assuming full conversion of the outstanding notes and preferred stock and the exercise of all the outstanding warrants and stock options. The number of our authorized shares of common stock is 1,400,000,000 shares. The large number of our shares of common stock underlying our notes, warrants, preferred stock and stock options will require us to increase the number of authorized shares. Failure to obtain stockholder approval to increase the number of authorized shares could result in the noteholders commencing legal action against us and foreclosing on all of our assets to recover damages. Any such action would require us to curtail or cease our operations. Convertible Notes April 27, 2005 Sale of $2,500,000 in Convertible Notes. To obtain funding for the Company's ongoing operations, the Company entered into a securities purchase agreement with four accredited investors on April 27, 2005 for the sale of (i) $2,500,000 in convertible notes and (ii) warrants to purchase 16,534,392 shares of its common stock. The sale of the convertible notes and warrants is to occur in three traunches and the investors provided the Company with an aggregate of $2,500,000 as follows: 27 o $850,000 was disbursed on April 27, 2005; o $800,000 was disbursed on June 23, 2005 after the Company filed a registration statement on June 22, 2005 to register the shares of common stock issuable upon conversion of the convertible notes and exercise of warrants; and o $850,000 was disbursed on June 30, 2005, the effective date of the registration statement. Under the terms of the securities purchase agreement, the Company agreed it would not, without the prior written consent of a majority-in-interest of the investors, negotiate or contract with any party to obtain additional equity financing (including debt financing with an equity component) that involves (i) the issuance of common stock at a discount to the market price of the common stock on the date of issuance (taking into account the value of any warrants or options to acquire common stock in connection therewith), (ii) the issuance of convertible securities that are convertible into an indeterminate number of shares of common stock, or (iii) the issuance of warrants during the lock-up period beginning April 27, 2005 and ending on the later of (a) 270 days from April 27, 2005, or (b) 180 days from the date the registration statement is declared effective. In addition, the Company agreed not to conduct any equity financing (including debt financing with an equity component) during the period beginning April 27, 2005 and ending two years after the end of the above lock-up period unless it first provided each investor an option to purchase its pro rata share (based on the ratio of each investor's purchase under the securities purchase agreement) of the securities being offered in any proposed equity financing. Each investor must be provided written notice describing any proposed equity financing at least 20 business days prior to the closing of such proposed equity financing and the option must be extended to each investor during the 15-day period following delivery of such notice. The $2,500,000 in convertible notes bear interest at 8% per annum from the date of issuance. Interest is computed on the basis of a 365-day year and is payable quarterly in cash, with six months of interest payable up front. The interest rate resets to zero percent for any month in which the stock price is greater than 125% of the initial market price, or $.0945, for each trading day during that month. Any amount of principal or interest on the convertible notes that is not paid when due will bear interest at the rate of 15% per annum from the date due thereof until such amount is paid. The notes mature in three years from the date of issuance, and are convertible into the Company's common stock at the noteholders' option, at the lower of (i) $.09 or (ii) 60% of the average of the three lowest intraday trading prices for the common stock on the OTC Bulletin Board for the 20 trading days before but not including the conversion date. Accordingly, there is no limit on the number of shares into which the notes may be converted. The convertible notes are secured by the Company's assets, including the Company's inventory, accounts receivable and intellectual property. Moreover, the Company has a call option under the terms of the notes. The call option provides the Company with the right to prepay all of the outstanding convertible notes at any time, provided there is no event of default by the Company and the Company's stock is trading at or below $.09 per share. An event of default includes the failure by the Company to pay the principal or interest on the notes when due or to timely file a registration statement as required by the Company or obtain effectiveness with the Securities and Exchange Commission of the registration statement. Prepayment of the notes is to be made in cash equal to either (a) 125% of the outstanding principal and accrued interest for prepayments occurring within 30 days following the issue date of the notes; (b) 130% of the outstanding principal and accrued interest for prepayments occurring between 31 and 60 days following the issue date of the notes; or (c) 145% of the outstanding principal and accrued interest for prepayments occurring after the 60th day following the issue date of the notes. The warrants are exercisable until five years from the date of issuance at a purchase price of $.20 per share. The investors may exercise the warrants on a cashless basis if the shares of common stock underlying the warrants are not registered pursuant to an effective registration statement. In the event the investors exercise the warrants on a cashless basis, the Company will not receive any proceeds therefrom. In addition, the exercise price of the warrants will be adjusted in the event the Company issues common stock at a price below market, with the exception of any securities issued as of the date of the warrants or issued in connection with the callable secured convertible notes issued pursuant to the securities purchase agreement. The noteholders have agreed to restrict their ability to convert their convertible notes or exercise their warrants and receive shares of the Company's common stock such that the number of shares of common stock held by them in the aggregate and their affiliates after such conversion or exercise does not exceed 4.99% of the then issued and outstanding shares of common stock. However, the noteholders may repeatedly sell shares of common stock in order to reduce their ownership percentage, and subsequently convert additional convertible notes. 28 February 28, 2006 Sale of $1,500,000 in Convertible Notes. To obtain additional funding for the Company's ongoing operations, the Company entered into a second securities purchase agreement on February 28, 2006 with the same four accredited investors for the sale of (i) $1,500,000 in convertible notes and (ii) warrants to purchase 12,000,000 shares of its common stock. The sale of the convertible notes and warrants is to occur in three traunches and the investors are obligated to provide the Company with an aggregate of $1,500,000 as follows: o $500,000 was disbursed on February 28, 2006; o $500,000 was disbursed on June 28, 2006 after the Company filed a registration statement on June 15, 2006 to register the shares of common stock underlying the convertible notes. The registration statement was subsequently withdrawn on July 25, 2006 and a new registration statement was filed on September 15, 2006 to register 60,000,000 shares of common stock issuable upon conversion of the notes. o $500,000 was disbursed on April 30, 2007, the day prior to the effective date of the registration statement on May 1, 2007. Under the terms of the securities purchase agreement, the Company also agreed it would not, without the prior written consent of a majority-in-interest of the investors, negotiate or contract with any party to obtain additional equity financing (including debt financing with an equity component) that involves (i) the issuance of common stock at a discount to the market price of the common stock on the date of issuance (taking into account the value of any warrants or options to acquire common stock in connection therewith), (ii) the issuance of convertible securities that are convertible into an indeterminate number of shares of common stock, or (iii) the issuance of warrants during the lock-up period beginning February 28, 2006 and ending on the later of (a) 270 days from February 28, 2006, or (b) 180 days from the date the registration statement is declared effective. In addition, the Company agreed not to conduct any equity financing (including debt financing with an equity component) during the period beginning February 28, 2006 and ending two years after the end of the above lock-up period unless it first provided each investor an option to purchase its pro rata share (based on the ratio of each investor's purchase under the securities purchase agreement) of the securities being offered in any proposed equity financing. Each investor must be provided written notice describing any proposed equity financing at least 20 business days prior to the closing of such proposed equity financing and the option must be extended to each investor during the 15-day period following delivery of such notice. The $1,500,000 in convertible notes bear interest at 8% per annum from the date of issuance. Interest is computed on the basis of a 365-day year and is payable quarterly in cash, with six months of interest payable up front. The interest rate resets to zero percent for any month in which the stock price is greater than 125% of the initial market price, or $.0275, for each trading day during that month. Any amount of principal or interest on the convertible notes that is not paid when due will bear interest at the rate of 15% per annum from the date due thereof until such amount is paid. The notes mature in three years from the date of issuance, and are convertible into the Company's common stock at the noteholders' option, at the lower of (i) $.02 or (ii) 60% of the average of the three lowest intraday trading prices for the common stock on the OTC Bulletin Board for the 20 trading days before but not including the conversion date. Accordingly, there is no limit on the number of shares into which the notes may be converted. The convertible notes are secured by the Company's assets, including the Company's inventory, accounts receivable and intellectual property. Moreover, the Company has a call option under the terms of the notes. The call option provides the Company with the right to prepay all of the outstanding convertible notes at any time, provided there is no event of default by the Company and the Company's stock is trading at or below $.02 per share. An event of default includes the failure by the Company to pay the principal or interest on the notes when due or to timely file a registration statement as required by the Company or obtain effectiveness with the Securities and Exchange Commission of the registration statement. Prepayment of the notes is to be made in cash equal to either (a) 125% of the outstanding principal and accrued interest for prepayments occurring within 30 days following the issue date of the notes; (b) 130% of the outstanding principal and accrued interest for prepayments occurring between 31 and 60 days following the issue date of the notes; or (c) 145% of the outstanding principal and accrued interest for prepayments occurring after the 60th day following the issue date of the notes. 29 The warrants are exercisable until five years from the date of issuance at a purchase price of $.10 per share. The investors may exercise the warrants on a cashless basis if the shares of common stock underlying the warrants are not registered pursuant to an effective registration statement. In the event the investors exercise the warrants on a cashless basis, then the Company will not receive any proceeds therefrom. In addition, the exercise price of the warrants will be adjusted in the event the Company issues common stock at a price below market, with the exception of any securities issued as of the date of the warrants or issued in connection with the notes issued pursuant to the securities purchase agreement. The noteholders have agreed to restrict their ability to convert their callable secured convertible notes or exercise their warrants and receive shares of the Company's common stock such that the number of shares of common stock held by them in the aggregate and their affiliates after such conversion or exercise does not exceed 4.99% of the then issued and outstanding shares of common stock. However, the noteholders may repeatedly sell shares of common stock in order to reduce their ownership percentage, and subsequently convert additional convertible notes. June 11, 2007 Sale of $500,000 in Callable Secured Convertible Notes: To obtain further funding for the Company's ongoing operations, the Company entered into a third securities purchase agreement on June 11, 2007 with the same four accredited investors for the sale of (i) $500,000 in callable secured convertible notes and (ii) warrants to purchase 10,000,000 shares of its common stock. The investors disbursed $500,000 to the Company on June 11, 2007. Under the terms of the June 11, 2007 securities purchase agreement, the Company agreed that it would not, without the prior written consent of a majority-in-interest of the investors, negotiate or contract with any party to obtain additional equity financing (including debt financing with an equity component) that involves (i) the issuance of common stock at a discount to the market price of the common stock on the date of issuance (taking into account the value of any warrants or options to acquire common stock in connection therewith), (ii) the issuance of convertible securities that are convertible into an indeterminate number of shares of common stock, or (iii) the issuance of warrants during the lock-up period beginning June 11, 2007 and ending on the later of (a) 270 days from June 11, 2007, or (b) 180 days from the date the registration statement is declared effective. In addition, the Company agreed not to conduct any equity financing (including debt financing with an equity component) during the period beginning June 11, 2007 and ending two years after the end of the above lock-up period unless it first provided each investor an option to purchase its pro-rata share (based on the ratio of each investor's purchase under the securities purchase agreement) of the securities being offered in any proposed equity financing. Each investor must be provided written notice describing any proposed equity financing at least 20 business days prior to the closing of such proposed equity financing and the option must be extended to each investor during the 15-day period following delivery of such notice. The $500,000 in convertible notes bear interest at 8% per annum from the date of issuance. Interest is computed on the basis of a 365-day year and is payable quarterly in cash, with six months of interest payable up front. The interest rate resets to zero percent for any month in which the stock price is greater than 125% of the initial market price, or $.0275, for each trading day during that month. Any amount of principal or interest on the callable secured convertible notes that is not paid when due will bear interest at the rate of 15% per annum from the date due thereof until such amount is paid. The convertible notes mature in three years from the date of issuance, and are convertible into the Company's common stock at the noteholders' option, at the lower of (i) $.02 or (ii) 50% of the average of the three lowest intraday trading prices for the common stock on the OTC Bulletin Board for the 20 trading days before but not including the conversion date. Accordingly, there is no limit on the number of shares into which the notes may be converted. The $500,000 in convertible notes are secured by the Company's assets, including the Company's inventory, accounts receivable and intellectual property. Moreover, the Company has a call option under the terms of the notes. The call option provides the Company with the right to prepay all of the outstanding convertible notes at any time, provided there is no event of default by the Company and its stock is trading at or below $.10 per share. An event of default includes the failure by the Company to pay the principal or interest on the convertible notes when due or to timely file a registration statement as required by the Company or obtain effectiveness with the Securities and Exchange Commission of the registration statement. Prepayment of the convertible notes is to be made in cash equal to either (a) 125% of the outstanding principal and accrued interest for prepayments occurring within 30 days following the issue date of the notes; (b) 130% of the outstanding principal and accrued interest for prepayments occurring between 31 and 60 days following the issue date of the notes; or (c) 145% of the outstanding principal and accrued interest for prepayments occurring after the 60th day following the issue date of the notes. 30 The warrants are exercisable until seven years from the date of issuance at a purchase price of $.005 per share. The investors may exercise the warrants on a cashless basis if the shares of common stock underlying the warrants are not then registered pursuant to an effective registration statement. In the event the investors exercise the warrants on a cashless basis, the Company will not receive any proceeds therefrom. In addition, the exercise price of the warrants will be adjusted in the event the Company issues common stock at a price below market, with the exception of any securities issued as of the date of the warrants or issued in connection with the convertible notes issued pursuant to the securities purchase agreement. The noteholders have agreed to restrict their ability to convert their convertible notes or exercise their warrants and receive shares of the Company's common stock such that the number of shares of common stock held by them in the aggregate and their affiliates after such conversion or exercise does not exceed 4.99% of the then issued and outstanding shares of common stock. However, the noteholders may repeatedly sell shares of common stock in order to reduce their ownership percentage, and subsequently convert additional convertible notes, provided, however, that such conversions do not exceed $75,000 per calendar month, or the average daily dollar volume calculated during the ten business days prior to conversion multiplied by the number of trading days of that calendar month, per calendar month. The Company is required to register the shares of its common stock issuable upon the conversion of the convertible notes and the exercise of the warrants that were issued to the noteholders pursuant to the securities purchase agreement the Company entered in to on June 11, 2007. The registration statement must be filed with the Securities and Exchange Commission within 60 days of the June 11, 2007 closing date and the effectiveness of the registration is to be within 135 days of such closing date. Penalties of 2% of the outstanding principal balance of the convertible notes plus accrued interest are to be applied for each month the registration is not effective within the required time. The penalty may be paid in cash or stock at the Company's option. December 19, 2007 Issuance of $389,010 in Callable Convertible Notes: On December 19, 2007, the Company was notified by the holders of the convertible notes that there was a past due interest owing on the outstanding convertible notes. The total amount of interest owed was $389,010. To pay this interest, the noteholders were willing to accept $389,010 in additional convertible notes due on December 31, 2010. Accordingly, on December 19, 2007, the Company issued $389,010 in convertible notes to the noteholders as full payment of the past due interest. The $389,010 in convertible notes bear interest at 2% per annum from December 31, 2007. Interest is computed on the basis of a 365-day year and is payable quarterly in cash, with six months of interest payable up front. The interest rate resets to zero percent for any month in which the stock price is greater than 125% of the initial market price, or $.0275, for each trading day during that month. Any amount of principal or interest on the callable secured convertible notes that is not paid when due will bear interest at the rate of 15% per annum from the date due thereof until such amount is paid. The convertible notes mature on December 31, 2010, and are convertible into the Company's common stock at the noteholders' option, at the lower of (i) $.02 or (ii) 50% of the average of the three lowest intraday trading prices for the common stock on the OTC Bulletin Board for the 20 trading days before but not including the conversion date. Accordingly, there is no limit on the number of shares into which the notes may be converted. The $389,010 in convertible notes have a call option under the terms of the notes. The call option provides the Company with the right to prepay all of the outstanding convertible notes at any time, provided there is no event of default by the Company and its stock is trading at or below $.04 per share. An event of default includes the failure by the Company to pay the principal or interest on the convertible notes when due. Prepayment of the convertible notes is to be made in cash equal to either (a) 135% of the outstanding principal and accrued interest for prepayments occurring within 30 days following the issue date of the notes; (b) 145% of the outstanding principal and accrued interest for prepayments occurring between 31 and 60 days following the issue date of the notes; or (c) 150% of the outstanding principal and accrued interest for prepayments occurring after the 60th day following the issue date of the notes. 31 The noteholders have agreed to restrict their ability to convert their convertible notes and receive shares of the Company's common stock such that the number of shares of common stock held by them in the aggregate and their affiliates after such conversion does not exceed 4.9% of the then issued and outstanding shares of common stock. However, the noteholders may repeatedly sell shares of common stock in order to reduce their ownership percentage, and subsequently convert additional convertible notes, provided, however, that such conversions do not exceed the average daily dollar volume calculated during the ten business days prior to conversion multiplied by the number of trading days of that calendar month, per calendar month. December 24, 2007 Sale of $250,000 in Callable Secured Convertible Notes: To obtain further funding for the

Company's ongoing operations, the Company entered into a fourth securities purchase agreement on December 24, 2007 with the same four accredited investors for the sale of (i) $250,000 in callable secured convertible notes and (ii) warrants to purchase 15,000,000 shares of its common stock. The investors disbursed $250,000 to the Company on December 24, 2007. Under the terms of the December 24, 2007 securities purchase agreement, the Company agreed that it would not, without the prior written consent of a majority-in-interest of the investors, negotiate or contract with any party to obtain additional equity financing (including debt financing with an equity component) that involves (i) the issuance of common stock at a discount to the market price of the common stock on the date of issuance (taking into account the value of any warrants or options to acquire common stock in connection therewith), (ii) the issuance of convertible securities that are convertible into an indeterminate number of shares of common stock, or (iii) the issuance of warrants during the lock-up period beginning December 24, 2007 and ending on the later of (a) 270 days from December 24, 2007, or (b) 180 days from the date the registration statement is declared effective. In addition, the Company agreed not to conduct any equity financing (including debt financing with an equity component) during the period beginning December 24, 2007 and ending two years after the end of the above lock-up period unless it first provided each investor an option to purchase its pro-rata share (based on the ratio of each investor's purchase under the securities purchase agreement) of the securities being offered in any proposed equity financing. Each investor must be provided written notice describing any proposed equity financing at least 20 business days prior to the closing of such proposed equity financing and the option must be extended to each investor during the 15-day period following delivery of such notice. The $250,000 in convertible notes bear interest at 8% per annum from the date of issuance. Interest is computed on the basis of a 365-day year and is payable quarterly in cash, with six months of interest payable up front. The interest rate resets to zero percent for any month in which the stock price is greater than 125% of the initial market price, or $.0275, for each trading day during that month. Any amount of principal or interest on the callable secured convertible notes that is not paid when due will bear interest at the rate of 15% per annum from the date due thereof until such amount is paid. The convertible notes mature in three years from the date of issuance, and are convertible into the Company's common stock at the noteholders' option, at the lower of (i) $.02 or (ii) 50% of the average of the three lowest intraday trading prices for the common stock on the OTC Bulletin Board for the 20 trading days before but not including the conversion date. Accordingly, there is no limit on the number of shares into which the notes may be converted. The $250,000 in convertible notes are secured by the Company's assets, including the Company's inventory, accounts receivable and intellectual property. Moreover, the Company has a call option under the terms of the notes. The call option provides the Company with the right to prepay all of the outstanding convertible notes at any time, provided there is no event of default by the Company and its stock is trading at or below $.10 per share. An event of default includes the failure by the Company to pay the principal or interest on the convertible notes when due or to timely file a registration statement as required by the Company or obtain effectiveness with the Securities and Exchange Commission of the registration statement. Prepayment of the convertible notes is to be made in cash equal to either (a) 125% of the outstanding principal and accrued interest for prepayments occurring within 30 days following the issue date of the notes; (b) 130% of the outstanding principal and accrued interest for prepayments occurring between 31 and 60 days following the issue date of the notes; or (c) 145% of the outstanding principal and accrued interest for prepayments occurring after the 60th day following the issue date of the notes. 32 The warrants are exercisable until seven years from the date of issuance at a purchase price of $.001 per share. The investors may exercise the warrants on a cashless basis if the shares of common stock underlying the warrants are not then registered pursuant to an effective registration statement. In the event the investors exercise the warrants on a cashless basis, the Company will not receive any proceeds therefrom. In addition, the exercise price of the warrants will be adjusted in the event the Company issues common stock at a price below market, with the exception of any securities issued as of the date of the warrants or issued in connection with the convertible notes issued pursuant to the securities purchase agreement. The noteholders have agreed to restrict their ability to convert their convertible notes or exercise their warrants and receive shares of the Company's common stock such that the number of shares of common stock held by them in the aggregate and their affiliates after such conversion or exercise does not exceed 4.99% of the then issued and outstanding shares of common stock. However, the noteholders may repeatedly sell shares of common stock in order to reduce their ownership percentage, and subsequently convert additional convertible notes, provided, however, that such conversions do not exceed $75,000 per calendar month, or the average daily dollar volume calculated during the ten business days prior to conversion multiplied by the number of trading days of that calendar month, per calendar month. The Company is required to register the shares of its common stock issuable upon the conversion of the convertible notes and the exercise of the warrants that were issued to the noteholders pursuant to the securities purchase agreement the Company entered in to on December 24, 2007. The registration statement must be filed with the Securities and Exchange Commission within 60 days of the December 24, 2007 closing date and the effectiveness of the registration is to be within 135 days of such closing date. Penalties of 2% of the outstanding principal balance of the convertible notes plus accrued interest are to be applied for each month the registration is not effective within the required time. The penalty may be paid in cash or stock at the Company's option. Simple Conversion Calculation The number of shares of common stock issuable upon conversion of the convertible notes issued on April 27, 2005, February 28, 2006, June 11, 2007, December 19, 2007, and December 24, 2007 is determined by dividing that portion of the principal of the notes to be converted and interest, if any, by the conversion price. For example, assuming conversion of $3,928,262 principal amount of the convertible notes on December 31, 2007 (consisting of $5,139,010 in convertible notes that were sold to the four investors pursuant to securities purchase agreements dated April 27, 2005, February 28, 2006, June 11, 2007, and December 24, 2007, plus $389,010 in convertible notes issued on December 19, 2007 in payment of past due interest on the notes, less $1,210,748 in notes converted during the period from June 12, 2005 to December 31, 2007) and a conversion price of $.0018 per share with a 40% discount, the number of shares issuable upon conversion would be: $3,928,262/$.0018 x 60% = 3,637,280,000 shares. The Company's obligation to issue shares upon conversion of the convertible notes issued on April 27, 2005, February 28, 2006, June 11, 2007, December 19, 2007, and December 24, 2007 is essentially limitless. The following is an example of the amount of shares of common stock that are issuable upon conversion of $3,928,262 principal amount of the convertible notes (including accrued interest), based on market prices 25%, 50%, and 75% below the market price, as of January 14, 2008 of $.0018 with a 40% discount: % Below Price Per With 40% Number of % of Outstanding Market Share Discount Shares Issuable Shares* ------ ----- -------- --------------- ------ 25% $.00135 $.00081 4,849,706,000 712% 50% $.0009 $.00054 7,274,559,000 10,682% 75% $.00045 $.00027 14,594,118,000 21,365% *Based on 680,984,307 shares outstanding. As illustrated, the number of shares of common stock issuable upon conversion of the Company's callable secured convertible notes will increase if the market price of the Company's common stock declines, which will cause dilution to existing stockholders.

33 Adjustable Conversion Price of Convertible Notes The callable secured convertible notes are convertible into shares of the Company's common stock at a 40% discount to the trading price of the common stock prior to the conversion. The significant downward pressure on the price of the common stock as the noteholders convert and sell material amounts of common stock could encourage short sales by investors. This could place further downward pressure on the price of the common stock. The noteholders could sell common stock into the market in anticipation of covering the short sale by converting their securities, which could cause further downward pressure on the stock price. In addition, not only the sale of shares issued upon conversion or exercise of notes, warrants and options, but also the mere perception that these sales could occur, may have a depressive effect on the market price of the common stock. Possible Dilution to Stockholders The issuance of shares upon conversion of convertible notes and exercise of warrants may result in substantial dissolution to the interests of other stockholders since the holders of the convertible notes may ultimately convert and sell the full amount issuable upon conversion. Although the noteholders may not convert their callable secured convertible notes and/or exercise their warrants if such conversion or exercise price would cause them to own more than 4.99% of the Company's outstanding common stock, this restriction does not prevent the noteholders from converting and/or exercising some of their holdings and then converting the rest of their holdings. In this way, the noteholders could sell more than this limit while never holding more than this limit. There is no upper limit on the number of shares that may be issued, which will have the effect of further diluting the proportionate equity interest and voting power of holders of the Company's common stock. Failure to Repay Convertible Notes May Require Company Operations to Cease On April 27, 2005, the Company entered into a securities purchase agreement for the sale of an aggregate of $2,500,000 principal amount of convertible notes. On February 28, 2006, the Company entered into a second securities purchase agreement for the sale of an aggregate of $1,500,000 principal amount of convertible notes. On June 11, 2007 and December 24, 2007, the Company entered into third and fourth securities purchase agreements for the sale of an aggregate of $750,000 principal amount of convertible notes. On December 19, 2007, the Company issued an additional $389,010 in convertible notes as payment of past due interest owing on the outstanding convertible notes. These convertible notes are all due and payable, with 8% interest, three years from the date of issuance, unless sooner converted into shares of the Company's common stock. Any event of default such as the Company's failure to repay the principal or interest when due on the notes, the Company's failure to issue shares of common stock upon conversion by the noteholders, the Company's breach of any covenant, representation or warranty in the securities purchase agreement or related convertible notes, the assignment or appointment of a receiver to control a substantial part of the Company's property or business, the filing of a money judgment, writ or similar process against the Company in excess of $50,000, the commencement of a bankruptcy, insolvency, reorganization or liquidation proceeding against the Company, and the delisting of the Company's common stock could require the early repayment of the convertible notes, including a default interest rate of 15% on the outstanding principal balance of the notes if the default is not cured within the specified grace period. The Company anticipates that the full amount of convertible notes will be converted into shares of its common stock, in accordance with the terms of the convertible notes. If the Company is required to repay the convertible notes, it would be required to use its limited working capital and raise additional funds. If the Company were unable to repay the notes when required, the noteholders could commence legal action against the Company and foreclose on all of its assets to recover the amounts due. Any such action would require the Company to curtail or cease operations. Results of Operations Fiscal Year Ended December 31, 2007 Compared to Fiscal Year Ended December 31, 2006 Net sales for the twelve months ended December 31, 2007 decreased by $323,000 to $1,872,000 as compared to $2,195,000 for the same period of 2006. This reduction in sales was primarily due to decreased sales of the P40, P45 and P60 Ultrasound Biomicroscopes, the P37 A/B Scan Ocular Ultrasound Diagnostic and the P55 Pachymeter. 34 For the twelve months ended December 31, 2007, sales from the Company's diagnostic products totaled $1,707,000, or 91% of total revenues, compared to $1,928,000, or 88% of total revenues for the same period of 2006. The remaining 9 % of sales, or $165,000 during the twelve months ended December 31, 2007 was from parts, disposables, and service revenue. Sales of the P40, P45 and P60 UBM Ultrasound Biomicroscopes decreased to $513,000 during the twelve months ended December 31, 2007, or 27% of total revenues for the period, compared to $547,000, or 25% of total revenues, for the same period last year. Sales of the Blood Flow Analyzer(TM) increased by $46,000 to $257,000, or 14% of total revenues, for the twelve months ended December 31, 2007, compared to net sales of $211,000, or 10% of total revenues during the same period in 2006. Sales from the P37, P37-II, P2700 and P3700 A/B Scan Ocular Ultrasound Diagnostic increased to $210,000, or 11% of total revenues, for the twelve month period ended December 31, 2007, up compared to $221,000 for the same period last year. Combined sales of the LD 400 and TKS 5000 autoperimeters and the CT 200 Corneal Topographer were $388,000, or 20% of the total revenues, for the twelve months ended December 31, 2007, compared to $856,000, or 39% of total revenues, for the same period of 2006. Sales of the Blood Flow Analyzer(TM) increased due in part from the reorganization of the Company's sales force. The Company anticipates continuing the upward trend in Blood Flow Analyzer(TM) sales through additional efforts by the Company to gain more wide spread support from the Blood Flow Analyzer(TM) through increased clinical awareness, product development and improved marketing plans. Sales of surgical products are at a standstill pending FDA approval of the Photon(TM) laser system. In the twelve month period ended December 31, 2007, the Company realized no sales in the surgical line consisting of the Photon(TM) laser system. There were also no sales in the surgical line for the comparable period of 2006. Gross profit for the twelve months ended December 31, 2007 increased to 46% of total revenues, compared to 42% of total revenues for the same period in 2006. This increase in gross profit in 2007 was mainly due to reductions in corporate expenditures due to improved operating efficiencies during the twelve months ending December 31, 2007. There was no increase to cost of sales as a result of a charge to the reserve for obsolete inventory in 2006. Marketing and selling expenses increased by $228,000, or 53%, to $662,000 for the twelve months ended December 31, 2007, from $434,000 for the comparable period in 2006. This increase was due primarily to an increased number of sales representatives and higher travel related and associated sales expenses. General and administrative expenses increased by $206,000, or 26%, to $998,000 for the twelve months ended December 31, 2007, from $792,000 for the comparable period in 2006. Contributing to this increase was a $42,000 increase in salaries from $246,000 in 2006 to $288,000 in 2007, primarily due to merit increases in the salaries of existing employees. Commission expenses increased by $16,000 from $72,000 in 2006 to $88,000 in 2007 due to an increased amount of convertible notes sold in 2007 compared to 2006. Accounting support expenditures increased by $25,000 in 2007 as a result of the necessary updates and modifications to the Company's network system services and associated software support. The bad debt allowance increased by $37,000 from $72,000 in 2006 to $109,000 in 2007 due to an increased amount of the Company's accounts receivable over 90 days during 2007 as compared to 2006. Also during 2007, the Company collected $22,000 in receivables that were previously allowed in the allowance for doubtful accounts. Research,

development and service expenses increased by $94,000, or 38%, to $344,000 for the twelve months ended December 31, 2007, compared to $250,000 for the same period of 2006. This increased was mainly due to the increased expenses in 2007 for the development of the new software package for the P60 UBM. Due to our ongoing cash flow difficulties, most of the Company's vendors and suppliers were contacted during 2006 and 2007 with attempts to negotiate reduced payments and settlement of outstanding accounts payable. Although some vendors refused to negotiate and demanded payment in full, some vendors were willing to settle for a reduced amount. The accounts payable forgiven by vendors and suppliers resulted in a gain of $91,000 and $34,000 during the years ended December 31, 2007 and 2006, respectively. 35 Liquidity and Capital Resources The Company used $1,135,000 in cash in operating activities for the twelve months ended December 31, 2007, compared to $828,000 for the twelve months ended December 31, 2006. The increase in cash used for operating activities for the twelve months ended December 31, 2007 was primarily attributable to the Company's net loss and increase in accounts payable, accounts receivable, and a significant decrease of the change of the fair value of derivative liabilities. There was no cash used for investment activities for the twelve months ended December 31, 2007, compared to cash used for investment activities of $20,000 for the same period in 2006. Net cash used in financing activities was $1,250,000 for the twelve months ended December 31, 2007, versus net cash used of $988,000 in the same period in 2006. The Company had working capital of $758,000 as of December 31, 2007. In the past, the Company has relied heavily upon sales of the Company's common and preferred stock to fund operations. There can be no assurance that such equity funding will be available on terms acceptable to the Company in the future. As of December 31, 2007, the Company had net operating loss carryforwards (NOLs) of approximately $56 million. These loss carryforwards are available to offset future taxable income, if any, and have begun to expire in 2001 and extend for twenty years. The Company's ability to use net operating loss carryforwards (NOLs) to offset future income is dependent upon certain limitations as a result of the pooling transaction with Vismed and the tax laws in effect at the time of the NOLs being utilized. The Tax Reform Act of 1986 significantly limits the annual amount that can be utilized for certain of these carryforwards as a result of change of ownership. As of December 31, 2007, the Company had accounts payable of $417,000, a significant portion of which was over 90 days past due. The Company has contacted many of the vendors or companies that have significant amounts of payables past due in an effort to delay payment, renegotiate a reduced settlement payment, or establish a longer term payment plan. While some companies have been willing to renegotiate the outstanding amounts, others have demanded payment in full. Under certain conditions, including but not limited to judgments rendered against the Company in a court of law, a group of creditors could force the Company into bankruptcy due to its inability to pay the liabilities arising out of such judgments at that time. In addition to the accounts payable noted above, the Company also has noncancelable capital lease obligations and operating lease obligations that require the payment of approximately $110,000 in 2007, and $218,000 in 2006. The Company has taken numerous steps to reduce costs and increase operating efficiencies. These steps consist of the following: 1. The Company closed its San Diego facility. In so doing, numerous manufacturing, accounting and management responsibilities were consolidated. In addition, such closure resulted in significant head count reductions as well as savings in rent and other overhead costs. 2. The Company has reduced the size of its manufacturing facility and corporate office in Salt Lake City. In doing so, management responsibilities were consolidated. Such reduction in space resulted in a reduction in the number of employees, as well as savings in rent and other overhead expenses. 3. The Company has significantly reduced the use of consultants, which has resulted in a large decrease to these expenses. 4. The Company has reduced its direct sales force to three representatives, which has resulted in less payroll, travel and other selling expenses. Because the Company has significantly fewer sales representatives, its ability to generate sales has been reduced. The Company has taken measures to reduce the amount of uncollectible accounts receivable such as more thorough and stringent credit approval, improved training and instruction by sales personnel, and frequent direct communication with the customer subsequent to delivery of the system. The allowance for doubtful accounts was 15% of total outstanding receivables as of December 31, 2007 and 15% as of December 31, 2006. The allowance for doubtful accounts increased from $72,000 at December 31, 2006 to $109,000 at December 31, 2007. 36 The Company intends to continue its efforts to reduce the allowance for doubtful accounts as a percentage of accounts receivable. The Company has ongoing efforts to collect a significant portion of the sales price in advance of the sale or in a timely manner after delivery. During the twelve months ended December 31, 2007, the Company added a net recovery of receivables previously allowed of $22,000, and during the twelve months ended December 31, 2006, the Company had a net zero to the allowance for doubtful accounts. The Company believes that by requiring a large portion of payment prior to shipment, it has greatly improved the collectibility of its receivables. The Company carried an allowance for obsolete or estimated non-recoverable inventory of $244,000 at December 31, 2007 and $1,320,000 at December 31, 2006, or 22% and 58% of total inventory, respectively. The Company's means of expansion and development of product has been largely from acquisition of businesses, product lines, existing inventory, and the rights to specific products. Through such acquisitions, the Company has acquired substantial inventory, some of which the eventual use and recoverability was uncertain. On December 31, 2007, the Company disposed of $1,076,000 in obsolete inventory, which had been previously reserved. On a quarterly basis, the Company attempts to identify inventory items that have shown relatively no movement or very slow movement. Generally, if an item has shown little or no movement for over a year, it is determined not to be recoverable and a reserve is established for that item. In addition, if the Company identifies products that have become obsolete due to product upgrades or enhancements, a reserve is established for such products. The Company intends to make efforts to sell these items at significantly discounted prices. If items are sold, the cash received would be recorded as revenue, but there would be no cost of sales on such items due to the reserve that has been recorded. At the time of sale, the inventory would be reduced for the item sold and the corresponding inventory reserve would also be reduced. At this time, the Company's Photon(TM) Laser Ocular Surgery Workstation requires regulatory FDA approval in order to be sold in the United States. Any possible future efforts to complete the clinical trials on the Photon(TM) in order to file for FDA approval would depend on the Company obtaining adequate funding. The Company estimates that the funds needed to complete the clinical trials in order to obtain the necessary regulatory approval on the Photon(TM) to be approximately $225,000. Effect of Inflation and Foreign Currency Exchange The Company has not realized a reduction in the selling price of its products as a result of domestic inflation. Nor has it experienced unfavorable profit reductions due to currency exchange fluctuations or inflation with its foreign customers. All sales transactions to date have been denominated in U.S. Dollars. The Company has experienced a higher cost for equipment manufactured for the Company by Tinsley in England due to the exchange rate value of the pound sterling. Impact of New Accounting Pronouncements In February 2006, the FASB issued SFAS No. 155, Accounting for Certain Hybrid Financial Instruments. This statement is an amendment of FASB Statements Nos. 133 and 140 to address what had been characterized as a temporary exemption from the application of the bifurcation

requirements of Statement No. 133 to beneficial interests in securitized financial assets. Prior to the effective date of Statement No. 133, the FASB received inquiries on the application of the exception in paragraph 14 of Statement No. 133 to beneficial interests in securitized financial assets. In response to the inquiries, Implementation Issue D1 indicated that, pending issuance of further guidance, entities may continue to apply the guidance related to accounting for beneficial interests in paragraphs 14 and 362 of Statement No. 140. Those paragraphs indicate that any security that can be contractually prepaid or otherwise settled in such a way that the holder of the security would not recover substantially all of his recorded investment should be subsequently measured like investments in debt securities classified as available-for-sale or trading under FASB Statement No. 115, Accounting for Certain Investments in Debt and Equity Securities, and may not be classified as held-to-maturity. Further, Implementation Issue D1 indicated that holders of beneficial interests in securitized financial assets that are not subject to paragraphs 14 and 362 of Statement No. 140 are not required to apply Statement No. 133 to those beneficial interests until further guidance is issued. The Company believes the adoption of new standards will not have a material effect on its financial position, results of operations, cash flows, or previously issued financial reports. 37 In March 2006, the FASB issued SFAS No. 156, Accounting for Servicing of Financial Assets ("SFAS 156"). SFAS 156 amends FASB Statement No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities, with respect to the accounting for separately recognized servicing assets and servicing liabilities. In SFAS 156 the board decided to broaden the scope of the project to include all servicing assets and servicing liabilities. Servicing assets and servicing liabilities may be subject to significant interest rate and prepayment risks, and many entities use financial instruments to mitigate those risks. Currently, servicing assets and servicing liabilities are amortized over the expected period of estimated net servicing income or loss and assessed for impairment or increased obligation at each reporting date. The board acknowledged that the application of the lower of carrying amount or fair value measurement attribute to servicing assets results in asymmetrical recognition of economic events, because it requires recognition of all decreases in fair value but limits recognition of increases in fair value to the original carrying amount. SFAS 156 requires that all separately recognized servicing assets and servicing liabilities be initially measured at fair value, if practicable. The board concluded that fair value is the most relevant measurement attribute for the initial recognition of all servicing assets and servicing liabilities, because it represents the best measure of future cash flows. SFAS 156 permits, but does not require, the subsequent measurement of servicing assets and servicing liabilities at fair value. An entity that uses derivative instruments to mitigate the risks inherent in servicing assets and servicing liabilities is required to account for those derivative instruments at fair value. Under SFAS 156, an entity can elect subsequent fair value measurement of its servicing assets and servicing liabilities by class, thus simplifying its accounting and providing for income statement recognition of the potential offsetting changes in fair value of the servicing assets, servicing liabilities, and related derivative instruments. An entity that elects to subsequently measure servicing assets and servicing liabilities at fair value is expected to recognize declines in fair value of the servicing assets and servicing liabilities more consistently than by reporting other-than-temporary impairments. The Company believes the adoption of new standards will not have a material effect on its financial position, results of operations, cash flows, or previously issued financial reports. In September 2006, the FASB issued SFAS No. 158, Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans, an amendment of FASB Statements No. 87, 88, 106, and 132(R) ("SFAS 158"). Under SFAS 158, companies must recognize a net liability or asset to report the funded status of their defined benefit pension and other postretirement benefit plans on their balance sheets. The effective date of the recognition and disclosure provisions for calendar-year public companies is for calendar years ending after December 15, 2006. The Company is currently evaluating the impact of this new standard but it is not expected to have a significant effect on the Company's consolidated financial statements. In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements ("SFAS 157"). SFAS 157 defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. SFAS 157 will be applied prospectively and is effective for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. SFAS 157 is not expected to have a material impact on the Company's consolidated 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 159"). SFAS 159 permits companies to choose to measure many financial instruments and certain other items at fair value that are not currently required to be measured at fair value, and establishes presentation and disclosure requirements designed to facilitate comparisons between companies that choose different measurement attributes for similar types of assets and liabilities. SFAS 159 is effective on January 1, 2008, and is not expected to have a material effect on the Company's consolidated financial statements. In December 2007, the FASB issued SFAS No. 141(R), Business Combinations ("SFAS 141R"). SFAS 141R establishes the principles and requirements for how an acquirer recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, any noncontrolling interest in the acquiree, and the goodwill acquired. SFAS 141R also establishes disclosure requirements to enable the evaluation of the nature and financial effects of the business combination. SFAS 141R is effective on January 1, 2009, and is not expected to have a material effect on the Company's consolidated financial statements. In December 2007, the FASB issued SFAS No. 160, Noncontrolling Interests in Consolidated Financial Statements, an amendment of ARB No. 51 ("SFAS 160"). SFAS 160 will change the accounting and reporting for minority interests, which will be recharacterized as noncontrolling interests and classified as a component of equity. This new consolidation method will significantly change the accounting for transactions with minority interest holders. SFAS 160 is effective on January 1, 2009, and is not expected to have a material effect on the Company's consolidated financial statements. 38 Item 7. Financial Statements PARADIGM MEDICAL INDUSTRIES, INC. FINANCIAL STATEMENTS DECEMBER 31, 2007 AND 2006 P A R A D I G M M E D I C A L I N D U S T R I E S , I N C . I N D E X T O F I N A N C I A L S T A T E M E N T S
 F-1 REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM THE BOARD OF DIRECTORS AND SHAREHOLDERS PARADIGM MEDICAL INDUSTRIES, INC. SALT LAKE CITY, UTAH We have audited the accompanying balance sheet of PARADIGM MEDICAL INDUSTRIES, INC. (the Company) as of December 31, 2007, and the related statements of operations, stockholders' deficit and cash flows for the years ended December 31, 2007 and 2006. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with the standards of the PCAOB (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material

misstatement. The Company is not required to have, nor were we engaged to perform, audits of its internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion. In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Paradigm Medical Industries, Inc. as of December 31, 2007, and the results of their operations and their cash flows for the years ended December 31, 2007 and 2006, in conformity with accounting principles generally accepted in the United States of America. The accompanying financial statements have been prepared assuming the Company will continue as a going concern. As discussed in Note 2 to the financial statements, the Company has a working capital deficit and has suffered recurring operating losses, which raises substantial doubt about its ability to continue as a going concern. Management's plans in regard to these matters are also described in Note 2. The financial statements do not include any adjustments that might result from the outcome of these uncertainties. Chisholm, Bierwolf & Nilson LLC Bountiful, Utah April 21, 2008 --- F-2 PARADIGM MEDICAL INDUSTRIES, INC. BALANCE SHEET DECEMBER 31, 2007 --- ASSETS Current assets: Cash $ 321,000 Receivables, net 624,000 Inventories, net 847,000 Prepaid and other assets 27,000 --------------- Total current assets 1,819,000 Property and equipment, net 16,000 Goodwill 339,000 --------------- Total assets $ 2,174,000 =============== LIABILITIES AND STOCKHOLDERS' (DEFICIT) Current liabilities: Accounts payable $ 370,000 Related party payable 46,000 Accrued liabilities 644,000 --------------- Total current liabilities 1,060,000 --------------- Convertible notes payable, net of debt discount of $889,000 3,039,000 Derivative liabilities 215,000 --------------- Total long-term liabilities 3,254,000 =============== Total liabilities 4,314,000 Commitments and contingencies - Stockholders' (Deficit): Preferred stock, $.001 par value, 5,000,000 shares authorized, 612,497 shares issued and outstanding (aggregate liquidation preference of $456,000) 1,000 Common stock, $.001 par value, 800,000,000 shares authorized, 544,986,907 shares issued and outstanding 545,000 Additional paid-in capital 58,435,000 Accumulated deficit (61,121,000) --------------- Total stockholders' (Deficit) (2,140,000) --------------- Total liabilities and stockholders' (Deficit) $ 2,174,000 =============== The accompanying notes are an integral part of these financial statements --- F-3 PARADIGM MEDICAL INDUSTRIES, INC. STATEMENTS OF OPERATIONS YEARS ENDED DECEMBER 31, -- 2007 2006 (RESTATED) Sales $ 1,872,000 $ 2,195,000 Cost of sales 1,020,000 1,277,000 ----------------- ----------------- Gross profit 852,000 918,000 ----------------- ----------------- Operating expenses: General and administrative (1,012,000) (793,000) Professional fees-related party - (187,000) Marketing and selling (662,000) (434,000) Research and development (344,000) (250,000) Gain on settlement of liabilities 91,000 34,000 ----------------- ----------------- Total operating expenses (1,927,000) (1,630,000) ----------------- ----------------- Operating loss (1,075,000) (712,000) ----------------- ----------------- Other income (expense): Other income - 109,000 Interest expense - Accretion of debt discount (864,000) (952,000) Interest income 11,000 - Interest expense (221,000) (214,000) Gain on derivative valuation 418,000 570,000 - - ----------------- ----------------- Total other income (expense) (656,000) (487,000) ----------------- ----------------- Income (loss) before provision for income taxes (1,731,000) (1,199,000) Provision for income taxes - - ----------------- ----------------- Net (loss) $ (1,731,000) $ (1,199,000) ================= ================= Earnings (loss) per common share - basic $ (0.01) $ (0.01) ----------------- ----------------- Earnings (loss) per common share - diluted $ (0.01) $ (0.01) ----------------- ----------------- Weighted average common shares - basic 264,736,000 175,034,000 ----------------- ----------------- Weighted average common shares - diluted 264,736,000 175,034,000 ================= ================= The accompanying notes are an integral part of these financial statements -- F-4 PARADIGM MEDICAL INDUSTRIES, INC. NOTES TO FINANCIAL STATEMENTS CONTINUED --- STATEMENTS OF STOCKHOLDERS' EQUITY FOR THE PERIOD JANUARY 1, 2006 THROUGH DECEMBER 31, 2007 --- PREFERRED ADDITIONAL STOCK COMMONS PAID-IN ACCUMULATED (SEE NOTE 8) SHARES AMOUNT CAPITAL DEFICIT --- BALANCE AT JANUARY 1, 2006 (RESTATED) 1,000 96,389,295 96,000 58,086,000 (58,191,000) Issuance of common stock for: Stock option valuation - - - 23,000 - Conversion of convertible debentures - 105,529,700 106,000 275,000 - Conversion of preferred stock - 39,999 - - - Net loss - - - - (1,199,000) --- BALANCE AT DECEMBER 31, 2006 (RESTATED) 1,000 201,958,994 202,000 58,384,000 (59,390,000) Issuance of common stock for: Stock option valuation - - - 14,000 - Conversion of convertible debentures - 343,017,246 343,000 37,000 - Conversion of preferred stock - 10,667 - - - Net loss - - - - (1,731,000) --- BALANCE AT DECEMBER 31, 2007 1,000 544,986,907 545,000 58,435,000 (61,121,000) === The accompanying notes are an integral part of these financial statements --- F-5 PARADIGM MEDICAL INDUSTRIES, INC. NOTES TO FINANCIAL STATEMENTS CONTINUED -- STATEMENTS OF CASH FLOWS YEARS ENDED DECEMBER 31, -- 2007 2006 CASH FLOWS FROM OPERATING ACTIVITIES: Net income (loss) $ (1,731,000) $ (1,199,000) Adjustments to reconcile net income (loss) to net cash used in operating activities: Depreciation and amortization 5,000 31,000 Stock option valuation 14,000 23,000 Change in fair value of derivative liabilities (418,000) (570,000) Accretion of debt discount 865,000 952,000 Provision for losses on receivables 56,000 (28,000) Provision for losses on inventory - (36,000) (Gain) loss on settlement of liabilities (91,000) (34,000) (Increase) decrease in: Accounts Receivables (251,000) 19,000 Inventories 98,000 (55,000) Prepaid and other assets (16,000) - Increase (decrease) in: Accounts payable 17,000 (30,000) Accrued liabilities 317,000 99,000 ------------ ------------ NET CASH USED IN OPERATING ACTIVITIES (1,135,000) (828,000) ------------ ------------ CASH FLOWS FROM INVESTING ACTIVITIES: Acquisition of property and equipment - (20,000) ------------ ------------ NET CASH PROVIDED BY (USED IN) INVESTING ACTIVITIES - (20,000) ------------ ------------ CASH FLOWS FROM FINANCING ACTIVITIES: Principal payments on notes payable and long-term debt - (12,000) Proceeds from issuance of convertible notes 1,250,000 1,000,000 ------------ ------------ NET CASH (USED IN) PROVIDED BY FINANCING ACTIVITIES 1,250,000 988,000 ------------ ------------ Net change in cash 115,000 140,000 Cash, beginning of year 206,000 66,000 ------------ ------------ CASH, END OF YEAR $ 321,000 $ 206,000 ============ ============ The accompanying notes are an integral part of these financial statements -- F-6 PARADIGM MEDICAL INDUSTRIES, INC. NOTES TO FINANCIAL STATEMENTS CONTINUED -- DECEMBER 31, 2007 AND 2006 -- 1. ORGANIZATION ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES Paradigm Medical Industries, Inc.(the Company) is a Delaware Corporation incorporated in October 1989. The Company is engaged in the design, development, manufacture, and sale of high technology surgical and diagnostic eye care products. Its surgical equipment is designed to perform minimally invasive cataract surgery and is comprised of surgical devices and related instruments and accessories, including disposable products. Its diagnostic products include a Blood Flow Analyzer, a pachymeter, an A/B Scan, ultrasound biomicroscopes, perimeters, and a corneal topographer. FAIR VALUE OF FINANCIAL INSTRUMENTS The fair value of the Company's cash and cash equivalents, receivables, accounts payable and accrued liabilities approximate carrying value based on their effective interest rates compared to current market prices. CASH EQUIVALENTS For purposes of the statement of cash flows, cash includes all cash and investments with original maturities to the Company of three months or less. The Company maintains its cash in bank deposit accounts which, at times, may exceed federally insured limits. The Company has not experienced any losses in such accounts and believes it is not exposed to any significant credit risk on cash and cash equivalents. The Company's financial instruments consist of cash, receivables, payables, and notes payable. The carrying amount of cash, receivables and payables approximates fair value because of the short-term nature of these items. The carrying amount of the notes payable approximates fair value as the individual borrowings bear interest at market interest rates. ACCOUNTS RECEIVABLE Accounts receivable are carried at original invoice amount less an estimate made for doubtful receivables based on a review of all outstanding amounts on a monthly basis. Specific reserves are estimated by management based on certain assumptions and variables, including the customer's financial condition, age of the customer's receivables, and changes in payment histories. Trade receivables are written off when deemed uncollectible. -- F-7 PARADIGM MEDICAL INDUSTRIES, INC. NOTES TO FINANCIAL STATEMENTS CONTINUED -- 1. ORGANIZATION Recoveries of trade receivables previously written off AND SIGNIFICANT are recorded when received. A trade receivable is ACCOUNTING POLICIES considered to be past due if any portion of the CONTINUED receivable balance has not been received by the contractual pay date. Interest is not charge on trade receivables that are past due. ALLOWANCE FOR DOUBTFUL ACCOUNTS: The Company records an allowance for doubtful accounts to offset estimated uncollectible accounts receivable. Bad debt expense associated with the increases in the allowance for doubtful accounts is recorded as part of general and administrative expense. The Company's accounting policy generally is to record an allowance for receivables over 90 days past due unless there is significant evidence to support that the receivable is collectible. Also during 2007, the Company collected $22,000 in receivables that were previously allowed in the allowance for doubtful accounts. During 2007, the Company increased net allowance for doubtful accounts by $56,000. The Company has taken measures to reduce the amount of uncollectible accounts receivable such as more thorough and stringent credit approval, improved training and instruction by sales personnel, and frequent direct communication with the customer subsequent to delivery of the system. The allowance for doubtful accounts was15% of total outstanding receivables as of December 31, 2007 and 15% as of December 31, 2006. The allowance for doubtful accounts increased from $72,000 at December 31, 2006 to $109,000 at December 31, 2007. INVENTORIES Inventories are stated at the lower of cost or market, cost is determined using the weighted average method. PROPERTY AND EQUIPMENT Property and equipment are recorded at cost, less accumulated depreciation. Depreciation on property and equipment is determined using the straight-line method over the estimated useful lives of the assets or terms of the lease, usually between 3-7 years. Expenditures for maintenance and repairs are expensed when incurred and betterments are capitalized. -- F-8 PARADIGM MEDICAL INDUSTRIES, INC. NOTES TO FINANCIAL STATEMENTS CONTINUED -- 1. ORGANIZATION PROPERTY AND EQUIPMENT AND SIGNIFICANT Gains and losses on sale of property and equipment are ACCOUNTING POLICIES reflected in operations. Leasehold improvements are CONTINUED depreciated over the lesser of the term of the lease or the useful life of the related asset. During the years 2007 and 2006 depreciation expense was $5,000 and $30,000 respectively. Newly acquired assets that have a value of $3,000 or more are capitalized and included on the depreciation schedule. GOODWILL As of December 31, 2007, the Company had recorded on their books goodwill related to the purchase of Ocular Blood Flow, Ltd., during 2001. In accordance with SFAS 142, "Goodwill and Other Intangible Assets, goodwill is not amortized. The Company performs tests for impairment of goodwill annually or more frequently if events or circumstances indicate it might be impaired. Such tests include comparing the fair value of a reporting unit with its carrying value, including goodwill. The analysis of the impairment test of goodwill did not result in a charge to the statements of operations for impairment for the years ended December 31, 2007 and 2006, respectively. Impairment assessments are performed using a variety of methodologies, including cash flow analysis and estimates of sales proceeds. Where applicable, an appropriate discount rate is used, based on the Company's cost of capital rate or location-specific economic factors. EVALUATION OF OTHER LONG-LIVED ASSETS The Company evaluates the carrying value of the unamortized balances of other long-lived assets to determine whether any impairment of these assets has occurred or whether any revision to the related amortization periods should be made. This evaluation is based on management's projections of the undiscounted future cash flows associated with each asset. If management's evaluation were to indicate that the carrying values of these assets were impaired, such impairment would be recognized by a write down of the applicable asset. -- F-9 PARADIGM MEDICAL INDUSTRIES, INC. NOTES TO FINANCIAL STATEMENTS CONTINUED -- 1. ORGANIZATION INCOME TAXES AND SIGNIFICANT Deferred income taxes are provided in amounts ACCOUNTING POLICIES sufficient to give effect to temporary differences CONTINUED between financial and tax reporting, principally related to net operating loss carryforwards, depreciation, impairment of intangible assets, stock compensation expense, and accrued liabilities. STOCK - BASED COMPENSATION On January 1, 2006, the Company adopted SFAS No. 123 (revised 2004), SHARE-BASED PAYMENT, ("SFAS 123(R)") which establishes standards for the accounting of transactions in which an entity exchanges its equity instruments for goods or services, primarily focusing on accounting for transactions where an entity obtains employee services in share-based payment transactions. SFAS 123(R) requires a public entity to measure the cost of employee services received in exchange for an award of equity instruments, including stock options, based on the grant-date fair value of the award and to recognize it as compensation expense over the period the employee is required to provide service in exchange for the award, usually the vesting period. In March 2005, the SEC issued Staff Accounting Bulletin No. 107 ("SAB 107") relating to SFAS 123(R). The Company has applied the provisions of SAB 107 in its adoption of SFAS 123(R). Stock-based compensation expense recognized during the period is based on the value of the portion of share-based payment awards that is ultimately expected to vest during the period. Stock-based compensation expense recognized in the Company's consolidated statement of operations for the year ended December 31, 2007 included compensation expense for the share-based payment awards granted based on the grant date fair value estimated in accordance with the provisions of SFAS 123(R). Stock based compensation expense for the years ended December 31, 2007 and 2006 was $14,000 and $23,000, respectively. EARNINGS PER SHARE The computation of diluted earnings per common share is based on the weighted average number of shares outstanding during the year plus the common stock equivalents, which would arise from the conversion of preferred stock to common stock, the conversion of the Company's convertible debentures, and from the exercise of stock options and warrants outstanding using the treasury stock method and the average market price per share during the year. Shares potentially issuable from the conversion of convertible debentures and preferred stock conversion of 3,637,280,000 and 862,438 shares of common stock, respectively, as well as, options and warrants to purchase 65,534,392 shares of common of common stock were considered in the computation of earnings per share but were not included because their inclusion would have been anti-dilutive. -- F-10 PARADIGM MEDICAL INDUSTRIES, INC. NOTES TO FINANCIAL STATEMENTS CONTINUED -- 1. ORGANIZATION The following table is a reconciliation of basic AND SIGNIFICANT earnings per share for the years ended December 31, ACCOUNTING POLICIES 2007 and 2006. CONTINUED YEARS ENDED DECEMBER 31, ------------------------- 2007 2006 ------------------------- Basic weighted average shares outstanding 264,736,000 175,034,000 Net loss (1,731,000) (1,199,000) Per share amount (0.01) (0.01) ========================= REVENUE RECOGNITION Revenues for sales of products that require specific installation and acceptance by the customer are recognized upon such installation and acceptance by the customer. Revenues for sales of other surgical systems, ultrasound diagnostic devices, and disposable products are recognized when the product is shipped. A signed purchase agreement and a deposit or payment in full from customers is required before a product leaves the premises. Title passes at time of shipment (F.O.B. shipping point). The products of the Company contain both hardware and software components. The Company does not recognize revenue for the software components of the products separate from the product as a whole because the software is incidental to the product, as defined in paragraph 2 of SOP 97-2. RESEARCH AND DEVELOPMENT Costs incurred in connection with research and development activities are expensed as incurred. These costs consist of direct and indirect costs associated with specific projects as well as fees paid to various entities that perform certain research on behalf of the Company. The total research and development expenses for the years ended December 2007 and 2006 was $344,000 and $250,000, respectively. -- F-11 PARADIGM MEDICAL INDUSTRIES, INC. NOTES TO FINANCIAL STATEMENTS CONTINUED -- 1. ORGANIZATION CONCENTRATION OF RISK AND SIGNIFICANT The market for ophthalmic lasers is subject to rapid ACCOUNTING POLICIES technological change, including advances in laser and CONTINUED other technologies and the potential development of alternative surgical techniques or new pharmaceutical products. Development by others of new or improved products, processes or technologies may make products developed by the Company obsolete or less competitive. The Company's high technology product line requires the Company to deal with suppliers and subcontractors supplying highly specialized parts, operating highly sophisticated and narrow tolerance equipment and performing highly technical calculations and tasks. Although there are a limited number of suppliers and manufacturers that meet the standards required of a regulated medical device, management believes that other suppliers and manufacturers could provide similar components and services. A significant portion of the Company's product sales is in foreign countries. The economic and political instability of some foreign countries may affect the ability of medical personnel to purchase the Company's products and the ability of the customers to pay for the procedures for which the Company's products are used. Such circumstances could cause a possible loss of sales, which would affect operating results adversely. During the year ended December 31, 2007 and 2006 one single customer, Grafton Optical Company Ltd. in the United Kingdom, represented more than 10% of total net sales for the years ended. Accounts receivable are due from medical distributors, surgery centers, hospitals, optometrists and ophthalmologists located throughout the U.S. and a number of foreign countries. The receivables are generally due within thirty days for domestic customers with extended terms offered for some international customers. The Company maintains an allowance for estimated potentially uncollectible amounts. WARRANTY The Company provides product warranties on the sale of certain products that generally extend for one year from the date of sale. The Company maintains a reserve for estimated warranty costs based on historical experience and management's best estimates. -- F-12 PARADIGM MEDICAL INDUSTRIES, INC. NOTES TO FINANCIAL STATEMENTS CONTINUED -- 1. ORGANIZATION AND SIGNIFICANT WARRANTY ACCRUALS ACCOUNTING POLICIES YEARS ENDED DECEMBER 31, CONTINUED ------------------------- 2007 2006 ------------------------- Beginning warranty liability balance 155,000 125,000 Less: Reductions for payments (20,000) (10,000) Plus: Increase for accrual 92,000 40,000 ------------------------- Ending warranty liability balance 227,000 155,000 ========================= USE OF ESTIMATES IN THE PREPARATION OF FINANCIAL STATEMENTS The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. RECLASSIFICATIONS No amounts in the 2007 financial statements have been reclassified to conform to the presentation of the current year financial statements. CONTINGENCIES The Company has adopted the guidance in Statement of Financial Accounting Standards No. 5, "Accounting for Contingencies," when booking for loss contingencies. The Company accrues a charge to income when (1) information available prior to issuance of the financial statements indicates that it is probable that an asset has been impaired or a liability has been incurred at the date of the financial statements, and (2) the amount of loss can be reasonably estimated. Loss contingencies related to litigation for the year ended December 31, 2007 were $255,000. BENEFICIAL CONVERSION FEATURE The Company has debt with conversion options that provide for a rate of conversion that is below the market value. This feature is normally characterized -- F-13 PARADIGM MEDICAL INDUSTRIES, INC. NOTES TO FINANCIAL STATEMENTS CONTINUED -- 1. ORGANIZATION as a beneficial conversion feature ("BCF"), which is AND SIGNIFICANT recorded by the Company pursuant to Emerging Issues ACCOUNTING POLICIES Task Force ("EITF") Issue No. 98-5 ("EITF 98-05"), CONTINUED accounting for Convertible Securities with beneficial conversion features of Contingently Adjustable Conversion Ratios, and EITF Issue No. 00-27, Application of EITF Issued No. 98-05 to Certain Convertible Instruments. If a BCF exists, the Company records it as a debt discount. Debt discounts are amortized to interest expense over the life of the debt on a straight-line basis, which approximates the effective interest method. DERIVATIVE FINANCIAL INSTRUMENTS The Company's derivative financial instruments consist of embedded derivatives related to the Callable Secure Convertible Term Notes ("the Notes") entered into agreements on April 27, 2005; June 23, 2005; June 30, 2005; February 28, 2006; June 28, 2006; April 30, 2007; June11, 2007; December 24, 2007; and December 31, 2007. These Notes included certain fixed conversion features, the variable conversion features, and variable interest featureand partial call option. Based on the complex nature of these terms the Company chose to employ a binomial lattice model to value these features. The Company used the lattice model because it allows for the consideration of the dynamic and interrelated nature of the unique terms of these securities. It takes into consideration that in each discrete period of time a stock can either go up or down (described as its "volatility") and produces a rande of potential future stock prices. A binomial lattice model assumes the price of the stock underlying the derivative follows one of the two price paths. There are three general steps in constructing a binomial lattice model: (1) calculation of the stock price lattice, (2) calculation of the potentially applicable option values at each node based on the terms and conditions of the specific security, and (3) progressively calculating the security value at each node starting at the maturity of the security and working back to the present testing for the greater of the current period value or the probability weighted holding value of the security. The following assumptions were used to calculated the fair values of the embedded derivatives: dividend yield of 0% ; annual volatility of 200%; and risk free interest rate equal to that of the interest rate of a U.S. treasury note with a maturity equal to the maturity of the security in question, as well as probability analysis related to trading volume restrictions and other factors. -- F-14 PARADIGM MEDICAL INDUSTRIES, INC. NOTES TO FINANCIAL STATEMENTS CONTINUED -- The accounting treatment of derivative instruments requires that the Company record the derivatives and related warrants at their fair values as of the inception date of the agreement and at a fair value of each subsequent balance sheet date. In addition, under the provisions of SFAS No. 133, "ACCOUNTING FOR DERIVATIVE INSTRUMENTS AND HEDGING ACTIVITIES", as a result of entering into the Notes, the Company is required to classify all other non-employee stock options and warrants as derivative liabilities and mark them to market at each reporting date. Any change in the fair value will be recorded as non-operating, non-cash income or expense at each reporting date. If the fair value of the derivatives is lower at the subsequent balance sheet date, the Company will record a non-operating, non-cash income. 2. GOING CONCERN The accompanying financial statements have been prepared on a going concern basis, which contemplates the realization of assets and the satisfaction of liabilities in the normal course of business. Historically, the Company has not demonstrated the ability to generate sufficient cash flows from operations to satisfy its liabilities and sustain operations, and the Company has incurred significant losses from operations. These factors raise substantial doubt about the Company's ability to continue as a going concern. 3. DETAIL OF CERTAIN Receivables BALANCE SHEET Trade Receivables $ 733,000 ACCOUNTS Allowance for doubtful accounts (109,000) ------------- $ 624,000 ============= Inventories: Raw Materials $ 558,000 Finished goods 533,000 Reserve for obsolescence (244,000) ------------- $ 847,000 ============= Accrued liabilities: Consulting and litigation reserve $ 283,000 Payroll and employment benefits 64,000 Sales tax payable 20,000 Customer deposits 20,000 Accrued royalties 3,000 Warranty and return allowance 227,000 Other accrued expenses 27,000 ------------- $ 644,000 ============= -- F-15 PARADIGM MEDICAL INDUSTRIES, INC. NOTES TO FINANCIAL STATEMENTS CONTINUED -- 4. PROPERTY AND Property and equipment consists of the following: EQUIPMENT Machinery and equipment $ 765,000 Computer equipment and software 663,000 Furniture and fixtures 252,000 Leasehold improvements 166,000 ------------ 1,846,000 Accumulated depreciation and amortization (1,830,000) ------------ $ 16,000 ============ 5. LEASE OBLIGATIONS During the years ended December 31, 2007 and 2006, the Company did not lease equipment under noncancellable capital leases. Any leases previously issued provided the Company the option to purchase the leased assets at the end of the initial lease term. Assets under capital leases included in fixed assets and are as follows: Computer and other equipment $ 291,000 Less accumulated amortization (291,000) ------------ $ - ============ -- F-16 PARADIGM MEDICAL INDUSTRIES, INC. NOTES TO FINANCIAL STATEMENTS CONTINUED -- 5. LEASE OBLIGATIONS Amortization expense on assets under capital leases CONTINUED during the years ended December 31, 2007 and 2006 was $5,000 and $31,000, respectively. The Company leases office and warehouse space under an operating lease agreement. Future minimum rental payments under the noncancellable operating lease as of December 31, 2007 are approximately as follows: YEAR ENDING DECEMBER 31, AMOUNT ------------ 2007 $ 108,000 2008 110,000 ------------ Total future minimum rental payments $ 218,000 ============ Rent expense related to noncancelable operating leases was approximately $108,000 and $108,000 for the years ended December 31, 2007 and 2006, respectively. 6. INCOME TAXES INCOME TAXES The provision for income taxes is different than amounts which would be provided by applying the statutory federal income tax rate to loss before provision for income taxes for the following reasons: YEARS ENDED DECEMBER 31, ------------------------- 2007 2006 ------------------------- Income tax (provision) benefit at statutory rate $ 588,000 $ 619,000 NOL adjustment - Taxable temporary differences (16,700) 22,000 Deductible temporary differences 74,000 (38,000) Non-deductible expenses (151,600) (172,000)

Change in valuation allowance (793,700) (252,000) -------------------------- $ - $ - ========================== -- F-17 PARADIGM MEDICAL INDUSTRIES, INC. NOTES TO FINANCIAL STATEMENTS CONTINUED -- 6. INCOME TAXES Deferred tax assets (liabilities) are comprised of the CONTINUED following: ------------------------- 2007 2006 ------------------------- Net operating loss carryforward $15,887,700 $14,720,000 Depreciation, amortization, and impairment - - Allowance and reserves 2,065,000 2,439,000 Research and development tax Credit 56,000 56,000 -------------------------- 18,008,700 17,215,000 Valuation allowance (18,008,700) (17,215,000) ------------------------- $ - $ - ========================= A valuation allowance has been established for the net deferred tax asset due to the uncertainty of the Company's ability to realize such asset. At December 31, 2007, the Company had net operating loss carryforwards of approximately $55.8 million and research and development tax credit carryforwards of approximately $55.8 million. These carryforwards are available to offset future taxable income and expire in 2006 through 2021. The utilization of the net operating loss carryforwards is dependent upon the tax laws in effect at the time the net operating loss carryforwards can be utilized. The Tax Reform Act of 1986 significantly limits the annual amount that can be utilized for certain of these carryforwards as a result of the change in ownership. 7. CAPITAL STOCK CAPITAL STOCK The Company has established a series of preferred stock with a total of 5,000,000 authorized shares and a par value of $.001, and one series of common stock with a par value of $.001 and a total of 800,000,000 authorized shares. SERIES A PREFERRED STOCK On September 1, 1993, the Company established a series of non-voting preferred shares designated as the 6% Series A Preferred Stock, consisting of 500,000 shares with $.001 par value. The Series A Preferred Stock has the following rights and privileges: -- F-18 PARADIGM MEDICAL INDUSTRIES, INC. NOTES TO FINANCIAL STATEMENTS CONTINUED -- 7. CAPITAL STOCK 1. The holders of the shares are entitled to CONTINUED dividends at the rate of twenty-four cents ($.24) per share per annum, payable in cash only from surplus earnings of the Company or in additional shares of Series A Preferred Stock. The dividends are non-cumulative and therefore deficiencies in dividend payments from one year are not carried forward to the next year. 2. Upon the liquidation of the Company, the holders of the Series A Preferred Stock are entitled to receive, prior to any distribution of any assets or surplus funds to the holders of shares of common stock or any other stock, an amount equal to $1.00 per share, plus any accrued and unpaid dividends related to the fiscal year in which such liquidation occurs. Total liquidation preference at December 31, 2007 was $6,000. 3. The shares are convertible at the option of the holder at any time into common shares, based on an initial conversion rate of one share of Series A Preferred Stock for 1.2 common shares. 4. The holders of the shares have no voting rights. 5. The Company may, at its option, redeem all of the then outstanding shares of the Series A Preferred Stock at a price of $4.50 per share, plus accrued and unpaid dividends related to the fiscal year in which such redemption occurs. SERIES B PREFERRED STOCK On May 9, 1994, the Company established a series of non-voting preferred shares designated as 12% Series B Preferred Stock, consisting of 500,000 shares with $.001 par value. The Series B Preferred Stock has the following rights and privileges: 1. The holders of the shares are entitled to dividends at the rate of forty-eight cents ($.48) per share per annum, payable in cash only from surplus earnings of the Company or in additional shares of Series B Preferred Stock. The dividends are non-cumulative and therefore deficiencies in dividend payments from one year are not carried forward to the next year. Upon the liquidation of the Company, the holders of the Series B Preferred Stock are entitled to receive, prior to any distribution of any assets or surplus funds to the holders of shares of common stock or any other stock, an amount equal to $4.00 per share, plus -- F-19 PARADIGM MEDICAL INDUSTRIES, INC. NOTES TO FINANCIAL STATEMENTS CONTINUED -- 7. CAPITAL STOCK any accrued and unpaid dividends related to the fiscal CONTINUED year in which such liquidation occurs. Such right, however, is subordinate to the rights of the holders of Series A Preferred Stock to receive a distribution of $1.00 per share plus accrued and unpaid dividends. Total liquidation preference at December 31, 2007 was $36,000. 2. The shares are convertible at the option of the holder at any time into common shares, based on an initial conversion rate of one share of Series B Preferred Stock for 1.2 common shares. 3. The holders of the shares have no voting rights. 4. The Company may, at its option, redeem all of the then outstanding share of the Series B Preferred Stock at a price of $4.50 per share, plus accrued and unpaid dividends related to the fiscal year in which such redemption occurs. SERIES C PREFERRED STOCK In January 1998, the Company authorized the issuance of a total of 30,000 shares of Series C Preferred Stock, $.001 par value, $100 stated value. As of December 31, 2007 there were no Series C Preferred Stock issued and outstanding. The Series C Preferred Stock have the following rights and privileges: 1. The holders of the shares are entitled to dividends at the rate of 12% per share per annum of the aggregate stated value. The dividends are non-cumulative and, therefore, deficiencies in dividend payments from one year are not carried forward to the next year. 2. Upon the liquidation of the Company, the holders of the Series C Preferred Stock are entitled to receive an amount per share equal to the greater of (a) the amount they would have received if they had converted the shares into shares of Common Stock immediately prior to such liquidation plus declared but unpaid dividends; or (b) the stated value, subject to adjustment. 3. Each share was convertible, at the option of the holder at any time until January 1, 2002, into approximately 57.14 shares of common stock at an initial conversion price, subject to adjustments for stock splits, stock dividends and certain combination or recapitalization of the common stock, equal to $1.75 per share of common stock. 4. The holders of the shares have no voting rights. -- F-20 PARADIGM MEDICAL INDUSTRIES, INC. NOTES TO FINANCIAL STATEMENTS CONTINUED -- 7. CAPITAL STOCK SERIES D PREFERRED STOCK CONTINUED In January 1999, the Company's Board of Directors authorized the issuance of a total of 1,140,000 shares of Series D Preferred Stock $.001 par value, $1.75 stated value. The Series D Preferred Stock has the following rights and privileges: 1. The holders of the shares are entitled to dividends at the rate of 10% per share per annum of the aggregate stated value. The dividends are non-cumulative and, therefore, deficiencies in dividend payments from one year are not carried forward to the next year. 2. Upon the liquidation of the Company, the holders of the Series D Preferred Stock are entitled to receive an amount per share equal to the greater of (a) the amount they would have received had they converted the shares into Common Stock immediately prior to such liquidation plus all declared but unpaid dividends; or (b) the stated value, subject to adjustment. Total liquidation preference at December 31, 2007 was $9,000. 3. Each share was convertible, at the option of the holder at any time until January 1, 2002, into one share of Common Stock at an initial conversion price, subject to adjustment. The Series D Preferred Stock shall be converted into one share of the Common Stock subject to adjustment (a) on January 1, 2002 or (b) upon 30 days written notice by the

Company to the holders of the Shares, at any time after (i) the 30-day anniversary of the registration statement on which the shares of Common Stock issuable upon conversion of the Series D Preferred Stock were registered and (ii) the average closing price of the Common Stock for the 20-day period immediately prior to the date on which notice of redemption is given by the Company to the holders of the Series D Preferred Stock is at least $3.50 per share. The Company in 1999 recorded $872,000 as a beneficial conversion feature related to the differences in the conversion price of the preferred stock to common stock. 4. The holders of the shares have no voting rights. -- F-21 PARADIGM MEDICAL INDUSTRIES, INC. NOTES TO FINANCIAL STATEMENTS CONTINUED -- 7. CAPITAL STOCK SERIES E PREFERRED STOCK CONTINUED In May 2001, the Company authorized the issuance of a total of 50,000 shares of Series E Preferred Stock $.001 par value, $100 stated value. The Series E Preferred Stock has the following rights And privileges: 1. The holders of the shares are entitled to dividends at the rate of 8% per share per annum of the aggregate stated value. The dividends are non-cumulative and, therefore, deficiencies in dividend payments from one year are not carried forward to the next year. 2. Upon the liquidation of the Company, the holders of the Series E Preferred Stock are entitled to receive an amount per share equal to the greater of (a) the amount they would have received had they converted the shares into Common Stock immediately prior to such liquidation plus all declared but unpaid dividends; or (b) the stated value, subject to adjustment. Total liquidation preference at December 31, 2007 was $13,000. 3. Each share is convertible, at the option of the holder at any time until January 1, 2005, into approximately 53.33 shares of Common Stock at an initial conversion price, subject to adjustment for stock splits, stock dividends and certain combination or recapitalization of the common stock, equal to $1.875 per share of common stock. The Series E Preferred Stock shall be converted into Common Stock subject to adjustment (a) on January 1, 2005 or (b) upon 30 days written notice by the Company to the holders of the Shares, at any time after (i) the 30-day anniversary of the registration statement on which the shares of Common Stock issuable upon conversion of the Series E Preferred Stock were registered and (ii) the average closing price of the Common Stock for the 20-day period immediately prior to the date on which notice of redemption is given by the Company to the holders of the Series E Preferred Stock is at least $3.50 per share. The Company in 2001 recorded $1,482,000 as a beneficial conversion feature related to the differences in the conversion price of the preferred stock to common stock. 4. The holders of the shares have no voting rights. 5. The holders of the shares also were issued warrants to purchase shares of common stock equal to 1,000 warrants for every 200 shares purchased at an exercise price of $4.00 per share. Each warrant is exercisable until May 23, 2006. -- F-22 PARADIGM MEDICAL INDUSTRIES, INC. NOTES TO FINANCIAL STATEMENTS CONTINUED -- 7. CAPITAL STOCK SERIES F PREFERRED STOCK CONTINUED In August 2001, the Company authorized the issuance of a total of 50,000 shares of Series F Preferred Stock $.001 par value, $100 stated value. The Series F Preferred Stock has the following rights and privileges: 1. The holders of the shares are entitled to dividends at the rate of 8% per share per annum of the aggregate stated value. The dividends are non-cumulative and, therefore, deficiencies in dividend payments from one year are not carried forward to the next year. 2. Upon the liquidation of the Company, the holders of the Series F Preferred Stock are entitled to receive an amount per share equal to the greater of (a) the amount they would have received had they converted the shares into Common Stock immediately prior to such liquidation plus all declared but unpaid dividends; or (b) the stated value, subject to adjustment. Total liquidation preference at December 31, 2007 was $235,000. 3. Each share is convertible, at the option of the holder at any time until January 1, 2005, into approximately 53.33 shares of Common Stock at an initial conversion price, subject to adjustment for stock splits, stock dividends and certain combination or recapitalization of the common stock, equal to $1.875 per share of common stock. The Series F Preferred Stock shall be converted into Common Stock subject to adjustment (a) on January 1, 2005 or (b) upon 30 days written notice by the Company to the holders of the Shares, at any time after (i) the 30-day anniversary of the registration statement on which the shares of Common Stock issuable upon conversion of the Series F Preferred Stock were registered and (ii) the average closing price of the Common Stock for the 20-day period immediately prior to the date on which notice of redemption is given by the Company to the holders of the Series F Preferred Stock is at least $3.50 per share. The Company in 2001 recorded $1,105,000 as a beneficial conversion feature related to the differences in the conversion price of the preferred stock to common stock. -- F-23 PARADIGM MEDICAL INDUSTRIES, INC. NOTES TO FINANCIAL STATEMENTS CONTINUED -- 4. The holders of the shares have no voting rights. 7. CAPITAL STOCK SERIES G PREFERRED STOCK CONTINUED In August 2003, the Company authorized the issuance of a total of 2,000,000 shares of Series G Preferred Stock $.001 par value, $1.00 stated value. The Series G Preferred Stock has the following rights and privileges: 1. The holders of the shares are entitled to dividends at the rate of 7% per share per annum of the aggregate stated value. The dividends are non-cumulative and, therefore, deficiencies in dividend payments from one year are not carried forward to the next YEAR. 2. Upon the liquidation of the Company, the holders of the Series G Preferred Stock are entitled to receive an amount per share equal to the greater of (a) the amount they would have received had they converted the shares into Common Stock immediately prior to such liquidation plus all declared but unpaid dividends; or (b) the stated value of $.25 per share plus declared but unpaid dividends. Total liquidation preference at December 31, 2007 was $147,000. 3. Each share is convertible, at the option of the holder at any time until August 1, 2005, into 1 share of common stock at an initial conversion price, subject to adjustment for dividends, equal to one share of common stock for each share of Series G Preferred Stock. The Series G Preferred Stock shall be converted into common stock subject to adjustment (a) on August 1, 2005 or (b) upon 30 days written notice by the Company to the holders of the shares, at any time after (i) the 30-day anniversary of the registration statement on which the shares of common stock issuable upon conversion of the Series G Preferred Stock were registered and (ii) the average closing price of the common stock for the 15-day period immediately prior to the date in which notice of redemption is given by the Company to the holders of the Series G Preferred Stock is at least $.50 per share. In 2003, the Company recorded a beneficial conversion feature of $217,000 related to the differences in the conversion price of the preferred stock to common stock. 4. The holders of the shares have no voting rights. -- F-24 PARADIGM MEDICAL INDUSTRIES, INC. NOTES TO FINANCIAL STATEMENTS CONTINUED -- 7. CAPITAL STOCK The following table summarizes preferred stock CONTINUED activity during the years ended December 31, 2007 and 2006: SERIES A SERIES B SERIES C SERIES D SHARES AMOUNT SHARES AMOUNT SHARES AMOUNT SHARES AMOUNT Balance at January 1, 2006 5,627 $

- 8,986 $ - - $ - 5,000 $ - Issuance of Series G preferred stock for cash - - - - - - - - Conversion of preferred stock - - - - - - - - --- Balance at December 31, 2006 5,627 - 8,986 - - - 5,000 - Issuance of Series G preferred stock for cash - - - - - - - - Conversion of preferred stock - - - - - - - - --- Balance at December 31, 2007 5,627 $ - 8,986 $ - - $ - 5,000 $ - --- Authorized 500,000 500,000 30,000 1,140,000 --- Liquidation preference $6,000 $36,000 $ - $9,000 --- SERIES E SERIES F SERIES G SHARES AMOUNT SHARES AMOUNT SHARES AMOUNT Balance at January 1, 2006 1,000 $ - 4,598.75 $ - 588,235 $ 1,000 Issuance of Series G preferred stock for cash - - - - - - Conversion of preferred stock (750.00) - - - - - --- Balance at December 31, 2006 250 - 4,598.75 - 588,235 1,000 Issuance of Series G preferred stock for cash - - - - - - Conversion of preferred stock - - (200) - - - --- Balance at December 31, 2007 250 $ - 4,398.75 $ - 588,235 $ 1,000 --- Authorized 50,000 50,000 2,000,000 --- Liquidation preference $13,000 $235,000 $147,000 --- --- F-25 PARADIGM MEDICAL INDUSTRIES, INC. NOTES TO FINANCIAL STATEMENTS CONTINUED --- 8. CONVERTIBLE NOTES CONVERTIBLE NOTES APRIL 27, 2005 SALE OF $2,500,000 IN CALLABLE SECURED CONVERTIBLE NOTES: To obtain funding for the Company's ongoing operations, the Company entered into a securities purchase agreement with four accredited investors on April 27, 2005 for the sale of (i) $2,500,000 in convertible notes and (ii) warrants to purchase 16,534,392 shares of its common stock. The sale of the convertible notes and warrants is to occur in three traunches and the investors provided the Company with an aggregate of $2,500,000 as follows: o $850,000 was disbursed on April 27, 2005; o $800,000 was disbursed on June 23, 2005 after the Company filed a registration statement on June 22, 2005 to register the shares of common stock issuable upon conversion of the convertible notes and exercise of warrants; and o $850,000 was disbursed on June 30, 2005, the effective date of the registration statement. Under the terms of the securities purchase agreement, the Company agreed it would not, without the prior written consent of a majority-in-interest of the investors, negotiate or contract with any party to obtain additional equity financing (including debt financing with an equity component) that involves (i) the issuance of common stock at a discount to the market price of the common stock on the date of issuance (taking into account the value of any warrants or options to acquire common stock in connection therewith), (ii) the issuance of convertible securities that are convertible into an indeterminate number of shares of common stock, or (iii) the issuance of warrants during the lock-up period beginning April 27, 2005 and ending on the later of (a) 270 days from April 27, 2005, or (b) 180 days from the date the registration statement is declared effective. In addition, the Company agreed not to conduct any equity financing (including debt financing with an equity component) during the period beginning April 27, 2005 and ending two years after the end of the above lock-up period unless it first provided each investor an option to purchase its pro rata share (based on the ratio of each investor's purchase under the securities purchase agreement) of the securities being offered in any proposed equity financing. Each investor must be provided written notice describing any proposed equity financing at least 20 business days prior to the closing of such proposed equity financing and the option must be extended to each investor during the 15-day period following delivery of such notice. --- F-26 PARADIGM MEDICAL INDUSTRIES, INC. NOTES TO FINANCIAL STATEMENTS CONTINUED --- 8. CONVERTIBLE NOTES The $2,500,000 in convertible notes bear interest at CONTINUED 8% per annum from the date of issuance. Interest is computed on the basis of a 365-day year and is payable quarterly in cash, with six months of interest payable up front. The interest rate resets to zero percent for any month in which the stock price is greater than 125% of the initial market price, or $.0945, for each trading day during that month. Any amount of principal or interest on the convertible notes that is not paid when due will bear interest at the rate of 15% per annum from the date due thereof until such amount is paid. The notes mature in three years from the date of issuance, and are convertible into the Company's common stock at the noteholders' option, at the lower of (i) $.09 or (ii) 60% of the average of the three lowest intraday trading prices for the common stock on the OTC Bulletin Board for the 20 trading days before but not including the conversion date. Accordingly, there is no limit on the number of shares into which the notes may be converted. The convertible notes are secured by the Company's assets, including the Company's inventory, accounts receivable and intellectual property. Moreover, the Company has a call option under the terms of the notes. The call option provides the Company with the right to prepay all of the outstanding convertible notes at any time, provided there is no event of default by the Company and the Company's stock is trading at or below $.09 per share. An event of default includes the failure by the Company to pay the principal or interest on the notes when due or to timely file a registration statement as required by the Company or obtain effectiveness with the Securities and Exchange Commission of the registration statement. Prepayment of the notes is to be made in cash equal to either (a) 125% of the outstanding principal and accrued interest for prepayments occurring within 30 days following the issue date of the notes; (b) 130% of the outstanding principal and accrued interest for prepayments occurring between 31 and 60 days following the issue date of the notes; or (c) 145% of the outstanding principal and accrued interest for prepayments occurring after the 60th day following the issue date of the notes. The warrants are exercisable until five years from the date of issuance at a purchase price of $.20 per share. The investors may exercise the warrants on a cashless basis if the shares of common stock --- F-27 PARADIGM MEDICAL INDUSTRIES, INC. NOTES TO FINANCIAL STATEMENTS CONTINUED --- 8. CONVERTIBLE NOTES underlying the warrants are not registered pursuant to CONTINUED an effective registration statement. In the event the investors exercise the warrants on a cashless basis, the Company will not receive any proceeds therefrom. In addition, the exercise price of the warrants will be adjusted in the event the Company issues common stock at a price below market, with the exception of any securities issued as of the date of the warrants or issued in connection with the callable secured convertible notes issued pursuant to the securities purchase agreement. The noteholders have agreed to restrict their ability to convert their convertible notes or exercise their warrants and receive shares of the Company's common stock such that the number of shares of common stock held by them in the aggregate and their affiliates after such conversion or exercise does not exceed 4.99% of the then issued and outstanding shares of common stock. However, the noteholders may repeatedly sell shares of common stock in order to reduce their ownership percentage, and subsequently convert additional convertible notes. FEBRUARY 28, 2006 SALE OF $1,500,000 IN CALLABLE SECURED CONVERTIBLE NOTES: To obtain additional funding for the Company's ongoing operations, the Company entered into a second securities purchase agreement on February 28, 2006 with the same four accredited investors for the sale of (i) $1,500,000 in convertible notes and (ii) warrants to purchase 12,000,000 shares of its common stock. The sale of the convertible notes and warrants is to occur in three traunches and the investors are obligated to provide the Company with an aggregate of $1,500,000 as follows: o $500,000 was disbursed on February 28, 2006; o $500,000 was disbursed on June 28, 2006 after the Company filed a registration statement on June 15, 2006 to register the shares of common stock underlying the convertible notes. The registration statement was subsequently withdrawn on July 25, 2006 and a new registration statement was filed on September 15, 2006 to register 60,000,000 shares of common stock issuable upon conversion of the notes. o $500,000 was disbursed on April 30, 2007, the day prior to the effective date of the registration statement on May 1, 2007. --- F-28 PARADIGM MEDICAL INDUSTRIES, INC. NOTES TO FINANCIAL STATEMENTS CONTINUED --- 8. CONVERTIBLE NOTES Under the terms of the securities purchase agreement, CONTINUED the Company also agreed it would not, without the prior written consent of a majority-in-interest of the investors, negotiate or contract with any party to obtain additional equity financing (including debt financing with an equity component) that involves (i) the issuance of common stock at a discount to the market price of the common stock on the date of issuance (taking into account the value of any warrants or options to acquire common stock in connection therewith), (ii) the issuance of convertible securities that are convertible into an indeterminate number of shares of common stock, or (iii) the issuance of warrants during the lock-up period beginning February 28, 2006 and ending on the later of (a) 270 days from February 28, 2006, or (b) 180 days from the date the registration statement is declared effective. In addition, the Company agreed not to conduct any equity financing (including debt financing with an equity component) during the period beginning February 28, 2006 and ending two years after the end of the above lock-up period unless it first provided each investor an option to purchase its pro rata share (based on the ratio of each investor's purchase under the securities purchase agreement) of the securities being offered in any proposed equity financing. Each investor must be provided written notice describing any proposed equity financing at least 20 business days prior to the closing of such proposed equity financing and the option must be extended to each investor during the 15-day period following delivery of such notice. The $1,500,000 in convertible notes bear interest at 8% per annum from the date of issuance. Interest is computed on the basis of a 365-day year and is payable quarterly in cash, with six months of interest payable up front. The interest rate resets to zero percent for any month in which the stock price is greater than 125% of the initial market price, or $.0275, for each trading day during that month. Any amount of principal or interest on the convertible notes that is not paid when due will bear interest at the rate of 15% per annum from the date due thereof until such amount is paid. The notes mature in three years from the date of issuance, and are convertible into the Company's common stock at the noteholders' option, at the lower of (i) $.02 or (ii) 60% of the average of the three lowest intraday trading prices for the common stock on the OTC Bulletin Board for the 20 trading days before but not including the conversion date. Accordingly, there is no limit on the number of shares into which the notes may be converted. --- F-29 PARADIGM MEDICAL INDUSTRIES, INC. NOTES TO FINANCIAL STATEMENTS CONTINUED --- 8. CONVERTIBLE NOTES The convertible notes are secured by the Company's CONTINUED assets, including the Company's inventory, accounts receivable and intellectual property. Moreover, the Company has a call option under the terms of the notes. The call option provides the Company with the right to prepay all of the outstanding convertible notes at any time, provided there is no event of default by the Company and the Company's stock is trading at or below $.02 per share. An event of default includes the failure by the Company to pay the principal or interest on the notes when due or to timely file a registration statement as required by the Company or obtain effectiveness with the Securities and Exchange Commission of the registration statement. Prepayment of the notes is to be made in cash equal to either (a) 125% of the outstanding principal and accrued interest for prepayments occurring within 30 days following the issue date of the notes; (b) 130% of the outstanding principal and accrued interest for prepayments occurring between 31 and 60 days following the issue date of the notes; or (c) 145% of the outstanding principal and accrued interest for prepayments occurring after the 60th day following the issue date of the notes. The warrants are exercisable until five years from the date of issuance at a purchase price of $.10 per share. The investors may exercise the warrants on a cashless basis if the shares of common stock underlying the warrants are not registered pursuant to an effective registration statement. In the event the investors exercise the warrants on a cashless basis, then the Company will not receive any proceeds therefrom. In addition, the exercise price of the warrants will be adjusted in the event the Company issues common stock at a price below market, with the exception of any securities issued as of the date of the warrants or issued in connection with the notes issued pursuant to the securities purchase agreement. The noteholders have agreed to restrict their ability to convert their callable secured convertible notes or exercise their warrants and receive shares of the Company's common stock such that the number of shares of common stock held by them in the aggregate and their affiliates after such conversion or exercise does not exceed 4.99% of the then issued and outstanding shares of common stock. However, the noteholders may repeatedly sell shares of common stock in order to reduce their ownership percentage, and subsequently convert additional convertible notes. --- F-30 PARADIGM MEDICAL INDUSTRIES, INC. NOTES TO FINANCIAL STATEMENTS CONTINUED --- 8. CONVERTIBLE NOTES JUNE 11, 2007 SALE OF $500,000 IN CALLABLE SECURED CONTINUED CONVERTIBLE NOTES: To obtain further funding for the Company's ongoing operations, the Company entered into a third securities purchase agreement on June 11, 2007 with the same four accredited investors for the sale of (i) $500,000 in callable secured convertible notes and (ii) warrants to purchase 10,000,000 shares of its common stock. The investors disbursed $500,000 to the Company on June 11, 2007. Under the terms of the June 11, 2007 securities purchase agreement, the Company agreed that it would not, without the prior written consent of a majority-in-interest of the investors, negotiate or contract with any party to obtain additional equity financing (including debt financing with an equity component) that involves (i) the issuance of common stock at a discount to the market price of the common stock on the date of issuance (taking into account the value of any warrants or options to acquire common stock in connection therewith), (ii) the issuance of convertible securities that are convertible into an indeterminate number of shares of common stock, or (iii) the issuance of warrants during the lock-up period beginning June 11, 2007 and ending on the later of (a) 270 days from June 11, 2007, or (b) 180 days from the date the registration statement is declared effective. In addition, the Company agreed not to conduct any equity financing (including debt financing with an equity component) during the period beginning June 11, 2007 and ending two years after the end of the above lock-up period unless it first provided each investor an option to purchase its pro-rata share (based on the ratio of each investor's purchase under the securities purchase agreement) of the securities being offered in any proposed equity financing. Each investor must be provided written notice describing any proposed equity financing at least 20 business days prior to the closing of such proposed equity financing and the option must be extended to each investor during the 15-day period following delivery of such notice. The $500,000 in convertible notes bear interest at 8% per annum from the date of issuance. Interest is computed on the basis of a 365-day year and is payable quarterly in cash, with six months of interest payable up front. The interest rate resets to zero percent for any month in which the stock price is greater than 125% of the initial market price, or $.0275, for each trading day during that month. Any amount of principal or interest on the callable secured convertible notes --- F-31 PARADIGM MEDICAL INDUSTRIES, INC. NOTES TO FINANCIAL STATEMENTS CONTINUED --- 8. CONVERTIBLE NOTES that is not paid when due will bear interest at the CONTINUED rate of 15% per annum from the date due thereof until such amount is paid. The convertible notes mature in three years from the date of issuance, and are convertible into the Company's common stock at the noteholders' option, at the lower of (i) $.02 or (ii) 50% of the average of the three lowest intraday trading prices for the common stock on the OTC Bulletin Board for the 20 trading days before but not including the conversion date. Accordingly, there is no limit on the number of shares into which the notes may be converted. The $500,000 in convertible notes are secured by the Company's assets, including the Company's inventory, accounts receivable and intellectual property. Moreover, the Company has a call option under the terms of the notes. The call option provides the Company with the right to prepay all of the outstanding convertible notes at any time, provided there is no event of default by the Company and its stock is trading at or below $.10 per share. An event of default includes the failure by the Company to pay the principal or interest on the convertible notes when due or to timely file a registration statement as required by the Company or obtain effectiveness with the Securities and Exchange Commission of the registration statement. Prepayment of the convertible notes is to be made in cash equal to either (a) 125% of the outstanding principal and accrued interest for prepayments occurring within 30 days following the issue date of the notes; (b) 130% of the outstanding principal and accrued interest for prepayments occurring between 31 and 60 days following the issue date of the notes; or (c) 145% of the outstanding principal and accrued interest for prepayments occurring after the 60th day following the issue date of the notes. The warrants are exercisable until seven years from the date of issuance at a purchase price of $.005 per share. The investors may exercise the warrants on a cashless basis if the shares of common stock underlying the warrants are not then registered pursuant to an effective registration statement. In the event the investors exercise the warrants on a cashless basis, the Company will not receive any proceeds therefrom. In addition, the exercise price of the warrants will be adjusted in the event the Company issues common stock at a price below market, with the exception of any securities issued as of the date of the warrants or issued in connection with the convertible notes issued pursuant to the securities purchase agreement. --- F-32 PARADIGM MEDICAL INDUSTRIES, INC. NOTES TO FINANCIAL STATEMENTS CONTINUED --- 8. CONVERTIBLE NOTES The noteholders have agreed to restrict their ability CONTINUED to convert their convertible notes or exercise their warrants and receive shares of the Company's common stock such that the number of shares of common stock held by them in the aggregate and their affiliates after such conversion or exercise does not exceed 4.99% of the then issued and outstanding shares of common stock. However, the noteholders may repeatedly sell shares of common stock in order to reduce their ownership percentage, and subsequently convert additional convertible notes, provided, however, that such conversions do not exceed $75,000 per calendar month, or the average daily dollar volume calculated during the ten business days prior to conversion multiplied by the number of trading days of that calendar month, per calendar month. The Company is required to register the shares of its common stock issuable upon the conversion of the convertible notes and the exercise of the warrants that were issued to the noteholders pursuant to the securities purchase agreement the Company entered in to on June 11, 2007. The registration statement must be filed with the Securities and Exchange Commission within 60 days of the June 11, 2007 closing date and the effectiveness of the registration is to be within 135 days of such closing date. Penalties of 2% of the outstanding principal balance of the convertible notes plus accrued interest are to be applied for each month the registration is not effective within the required time. The penalty may be paid in cash or stock at the Company's option. DECEMBER 24, 2007 SALE OF $250,000 IN CALLABLE SECURED CONVERTIBLE NOTES: To obtain further funding for the Company's ongoing operations, the Company entered into a fourth securities purchase agreement on December 24, 2007 with the same four accredited investors for the sale of (i) $250,000 in callable secured convertible notes and (ii) warrants to purchase 15,000,000 shares of its common stock. The investors disbursed $250,000 to the Company on December 24, 2007. Under the terms of the December 24, 2007 securities purchase agreement, the Company agreed that it would not, without the prior written consent of a majority-in-interest of the investors, negotiate or contract with any party to obtain additional equity financing (including debt financing with an equity component) that involves (i) the issuance of common stock at a discount to the market price of the common --- F-33 PARADIGM MEDICAL INDUSTRIES, INC. NOTES TO FINANCIAL STATEMENTS CONTINUED --- 8. CONVERTIBLE NOTES stock on the date of issuance (taking into account the CONTINUED value of any warrants or options to acquire common stock in connection therewith), (ii) the issuance of convertible securities that are convertible into an indeterminate number of shares of common stock, or (iii) the issuance of warrants during the lock-up period beginning December 24, 2007 and ending on the later of (a) 270 days from December 24, 2007, or (b) 180 days from the date the registration statement is declared effective. In addition, the Company agreed not to conduct any equity financing (including debt financing with an equity component) during the period beginning December 24, 2007 and ending two years after the end of the above lock-up period unless it first provided each investor an option to purchase its pro-rata share (based on the ratio of each investor's purchase under the securities purchase agreement) of the securities being offered in any proposed equity financing. Each investor must be provided written notice describing any proposed equity financing at least 20 business days prior to the closing of such proposed equity financing and the option must be extended to each investor during the 15-day period following delivery of such notice. The $250,000 in convertible notes bear interest at 8% per annum from the date of issuance. Interest is computed on the basis of a 365-day year and is payable quarterly in cash, with six months of interest payable up front. The interest rate resets to zero percent for any month in which the stock price is greater than 125% of the initial market price, or $.0275, for each trading day during that month. Any amount of principal or interest on the callable secured convertible notes that is not paid when due will bear interest at the rate of 15% per annum from the date due thereof until such amount is paid. The convertible notes mature in three years from the date of issuance, and are convertible into the Company's common stock at the noteholders' option, at the lower of (i) $.02 or (ii) 50% of the average of the three lowest intraday trading prices for the common stock on the OTC Bulletin Board for the 20 trading days before but not including the conversion date. Accordingly, there is no limit on the number of shares into which the notes may be converted. The $250,000 in convertible notes are secured by the Company's assets, including the Company's inventory, accounts receivable and intellectual property. Moreover, the Company has a call option under the terms of the notes. The call option provides the Company with the right to prepay all of the -- F-34 PARADIGM MEDICAL INDUSTRIES, INC. NOTES TO FINANCIAL STATEMENTS CONTINUED -- 8. CONVERTIBLE NOTES outstanding convertible notes at any time, provided CONTINUED there is no event of default by the Company and its stock is trading at or below $.10 per share. An event of default includes the failure by the Company to pay the principal or interest on the convertible notes when due or to timely file a registration statement as required by the Company or obtain effectiveness with the Securities and Exchange Commission of the registration statement. Prepayment of the convertible notes is to be made in cash equal to either (a) 125% of the outstanding principal and accrued interest for prepayments occurring within 30 days following the issue date of the notes; (b) 130% of the outstanding principal and accrued interest for prepayments occurring between 31 and 60 days following the issue date of the notes; or (c) 145% of the outstanding principal and accrued interest for prepayments occurring after the 60th day following the issue date of the notes. The warrants are exercisable until seven years from the date of issuance at a purchase price of $.001 per share. The investors may exercise the warrants on a cashless basis if the shares of common stock underlying the warrants are not then registered pursuant to an effective registration statement. In the event the investors exercise the warrants on a cashless basis, the Company will not receive any proceeds therefrom. In addition, the exercise price of the warrants will be adjusted in the event the Company issues common stock at a price below market, with the exception of any securities issued as of the date of the warrants or issued in connection with the convertible notes issued pursuant to the securities purchase agreement. The noteholders have agreed to restrict their ability to convert their convertible notes or exercise their warrants and receive shares of the Company's common stock such that the number of shares of common stock held by them in the aggregate and their affiliates after such conversion or exercise does not exceed 4.99% of the then issued and outstanding shares of common stock. However, the noteholders may repeatedly sell shares of common stock in order to reduce their ownership percentage, and subsequently convert additional convertible notes, provided, however, that such conversions do not exceed $75,000 per calendar month, or the average daily dollar volume calculated during the ten business days prior to conversion multiplied by the number of trading days of that calendar month, per calendar month. -- F-35 PARADIGM MEDICAL INDUSTRIES, INC. NOTES TO FINANCIAL STATEMENTS CONTINUED -- 8. CONVERTIBLE NOTES The Company is required to register the shares of its CONTINUED common stock issuable upon the conversion of the convertible notes and the exercise of the warrants that were issued to the noteholders pursuant to the securities purchase agreement the Company entered in to on December 24, 2007. The registration statement must be filed with the Securities and Exchange Commission within 60 days of the December 24, 2007 closing date and the effectiveness of the registration is to be within 135 days of such closing date. Penalties of 2% of the outstanding principal balance of the convertible notes plus accrued interest are to be applied for each month the registration is not effective within the required time. The penalty may be paid in cash or stock at the Company's option. DECEMBER 19, 2007 ISSUANCE OF $389,010 IN CALLABLE SECURED CONVERTIBLE Notes: On December 19, 2007 the Company was notified by the holders of the convertible notes that there was a past due interest owing on the outstanding convertible notes. The total amount of interest was $389,010. To pay the interest, the noteholders were willing to accept $389,010 in additional convertible notes due on December 31, 2010. Accordingly, on December 19, 2007, the Company issued $389,010 in convertible notes to the noteholders as full payment of the past due interest. The $389,000 in convertible notes bear interest at 2% per annum from the date of issuance. Interest is computed on the basis of a 365-day year and is payable quarterly in cash, with six months of interest payable up front. The interest rate resets to zero percent for any month in which the stock price is greater than 125% of the initial market price, or $.0275, for each trading day during that month. Any amount of principal or interest on the callable secured convertible notes that is not paid when due will bear interest at the rate of 15% per annum from the date due thereof until such amount is paid. The convertible notes mature on December 31, 2007, and are convertible into the Company's common stock at the noteholders' option, at the lower of (i) $.02 or (ii) 50% of the average of the three lowest intraday trading prices for the common stock on the OTC Bulletin Board for the 20 trading days before but not including the conversion date. Accordingly, there is no limit on the number of shares into which the notes may be converted. The $389,000 in convertible notes has a call option under the terms of the notes. The call option provides the Company with the right to prepay all of the -- F-36 PARADIGM MEDICAL INDUSTRIES, INC. NOTES TO FINANCIAL STATEMENTS CONTINUED -- 8. CONVERTIBLE NOTES outstanding convertible notes at any time, provided CONTINUED there is no event of default by the Company and its stock is trading at or below $.04 per share. An event of default includes the failure by the Company to pay the principal or interest on the convertible notes when due. Prepayment of the convertible notes is to be made in cash equal to either (a) 135% of the outstanding principal and accrued interest for prepayments occurring within 30 days following the issue date of the notes; (b) 145% of the outstanding principal and accrued interest for prepayments occurring between 31 and 60 days following the issue date of the notes; or (c) 150% of the outstanding principal and accrued interest for prepayments occurring after the 60th day following the issue date of the notes. The noteholders have agreed to restrict their ability to convert their convertible notes and receive shares of the Company's common stock such that the number of shares of common stock held by them in the aggregate and their affiliates after such conversion or exercise does not exceed 4.9% of the then issued and outstanding shares of common stock. However, the noteholders may repeatedly sell shares of common stock in order to reduce their ownership percentage, and subsequently convert additional convertible notes, provided, however, that such conversions do not exceed the average daily dollar volume calculated during the ten business days prior to conversion multiplied by the number of treading days of that calendar month, per calendar month. The Notes include certain features that are considered embedded derivative financial instruments, such as a variety of conversion options, a variable interest feature, events of default and a variable liquidated damage clause. These features are described below, as follows: o The fixed conversion feature which allows the investor to convert the Notes at a fixed price per share; o The variable conversion feature, which allows the investor to convert the Notes at a specified percentage of the market price at the time of conversion; o The variable interest rate provision that calls for no interest to be paid if the stock price exceeds a predetermined amount for a given months; -- F-37 PARADIGM MEDICAL INDUSTRIES, INC. NOTES TO FINANCIAL STATEMENTS CONTINUED -- 8. CONVERTIBLE NOTES o The partial call option feature that CONTINUED allows the Company to minimize the investors conversion rights by repaying a portion of the note when the sotck price exceeds certain predetermined parameters; and o The value of the warrants issued in conjunction with each funding. The initial fair value assigned to the embedded derivatives was $4,169,000, which consisted of the fair values of the conversion-related derivatives of $2,588,000 and the fair value of the warrants of $1,582,000. The Company recorded the first $2,500,000 of fair value of the derivatives and warrants to debt discount (equal to the total proceeds received as of June 30, 2005), which will be amortized to interest expense over the term of the Notes. The remaining balance of $1,669,000 was recorded as loss of derivative valuation for the period ended June 30, 2005. As of December 31, 2005, the carrying amount on the Notes was $339,000, net of the unamortized debt discount of $1,699,000. Interest expense on the Notes totaled $1,171,000 for the period ended December 31, 2005, which consisted of $462,000 related to the conversion of a portion of the Notes into 66,880,000 shares of the Company's common stock, in accordance with EITF 00-27, paragraph 21. The remaining $709,000 recorded as interest expense, consisted of $339,000 of normal accretion of the Note discount, and $370,000 of accrued interest on the outstanding Note balance for the period. The fair value of the embedded derivatives decreased to $195,000 during the year ended December 31, 2005, which consists of a fair value of the conversion-related derivatives of $137,000 and the fair value of the warrants of $58,000. The corresponding decrease in derivative value was reflected as a gain on derivative valuation on the statements of operations in the amount of $3,975,000. During 2006, the Company entered into another securities purchase agreement in the amount $1,000,000. The initial fair value assigned to the embedded derivatives was $541,000, for this Note, which consisted of the fair values of the conversion-related derivatives of $464,000 and the fair value of the warrants of $77,000. The Company recorded the $541,000 of fair value of the derivatives and warrants to debt discount, which will be amortized to interest expense over the term of the Notes. -- F-38 PARADIGM MEDICAL INDUSTRIES, INC. NOTES TO FINANCIAL STATEMENTS CONTINUED -- 8. CONVERTIBLE NOTES As of December 31, 2006, the carrying amount on the CONTINUED Notes was $1,367,000, net of the unamortized debt discount of $1,288,000. Interest expense on the Notes totaled $1,159,000 for the period ended December 31, 2006, which consisted of $383,000 related to the conversion of a portion of the Notes into 105,570,000 shares of the Company's common stock. The remaining $776,000 recorded as interest expense, consisted of $569,000 of normal accretion of the Note discount, and $207,000 of accrued interest on the outstanding Note balance for the period. The fair value of the embedded derivatives decreased by a total of $570,000 during the year ended December 31, 2006, which consists of a decrease in the fair value of the conversion-related derivatives of $485,000 and the fair value of the warrants of $85,000. Accordingly, the Company recorded a gain on derivative valuation to the statement of operations of $570,000 for the year ended December 31, 2006. During 2007, the Company entered into four securities purchase agreements in the aggregate amount of $1,639,000. The initial fair value assigned to the embedded derivatives was $466,000, for these Notes, which consisted of the fair values of the conversion-related derivatives of $344,000 and the fair value of the warrants of $122,000. The Company recorded $466,000 of fair value of the derivatives and warrants to debt discount, which will be amortized to interest expense over the term of the Notes. At December 31, 2007, the carrying amount on the Notes was $3,039,000, net of the unamortized debt discount of $889,000. Interest expense on the Notes totaled $1,084,000 for the period ended December 31, 2007, which consisted of $366,000 related to the conversion of a portion of the Notes into 343,017,000 shares of the Company's common stock. The remaining $718,000 recorded as interest expense, consisted of $499,000 on normal accretion of the Note discount, and $219,000 of accrued interest on the outstanding Note balance for the period. The fair value of the embedded derivatives decreased by a total of $418,000 during the year ended December 31, 2007, which consists of a decrease in the fair value of the conversion-related derivatives of $444,000 and the fair value of the warrants of $22,000. Accordingly, the Company recorded a gain on derivative valuation to the statement of operations of $418,000 for the year ended December 31, 2007. The market price of the Company's common stock significantly impacts the extent to which the Company may be required or may be permitted to convert the unrestricted and restricted portion of the Notes into -- F-39 PARADIGM MEDICAL INDUSTRIES, INC. NOTES TO FINANCIAL STATEMENTS CONTINUED -- 8. CONVERTIBLE NOTES shares of the Company's common stock. The lower the CONTINUED market price of the Company's common stock at the respective times of conversion, the more shares the Company will need to issue to convert the principal and interest payments then due on the Notes. If the market price of the company's common stock falls below certain thresholds, the Company will be unable to convert any such repayments of principal and interest into equity, and the Company will be forced to make such repayments in cash. The Company's operations could be materially impacted, in an adverse way, if the Company is forced to make repeated cash payments on the Notes. 9. STOCK OPTION PLAN The Option Plan provides for the grant of incentive AND WARRANTS stock options and non-qualified stock options to employees and directors of the Company. Incentive stock options may be granted only to employees. The Option Plan is administered by the Board of Directors or a Compensation Committee, which determines the terms of options granted including the exercise price, the number of shares subject to the option, and the exercisability of the option. The Company granted the following options and warrants to non-employees during the year ended December 31, 2006: o Options to employees, officers and the board of directors to purchase 4,700,000 shares of common stock at an exercise price ranging from $0.01 to $0.02. o Warrants to purchase 8,000,000 shares of common stock at an exercise price of $0.10 per share in return for the sale of callable secure convertible notes. The Company granted the following options and warrants to non-employees during the year ended December 31, 2007: o Warrants to purchase 4,000,000 shares of common stock at an exercise price of $0.10 per share in return for the sale of callable secure convertible notes, exercisable through April 26, 2012. o Warrants to purchase 10,000,000 shares of common stock at an exercise price of $0.005 per share in return for the sale of callable secure convertible notes, exercisable through June 11, 2012. -- F-40 PARADIGM MEDICAL INDUSTRIES, INC. NOTES TO

FINANCIAL STATEMENTS CONTINUED -- 9. STOCK OPTION PLAN o Warrants to purchase 15,000,000 shares of AND WARRANTS common stock at an exercise price of CONTINUED $0.001 per share in return for the sale of callable secure convertible notes, exercisable through December 24, 2014. o Options to the Company's President and Chief Executive Officer to purchase 4,500,000 share of common stock at an exercise price of $0.01, exercisable through July 1, 2010. A schedule of the options and warrants is as follows: NUMBER OF EXERCISE ----------------------- PRICE PER OPTIONS WARRANTS SHARE ----------------------------------- Outstanding at January 1, 2006 3,932,500 19,582,190 $0.10-12.98 Granted 4,700,000 8,000,000 0.01-0.10 Exercised - - - Expired (225,000) (2,522,798) 0.50-7.50 Forfeited (1,402,500) - 0.10-2.75 Outstanding at December 31, 2006 7,005,000 25,059,392 0.01-6.75 Granted 4,500,000 29,000,000 0.001-0.10 Exercised - - - Expired - (25,000) 0.15-0.15 Forfeited (5,000) - 0.10-0.10 ----------------------------------- Outstanding at December 31, 2007 11,500,000 54,034,392 $0.001-6.75 =================================== The following table summarizes information about stock options and warrants outstanding at December 31, 2007: OUTSTANDING EXERCISABLE ---------------------------------- ----------------------- WEIGHTED AVERAGE REMAINING WEIGHTED WEIGHTED RANGE OF CONTRACTUAL AVERAGE AVERAGE EXERCISE NUMBER LIFE EXERCISE NUMBER EXERCISE PRICES OUTSTANDING (YEARS) PRICE EXERCISABLE PRICE --- $0.001-0.75 64,459,392 0.31 $0.0036 2,759,339 $ 0.17 2.00-5.00 1,025,000 2.30 3.11 1,027,500 3.14 6.00-8.13 50,000 2.92 6.75 50,000 6.75 12.98 - - 12.98 - 12.98 -- ----------------------- $0.001-12.98 65,534,392 0.34 $ 0.06 3,836,839 $ 1.14 == ======================= -- F-41 PARADIGM MEDICAL INDUSTRIES, INC. NOTES TO FINANCIAL STATEMENTS CONTINUED -- 9. STOCK OPTION The fair value of each option and warrant grant, PLAN AND outside of those granted in conjunction with the Notes WARRANTS are estimated at the date of grant using the CONTINUED Black-Scholes option pricing model with the following assumptions: DECEMBER 31, ------------------------- 2007 2006 ------------------------- Expected dividend yield $ - $ - Expected stock price Volatility 210%-210% 216%-210% Risk-free interest rate 4.14%-5.37% 4.30%-5.18% Expected life of options 3-5 years 3-5 years The weighted average fair value of options granted during 2007 and 2006 are $0.01 and $0.01, respectively. 10. GAIN ON SETTLEMENT Due to the Company's ongoing cash flow difficulties, OF LIABILITIES during 2007 and 2006 most vendors and suppliers were contacted with attempts to negotiate reduced payments and settlements of outstanding accounts payable and accrued expenses. While some vendors refused to negotiate and demanded payment in full, some vendors were willing to settle for a reduced amount. The accounts payable forgiven by vendors and suppliers and accrued expenses settled resulted in a gain of $91,000 and $34,000 in 2007 and 2006, respectively. 11. RELATED PARTY A law firm, of which the chairman of the board of TRANSACTIONS directors of the Company is a shareholder, has rendered legal services to the Company. The Company paid this firm $156,000 and $148,000, for the years ended December 31, 2007 and 2006, respectively. As of December 31, 2007, the Company owed this firm $46,000, which is included in accounts payable. -- F-42 PARADIGM MEDICAL INDUSTRIES, INC. NOTES TO FINANCIAL STATEMENTS CONTINUED -- 12. SUPPLEMENTAL During the year ended December 31, 2007, the Company: FLOW CASH INFORMATION o Incurred paid obligation of approximately $20,000 for the settlement of accrued liabilities of approximately $111,000 and recorded a corresponding gain of $91,000. Actual amounts paid for interest and income taxes are as follows: YEARS ENDED DECEMBER 31, ------------------------- 2007 2006 ------------------------- Interest $ 11,000 $ 7,000 ========================= Income taxes $ - $ - ========================= 13. EXPORT SALES In accordance with Paragraph 38(a) of SFAS 131 "Disclosures about Segments of an Enterprise and Related Information," The company has the following information regarding revenues to external customers. Revenues are attributed to countries based on location of customer. Total sales include export sales by major geographic area as follows: -- F-43 PARADIGM MEDICAL INDUSTRIES, INC. NOTES TO FINANCIAL STATEMENTS CONTINUED --- 13. EXPORT SALES Years Ended December 31, CONTINUED --------------------------------- GEOGRAPHIC AREA 2007 2006 --------------------------------- EUROPE: Belgium $ - $ 650 Bulgaria 28,400 4,900 France 34,224 6,250 Germany - 7,200 Greece 11,750 75,455 Italy 38,040 17,725 Poland 37,000 12,650 Russia 204,540 158,620 Spain 7,200 32,550 Turkey 102,940 57,750 United Kingdom 255,717 293,240 ------------- ------------- SUB TOTAL 719,811 666,340 ------------- ------------- FAR EAST: Bangladesh $ 560 $ 29,850 China 91,600 74,544 India 16,800 63300 Pakistan 8,200 - South Korea 42,500 175,656 Taiwan 32,650 31,050 Thailand - 32,250 Vietnam 80,600 - ------------- ------------- SUB TOTAL 272,910 406,650 ------------- ------------- MIDDLE EAST: Egypt $ 9,540 $ 27,200 Israel 2,800 2,150 Jordan - 5,100 Saudi Arabia 65,700 33,950 UAE 10,600 - SUB TOTAL 88,640 68,400 NORTH AMERICA: Canada $ 44,750 $ 99,402 Mexico - 6,800 USA 636,879 894758 ------------- ------------- SUB TOTAL 681,629 1,000,960 ------------- ------------- --- F-44 PARADIGM MEDICAL INDUSTRIES, INC. NOTES TO FINANCIAL STATEMENTS CONTINUED --- 13. EXPORT SALES CONTINUED CENTRAL, SOUTH AMERICA, AND CARIBBEAN: Argentina $ 21,915 $ - Brazil 36,698 9,500 El Salvador 8,749 12,650 Guatemala - 8,300 Honduras - 5,150 Puerto Rico 26,798 10,825 Venezuela 14,850 - Colombia - 5,900 ------------- ------------- SUB TOTAL 109,010 52,325 ------------- ------------- ------------- ------------- TOTAL $ 1,872,000 $ 2,195,000 ------------- ------------- --- F-45 PARADIGM MEDICAL INDUSTRIES, INC. NOTES TO FINANCIAL STATEMENTS CONTINUED -- 13. EXPORT SALES CONTINUED -------------------- --- ------------- ------------- PRODUCT MODEL 2,006 2,007 -------------------- --- ------------- ------------- Humphrey Systems: P55 & A/Pachymeter (P55), A/B Scan (P37) (314,227) (548,902) MEDA Systems P2000, P2200, P2500, P2700, P3700 14% 29% Dicon diagnostic: Perimeter and corneal topographer (855,800) (388,179) LD, TKS, CT 39% 21% UBM biomicroscope: (546,793) (512,644) P40, P45, P60 25% 27% Blood Flow Analyzer: (210,929) (256,511) BFA 10% 14% ---------------------------- SUB-TOTAL (1,927,748) (1,706,236) ---------------------------- 1 1 Cataract removal sales (Precisionist and SIStem) 5,856 - PHO, SIS (Surgical) 0% 0% Service, parts, disposables, and other (273,577) (165,318) 12% 9%

---------------------------- TOTAL YTD SALES (2,195,469) (1,871,554) ============================ 100% 100% 14. SAVINGS PLAN In November 1996, the Company established a 401(k) Retirement Savings Plan for the Company's officers and employees. The Plan provisions include eligibility after six months of service, a three year vesting provision and nondiscriminatory no matching contributions at this time. During the years ended December 31, 2007 and 2006, the Company made no contributions to the Plan. 15. COMMITMENTS AGREEMENTS AND On June 12, 2006, the Company entered into a Worldwide CONTINGENCIES OEM Agreement with MEDA Co., Ltd., one of China's leading developers and producers of ultrasound devices. Under the terms of the agreement, MEDA agrees to jointly engineer, develop and manufacture the -- F-46 PARADIGM MEDICAL INDUSTRIES, INC. NOTES TO FINANCIAL STATEMENTS CONTINUED -- Company's next generation of the Ultrasound BioMicroscope, as well as other proprietary new products and enhancement of the Company's current products. The products to be manufactured by MEDA, at agreed upon costs, and supplied to the Company for resale include the following new products: an ultrasound biomicroscope, two ultrasound A/B Scans, a biometric A-Scan and a pachymeter. The agreement provides that the Company and MEDA agree to jointly develop and collaborate in the improvement and enhancement of the Company's products and, in the interest of product development, enhancement and differentiation, MEDA agrees to give consideration to potential software development or enhancements made available to the Company for its products. Moreover, in the interest of product improvement, MEDA agrees to collaborate with the Company and its designated engineers, employees and consultants to consider and potentially implement jointly or individually the development of product Contingencies enhancements to the Company's products to be manufactured by MEDA. The software and hardware modifications designed jointly by the Company and MEDA will be considered the joint intellectual property of the Company and MEDA and may be used, without restriction, unless otherwise previously agreed to, by either party. MEDA also agrees to provide a twelve month warranty on all products that it manufactures for the Company. If defects cannot be corrected at the Company's facilities, the products may be returned to MEDA for the purposes of carrying out such repairs as required, and MEDA agrees to return the repaired products to the Company or its designated agent or distributor within ten working days from the date of receiving such products, at no cost to the Company, and MEDA will pay return freight costs. MEDA further agrees to endeavor to answer any technical inquiries concerning the products it has manufactured. MEDA also agrees to train the Company's technical service engineers and designated international distributors as soon as possible after the signing of this agreement, and as future needs arise and as MEDA can reasonably fit such training into the regular schedules of its employees. MEDA agrees to determine the need for future training on new products as necessary and will offer such training in Tiangin, China. For training conducted outside China, the Company or its designated distributors -- F-47 PARADIGM MEDICAL INDUSTRIES, INC. NOTES TO FINANCIAL STATEMENTS CONTINUED -- and/or service centers will be responsible for the traveling, living and hotel expenses for MEDA's engineers. Training is at no charge to the Company. The training will also be made available to the Company's designated repair agencies in order to provide service and repair on a worldwide basis. Such agencies will be considered authorized repair facilities for the products manufactured by MEDA. MEDA provides the Company with several ultrasound devices. These devices include the P37-II A/B Scan, the P2000 A-Scan Biometric Analyzer, P2200 Pachymeter and the P2500, which is a combined A-Scan and pachymeter. MEDA also manufactures the P2700, P3700, and P37-II A/B Scans and the P50 Ultrasound Biomicroscope. The agreement provides exclusive distribution rights to the Company throughout most of the world, including the United States and Canada, once FDA approval is received on these devices. The agreement shall be effective for three years from date of execution. At the end of the three year term, representatives of the Company and MEDA will confer to determine whether to extend the term of the agreement. This will have a practical effect of extending the term of the agreement for an additional 120 days. If mutual agreement for extending the term of the Contingencies agreement is not reached within 120 days after the end of the three year Continued term, then the agreement will be deemed terminated. However, if within the 120 day period, the Company and MEDA mutually agree to extend the term of the agreement, then thereafter either party may terminate the agreement by providing at least twelve months' prior written notice to the other party. All outstanding orders at the time of notification will be supplied under the terms of the agreement, and MEDA will continue to fulfill all orders from the Company until the twelve month notice period has expired. On January 31 and February 1, 2007, the Company received FDA 510(k) premarket approval for a new generation of ultrasound devices. This approval allows the new devices to be sold in the United States. The new ultrasound devices, which are to be manufactured by MEDA and sold by the Company in the United States, include the P2000 A-Scan (used to measure axial length of the eye), the P2200 Pachymeter (used for measuring corneal thickness), the P2500 A-Scan/Pachymeter (a combination of the two stand alone devices), the P2700 AB/Scan (an ultrasound imaging device for detecting -- F-48 PARADIGM MEDICAL INDUSTRIES, INC. NOTES TO FINANCIAL STATEMENTS CONTINUED -- 15. COMMITMENTS abnormalities within the eye) and the P37-II (a more AND advanced AB/Scan used to provide portability for CONTINGENCIES ophthalmology veterinary applications) and the P50 CONTINUED Ultrasound Biomicroscope for high frequency imaging of the anterior chamber of the eye. On September 25, 2006, the Company entered into a Worldwide OEM Agreement with Tinsley, a division of Hartest Precision Instruments Limited, and one of Europe's leading developers and producers of visual fields analysis devices or perimeters. Under the terms of the agreement, Tinsley agrees to engineer, develop and manufacture the Company's newest perimeter, the LD700 Visual Fields Analyzer. The product is to be manufactured by Tinsley at agreed upon costs and supplied to the Company for resale. On August 14, 2007, the Company entered into an agreement with Equity Source Partners, LLC of Jericho, New York. Under the terms of the agreement, Equity Source Partners will act as the exclusive financial advisor to the Company and will assist the Company in raising private capital, creating a strategy for growing its core business, pursuing a follow on offering, and providing general strategic corporate advice. Among the strategic advisory services Equity Source Partners will provide are to assist in identifying and introducing the Company to third parties in connection with potential strategic relationships, provide advice concerning issues relating to potential strategic relations, capital raises and potential investment banking contacts, and establish contact with prospective providers of capital. Among the financing services Equity Source Partners will perform is to solicit prospective providers of capital on the Company's behalf. The term of the agreement is for twelve months unless extended by mutual consent. As compensation for its services, the Company agrees to provide equity Source Partners with an advisory fee equal to an aggregate of 3% of the outstanding shares of the Company's common stock. In addition, the Company agrees to pay Equity Source Partners a cash fee equal to 7.5% of the gross proceeds from the sale of securities to investors that were introduced to the Company by Equity Source Partners and a cash fee equal to 3% of the gross proceeds received from the sale of securities to investors that were not introduced by Equity Source Partners. -- F-49 PARADIGM MEDICAL INDUSTRIES, INC. NOTES TO FINANCIAL STATEMENTS CONTINUED -- 15. COMMITMENTS LEGAL PROCEEDINGS AND On December 27, 2007, the Company entered into a CONTINGENCIES settlement agreement with Larry Hicks to settle the CONTINUED lawsuit Mr. Hicks brought against the Company for payments due under a consulting agreement with the Company (Third Judicial District Court, Salt Lake County, State of Utah, Civil No. 030922220). Under the terms of the agreement, the Company agrees to pay Mr. Hicks a total of $20,000, of which $10,000 has been paid. The remaining amount owing of $10,000 is to be paid in quarterly installments of $2,500 each prior to the end of the next four consecutive quarters, with the next payment due on or before June 30, 2008. An action was brought against the Company on September 11, 2000 by PhotoMed International, Inc. and Daniel M. Eichenbaum, M.D. in the Third District Court of Salt Lake County, State of Utah. The action involves an amount of royalties that are allegedly due and owing to PhotoMed International, Inc. and Dr. Eichenbaum under a license agreement dated July 7, 1993, with respect to the sale of certain equipment, plus costs and attorney's fees. Certain discovery has taken place and the Company has paid royalties of $15,717, which the Company believes brings all payments current as of the date of last payment on January 7, 2005. The Company has been working with PhotoMed and Dr. Eichenbaum to ensure that the calculations have been correctly made on the royalties paid as well as the proper method of calculation for the future. It is anticipated that once the parties can agree on the correct calculations on the royalties, the legal action will be dismissed. An issue in dispute concerning the method of calculating royalties is whether royalties should be paid on returned equipment. Since July 1, 2001, only one Photon(TM) laser system has been sold and no systems returned. Thus, the amount of royalties due, according to the Company's calculations, is $981. The Company made payment of this amount to Photomed and Dr. Eichenbaum on January 5, 2005 and, as a result, seeks to have the legal action dismissed. However, if the parties are unable to agree on a method for calculating royalties, there is a risk that PhotoMed and Dr. Eichenbaum might amend their complaint to request termination of the license agreement and, if successful, the Company would lose its right to manufacture and sell the Photon(TM) laser system. An action was filed on June 20, 2003, in the Third -- F-50 PARADIGM MEDICAL INDUSTRIES, INC. NOTES TO FINANCIAL STATEMENTS CONTINUED -- 15. COMMITMENTS Judicial District Court, Salt Lake County, State of AND Utah (Civil No. 030914195) by CitiCorp Vendor Finance, CONTINGENCIES Inc., formerly known as Copelco Capital, Inc. The CONTINUED complaint claims that $49,626 plus interest is due for the leasing of three copy machines that were delivered to the Company's Salt Lake City facilities on or about April of 2000. The action also seeks an award of attorney's fees and costs incurred in the collection. The Company filed an answer to the complaint disputing the amounts allegedly owed due to machine problems and a claimed understanding with the vendor. The Company returned two of the machines. The Company was engaged in settlement discussions with CitiCorp until counsel for CitiCorp withdrew from the case. New counsel for CitiCorp was appointed. After an initial meeting with new counsel, the Company provided initial disclosures to the new counsel. The Company is not a party to any other material legal proceedings outside the ordinary course of its business or to any other legal proceedings, which, if adversely determined, would have a material adverse effect on its financial condition or results of operations. EMPLOYMENT AGREEMENTS The Company entered into an employment agreement with Raymond P.L. Cannefax, which commenced on January 5, 2006 and expired on January 5, 2007. The employment agreement requires Mr. Cannefax to devote substantially all of his working time as the Company's President and Chief Executive Officer, providing that he may be terminated for "cause" (as provided in the agreement) and prohibits him from competing with the Company for two years following the termination of his employment agreement. The employment agreement provides for the payment of an initial base salary of $125,000. The employment agreement also provides for salary increases and bonuses as shall be determined at the discretion of the Board of Directors, with the first review of the annual salary to be made as of June 30, 2006. The employment agreement further provides for the issuance of stock options to purchase 4,500,000 shares of the Company's common stock at $.01 per share. The options vest in twelve equal monthly installments of 375,000 shares, beginning on February 5, 2006 until such shares are vested. In the event of a change of control of the Company, then all outstanding stock options granted to Mr. Cannefax shall be immediately vested. A change of control shall be deemed to have occurred if (i) a -- F-51 PARADIGM MEDICAL INDUSTRIES, INC. NOTES TO FINANCIAL STATEMENTS CONTINUED -- 15. COMMITMENTS tender offer shall be made and consummated for the AND ownership of more than 25% of the Company's CONTINGENCIES outstanding shares; (ii) the Company shall be merged CONTINUED or consolidated with another corporation and, as a result, less than 25% of the outstanding common shares of the surviving corporation shall be owned in the aggregate by the Company's former shareholders, as the same shall have listed prior to such merger or consolidation; (iii) the Company shall sell all or substantially all of its assets to another corporation that is not a wholly owned subsidiary or affiliate; (iv) as a result of any contested election for the Board of Directors, or any tender or exchange offer, merger of business combination or sale of assets, the persons who were directors of the Company before such a transaction shall cease to constitute a majority of the Board of Directors; or (v) a person other than an officer or director of the Company shall acquire more than 20% of the outstanding shares of common stock of the Company. Effective July 1, 2007, the Company entered into an amendment of the employment agreement with Mr. Cannefax, which extends the term of the employment agreement until January 5, 2009. Under the terms of the amendment, Mr. Cannefax's annual base salary increased to $150,000. The initial base salary in the employment agreement dated January 5, 2006 was $125,000, which the Board of Directors increased to $140,000 as of July 1, 2006. The amendment also provides for the granting of additional stock options to Mr. Cannefax to purchase an additional 4,500,000 shares of the Company's common stock at $.01 per share. These options vest in twelve equal monthly installments of 375,000 shares beginning on June 1, 2007 until such shares are vested. RETIREMENT AGREEMENT On May 6, 1999, the Company's Board of Directors approved resolutions relating to the retirement of John M. Hemmer, then Vice President of Finance and Chief Financial Officer of the Company. The board resolutions provided that Mr. Hemmer's annual salary of $120,000 per annum was to continue until June 1, 1999, at which time his employment contract and change of control agreement with the Company would terminate and he would become an independent consultant to the Company. As a consultant, Mr. Hemmer was to receive an initial payment of $12,500 with annual payments thereafter of $25,000 payable on January 1, 2000, 2001 and 2002, and a final payment of $12,500 payable on January 1, 2003, for a total consulting contract of $100,000. -- F-52 PARADIGM MEDICAL INDUSTRIES, INC. NOTES TO FINANCIAL STATEMENTS CONTINUED -- 15. COMMITMENTS In addition, the board resolutions provided that the AND Company was to issue to Mr. Hemmer warrants to CONTINGENCIES purchase 125,000 shares of common stock at $2.63 per CONTINUED share, exercisable for a period of five years, and warrants to purchase 75,000 shares of common stock at $7.50 per share, exercisable for a period of five years, but such warrants were not to be issued until Mr. Hemmer exercised all of the warrants to purchase 125,000 common shares at $2.63 per share. The Company has paid a total of $87,500 to Mr. Hemmer under the consulting agreement. On May 30, 2006, the Company entered into an agreement with Mr. Hemmer in which he acknowledged that the Company owed him a total of $12,500 for past services he rendered to the Company, including as a consultant, and the Company agreed to pay him the sum of $12,500 in twelve monthly installments of $1,000 each and a final monthly payment of $500. The Company has paid $7,000 to Mr. Hemmer under this agreement, as of December 31, 2007. 16. RECENT RECENT ACCOUNTING PRONOUNCEMENTS ACCOUNTING In September 2006, the Financial Accounting Standards PRONOUNCE- Board issued Statement of Financial Accounting MENTS Standards No. 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans, an amendment of FASB Statements No. 87, 88, 106 and 132R" ("SFAS 158"). SFAS 158 requires employers that sponsor defined benefit pension and postretirement plans to recognize previously unrecognized actuarial losses and prior service costs in the statement of financial position and to recognize future changes in these amounts in the year in which changes occur through comprehensive income. As a result, the statement of financial position will reflect funded status of those plans as an asset or liability. Additionally, employers are required to measure the funded status of a plan as of the date of their year-end statements of financial position and provide additional disclosures. SFAS 158 is effective for financial statements issued for fiscal years ending after December 15, 2006 for companies whose securities are publicly traded. The Company does not expect the adoption of SFAS 158 to have a significant effect on its financial position or results of operation. In September 2006, the Financial Accounting Standards -- F-53 PARADIGM MEDICAL INDUSTRIES, INC. NOTES TO FINANCIAL STATEMENTS CONTINUED -- 16. RECENT Board issued Statement of Financial Accounting ACCOUNTING Standards No. 157, "Fair Value Measurements" ("SFAS PRONOUNCE- 157"), which defines fair value, establishes a MENTS framework for measuring fair value in generally CONTINUED accepted accounting principles ("GAAP"), and expands disclosures about fair value measurements. Where applicable, SFAS 157 simplifies and codifies related guidance within GAAP and does not require any new fair value measurements. SFAS 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. Earlier adoption is encouraged. The Company does not expect the adoption of SFAS 157 to have a significant effect on its financial position or results of operation. In June 2006, the Financial Accounting Standards Board issued FASB Interpretation No. 48, "Accounting for Uncertainty in Income Taxes - an interpretation of FASB Statement No. 109" ("FIN 48"), which prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 also provides guidance on de-recognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. FIN 48 is effective for fiscal years beginning after December 15, 2006. The Company does not expect the adoption of FIN 48 to have a material impact on its financial reporting, and the Company is currently evaluating the impact, if any, the adoption of FIN 48 will have on its disclosure requirements. In March 2006, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 156, "Accounting for Servicing of Financial Assets -- an Amendment of FASB Statement No. 140 ("SFAS 156")." This statement requires an entity to recognize a servicing asset or servicing liability each time it undertakes an obligation to service a financial asset by entering into a servicing contract in any of the following situations: a transfer of the servicer's financial assets that meets the requirements for sale accounting; a transfer of the servicer's financial assets to a qualifying special-purpose entity in a guaranteed mortgage securitization in which the transferor retains all of the resulting securities and classifies them as either available-for-sale securities or trading securities; or an acquisition or assumption of an obligation to service a financial asset that does not relate to financial assets of the service or its consolidated affiliates. The statement also requires all separately -- F-54 PARADIGM MEDICAL INDUSTRIES, INC. NOTES TO FINANCIAL STATEMENTS CONTINUED -- 16. RECENT recognized servicing assets and servicing liabilities ACCOUNTING to be initially measured at fair value, if PRONOUNCE- practicable, and permits an entity to choose either MENTS the amortization or fair value method for subsequent CONTINUED measurement of each class of servicing assets and liabilities. The statement further permits, at its initial adoption, a one-time reclassification of available-for-sale securities to trading securities by entities with recognized servicing rights, without calling into question the treatment of other available-for-sale securities under Financial Accounting Standards Board Statement No. 115, provided that the available-for-sale securities are identified in some manner as offsetting the entity's exposure to changes in fair value of servicing assets or servicing liabilities that a services elects to subsequently measure at fair value and requires separate presentation of servicing assets and servicing liabilities subsequently measured at fair value in the statement of financial position and additional disclosures for all separately recognized servicing assets and servicing liabilities. SFAS 156 is effective for fiscal Continued years beginning after September 15, 2006, with early adoption permitted as of the beginning of an entity's fiscal year. Management believes the adoption of SFAS 156 will have no immediate impact on the Company's financial condition or results of operations. In February 2006, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 155, "Accounting for Certain Hybrid Financial Instruments - an amendment of FASB Statements No. 133 and 140" ("SFAS 155"), to (a) permit fair value re-measurement for any hybrid financial instrument that contains an embedded derivative that otherwise would require bifurcation, (b) clarify which interest-only strip and principal-only strip are not subject to the requirements of Statement 133, (c) establish a requirement to evaluate interests in securitized financial assets to identify interests that are freestanding derivatives or that are hybrid financial instruments that contain an embedded derivative requiring bifurcation, (d) clarify that concentrations of credit risk in the form of subordination are not embedded derivatives, and (e) amend Statement 140 to eliminate the prohibition on a qualifying special purpose entity from holding a derivative financial instrument that pertains to a beneficial interest other than another derivative financial instrument. This statement is effective for financial statements for fiscal years beginning after September 15, 2006. Earlier adoption of SFAS 155 is permitted as of the beginning of an entity's fiscal year, provided the --- F-55 PARADIGM MEDICAL INDUSTRIES, INC. NOTES TO FINANCIAL STATEMENTS CONTINUED --- 16. RECENT entity has not yet issued any financial statements for ACCOUNTING that fiscal year. Management believes SFAS 155 will PRONOUNCE- have no impact on the financial statements of the MENTS Company once adopted. CONTINUED In December 2007, the Financial Accounting Standards Board ("FASB") issued SFAS No. 141(R), "Business Combinations" ("SFAS 141R"). SFAS 141R establishes the principles and requirements for how an acquirer recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, any noncontrolling interest in the acquiree, and the goodwill acquired. SFAS 141R also establishes disclosure requirements to enable the evaluation of the nature and financial effects of the business combination. SFAS 141R is effective for us on January 1, 2009, and is not expected to have a material effect on our consolidated financial statements. In December 2007, the FASB issued SFAS No. 160, "Noncontrolling Interests in Consolidated Financial Statements, an amendment of ARB No. 51 ("SFAS 160"). SFAS 160 will change the accounting and reporting for minority 16. Recent interests, which will be recharacterized as noncontrolling interests and Accounting classified as a component of equity. This new consolidation method will Pronounce- significantly change the accounting for transactions with minority interest ments holders. SFAS 160 is effective for us on January 1, 2009, and is not Continued expected to have a material effect on our consolidated 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 159"). SFAS 159 permits companies to choose to measure many financial instruments and certain other items at fair value that are not currently required to be measured at fair value, and establishes presentation and disclosure requirements designed to facilitate comparisons between companies that choose different measurement attributes for similar types of assets and liabilities. SFAS 159 is effective for us on January 1, 2008, and is not expected to have a material effect on our consolidated financial statements. The implementation of the provisions of these pronouncements is not expected to have a significant effect on the Company's consolidated financial statement presentation. --- F-56 PARADIGM MEDICAL INDUSTRIES, INC. NOTES TO FINANCIAL STATEMENTS CONTINUED --- 17. SUBSEQUENT SUBSEQUENT EVENTS EVENTS On January 16, 2008, the Company entered into a consulting agreement with Corcoran Consulting Group, which specializes in medical reimbursement issues for optometry and ophthalmology. The Company plans to work with Corcoran Consulting Group to create a new common procedure technology, or CPT code number, for reimbursement purposes for physicians and practitioners using the Blood Flow Analyzer(TM). In addition, the Company plans to work with Corcoran Consulting Group to offer educational seminars for physicians and practitioners who purchase the Blood Flow Analyzer(TM). On January 28, 2008, the Company entered into a Distribution Agreement with LACE Elettronica srl to distribute its Glaid device, a proprietary electrophysiology instrument for the early detection of glaucoma by means of measuring the physical condition of the retina's ganglion cells, including retinal ganglion cell loss. The Glaid device was approved by the FDA in 2005 and has undergone extensive testing and clinical studies in the United States, Canada and Italy, including at Bascom Palmer Eye Institute, University of California at San Diego's Hamilton Glaucoma Center, and New York State College of Optometry Under the terms of the agreement, the Company has the exclusive right to distribute the Glaid device in the United States and Canada. The Company also has a first right of refusal for distribution of the product to countries outside the United States and Canada where LACE is not currently selling or marketing the product. These additional distribution rights are subject to reasonable new minimum quotas. The Distribution Agreement requires the Company to purchase the Glaid device from LACE at an agreed upon price and to then sell the product in compliance with minimum order requirements. The five year quotas for the Glaid device are 27 units, 60 units, 100 units, 120 units, and 120 units for years one through five of the agreement. Paradigm sales for quota requirements are to begin as soon as the product is fully completed, with all accessories and consumables, and ready for delivery. The Distribution Agreement is for the term of five years. At the end of the five year term, representatives of the Company and LACE will determine whether to extend the term of the agreement. If mutual --- F-57 PARADIGM MEDICAL INDUSTRIES, INC. NOTES TO FINANCIAL STATEMENTS CONTINUED --- 17. SUBSEQUENT agreement for continuation of the agreement is not EVENTS reached within 120 days thereafter, the agreement will CONTINUED be deemed terminated. However, if within the 120 day period, the Company and LACE mutually agree to continue the agreement, then either party may terminate the agreement at any time thereafter by providing at least twelve months' prior written notice to the other party. All outstanding orders at the time of notification will be supplied under the terms of the agreement, and LACE will continue to fulfill all orders from the Company until the twelve month notice period has expired. LACE also agrees to provide a twelve month warranty from the day of delivery on all Glaid devices supplied to the Company. If the defects cannot be corrected at the Company's facilities or at the facilities of trained Company repair centers, the products must then be returned to LACE for purposes of carrying out such repairs as required, and LACE agrees to return the repaired products to the Company or its designated agent or distributor within ten working days from the date of receiving such products, at no cost to the Company, and LACE will pay return freight costs. The Company additionally agrees to arrange for installation of the Glaid device at no cost to LACE. The Company further agrees to provide Company brand specific labeling to be applied to the LACE devices shipped directly to the Company's customers. --- F-58 PARADIGM MEDICAL INDUSTRIES, INC. NOTES TO FINANCIAL STATEMENTS CONTINUED --- 18. RESTATEMENT We have restated our annual financial statements for AND the years ended December 31, 2006 and 2005, and our RECLASSIFICA- quarterly financial statements for the quarter ended TION March 31, June 30, and September 30, 2007 and 2006, respectively. These restatements have been performed to reflect issues identified during a regulatory review of our financial statements associated with a filing with the SEC. Management and the board of directors concluded these restatements were necessary to reflect the changes described below. o We erroneously treated the conversion-related derivatives and warrants associated with the Company's Callable Secured Convertible Notes for the years ended December 31, 2005, 2006 and 2007. The correct presentation is as a liability adjusted for changes in fair value, at each balance sheet date, through the statements of operations, as provided by SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities." o We have also expanded footnote disclosures and added disclosures to help clarify the amounts recorded in the financial statements of the Company. A summary of the effects of these changes is as follows: --- F-59 PARADIGM MEDICAL INDUSTRIES, INC. NOTES TO FINANCIAL STATEMENTS CONTINUED

--- PARADIGM MEDICAL INDUSTRIES, INC. BALANCE SHEET AS PREVIOUSLY DECEMBER 31, 2005 REPORTED AS RESTATED CHANGE --------------- --------------- --------------- ASSETS Current assets: Cash $ 66,000 $ 66,000 $ - Receivables, net 401,000 401,000 - Inventories, net 853,000 853,000 - Prepaid and other assets 11,000 11,000 - --------------- --------------- --------------- Total current assets 1,331,000 1,331,000 - Property and equipment, net 32,000 32,000 - Goodwill 339,000 339,000 - --------------- --------------- --------------- Total assets $ 1,702,000 $ 1,702,000 $ - =============== =============== =============== LIABILITIES AND STOCKHOLDERS' (DEFICIT) Current liabilities: Accounts payable $ 459,000 $ 459,000 $ - Accrued liabilities 704,000 704,000 - Current portion of capital lease obligations 14,000 14,000 - --------------- --------------- --------------- Total current liabilities 1,177,000 1,177,000 - --------------- --------------- --------------- Convertible notes payable, net of discount $1,699,000 2,038,000 339,000 (1,699,000) Derivative liabilities - 195,000 195,000 --------------- --------------- --------------- Total long-term liabilities 2,038,000 534,000 (1,504,000) --------------- --------------- --------------- Total liabilities 3,215,000 1,711,000 (1,504,000) Commitments and contingencies - - - Stockholders' (Deficit): Preferred stock, $.001 par value, 5,000,000 shares authorized, 613,447 shares issued and outstanding (aggregate liquidation preference of $496,000) 1,000 1,000 - Common stock, $.001 par value, 250,000,000 shares authorized, 96,389,295 shares issued and outstanding 96,000 96,000 - Additional paid-in capital 60,586,000 58,086,000 (2,500,000) Accumulated deficit (62,196,000) (58,192,000) 4,004,000 --------------- --------------- --------------- Total stockholders' (Deficit) (1,513,000) (9,000) 1,504,000 --------------- --------------- --------------- Total liabilities and stockholders' (Deficit) $ 1,702,000 $ 1,702,000 $ - =============== =============== =============== a To properly record convertible debenture b To properly record derivative liabilities c To reclassify additional paid-in capital d To reclassify derivative accumulated deficit --- F-60 PARADIGM MEDICAL INDUSTRIES, INC. NOTES TO FINANCIAL STATEMENTS CONTINUED --- PARADIGM MEDICAL INDUSTRIES, INC. STATEMENTS OF OPERATIONS AS PREVIOUSLY TWELVE MONTHS ENDED DECEMBER 31, 2005 REPORTED AS RESTATED CHANGE --------------- --------------- --------------- Sales $ 2,201,000 $ 2,201,000 $ - Cost of sales 1,599,000 1,599,000 - --------------- --------------- --------------- Gross profit 602,000 602,000 - --------------- --------------- --------------- Operating expenses: General and administrative (1,298,000) (1,298,000) - Marketing and selling (641,000) (641,000) - Research and development (855,000) (855,000) - Gain on settlement of liabilities 12,000 12,000 - --------------- --------------- --------------- Total operating expenses (2,782,000) (2,782,000) - --------------- --------------- --------------- Operating loss (2,180,000) (2,180,000) - --------------- --------------- --------------- Other income (expense): Other income 16,000 16,000 - Other expenses (2,870,000) - 2,870,000 a Interest expense-Accetion of debt discount - (801,000) (801,000)b Gain and loss on derivative valuation - 3,974,000 3,974,000 c Initial fair value of derivative and warrant - (1,669,000) (1,669,000)d Interest expense (15,000) (385,000) (370,000)e Impairment of intangible assets (340,000) (340,000) - --------------- --------------- --------------- Total other income (expense) (3,209,000) 795,000 4,004,000 --------------- --------------- --------------- Income (loss) before provision for income taxes (5,389,000) (1,385,000) 4,004,000 Provision for income taxes - - - --------------- --------------- --------------- Net (loss) $ (5,389,000) $ (1,385,000) $ 4,004,000 =============== =============== =============== Earnings (loss) per common share - basic $ (0.13) $ (0.03) $ 0.11 --------------- --------------- --------------- Earnings (loss) per common share - diluted $ (0.13) $ (0.03) $ 0.10 =============== =============== =============== Weighted average common shares - basic 42,033,000 42,033,000 - --------------- --------------- --------------- Weighted average common shares - diluted 42,942,000 42,942,000 - =============== =============== =============== a To reclassify other expense of benefitial convertion feature b To propertly record Interest expense-Accetion of debt discount c To properly record Gain and loss on derivative valuation d To properly record Initial value fair value of derivative and warrant e To reclassify interest expense --- F-61 PARADIGM MEDICAL INDUSTRIES, INC. NOTES TO FINANCIAL STATEMENTS CONTINUED --- PARADIGM MEDICAL INDUSTRIES, INC. STATEMENTS OF CASH FLOWS AS PREVIOUSLY DECEMBER 31, 2005 REPORTED AS RESTATED CHANGE --------------- --------------- --------------- CASH FLOWS FROM OPERATING ACTIVITIES: Net income (loss) $ (5,389,000) $ (1,385,000) $ 4,004,000 a Adjustments to reconcile net income (loss) to net cash used in operating activities: Depreciation and amortization 77,000 77,000 - Issuance of common stock for satisfaction of penalty 53,000 53,000 - Issuance of common stock for services 23,000 23,000 - Change in fair value of derivative liabilities - (2,305,000) (2,305,000)b Beneficial conversion interest 2,009,000 801,000 (1,208,000)c Issuance of stock options and warrants for services 491,000 - (491,000)d Provision for losses on receivables (1,000) (1,000) - Provision for losses on inventory (61,000) (61,000) - Impairment of Intangibles and investments 340,000 340,000 - (Gain) loss on settlement of liabilities (12,000) (12,000) - (Increase) decrease in: Accounts Receivables 257,000 257,000 - Inventories (72,000) (72,000) - Prepaid and other assets 56,000 56,000 - Increase (decrease) in: Accounts payable (291,000) (291,000) - Accrued liabilities (148,000) (148,000) - --------------- --------------- --------------- NET CASH USED IN OPERATING ACTIVITIES (2,668,000) (2,668,000) - --------------- --------------- --------------- CASH FLOWS FROM INVESTING ACTIVITIES: --------------- --------------- --------------- NET CASH PROVIDED BY (USED IN) INVESTING ACTIVITIES - - - --------------- --------------- --------------- CASH FLOWS FROM FINANCING ACTIVITIES: Principal payments on notes payable and long-term debt (47,000) (47,000) - Proceeds from issuance of common stock 150,000 150,000 - Proceeds from issuance of convertible notes 2,500,000 2,500,000 - --------------- --------------- --------------- NET CASH (USED IN) PROVIDED BY FINANCING ACTIVITIES 2,603,000 2,603,000 - --------------- --------------- --------------- Net change in cash (65,000) (65,000) - Cash, beginning of year 131,000 131,000 - --------------- --------------- --------------- CASH, END OF YEAR $ 66,000 $ 66,000 $ - =============== =============== =============== a To reclassify net loss b To propertly record Change in fair value of derivative liabilities c To reclassify Beneficial conversion interest d To reclassigy Issuance of stock options and warrants for services --- F-62 PARADIGM MEDICAL INDUSTRIES, INC. NOTES TO FINANCIAL STATEMENTS CONTINUED --- PARADIGM MEDICAL INDUSTRIES, INC. BALANCE SHEET AS PREVIOUSLY MARCH 31, 2006 REPORTED AS RESTATED CHANGE --------------- ---------------

-------------- ASSETS Current assets: Cash $ 400,000 $ 400,000 $ - Receivables, net 319,000 319,000 - Inventories, net 820,000 820,000 - Prepaid and other assets 61,000 61,000 - --------------- --------------- --------------- Total current assets 1,600,000 1,600,000 - Property and equipment, net 21,000 21,000 - Goodwill 339,000 339,000 - --------------- --------------- --------------- Total assets $ 1,960,000 $ 1,960,000 $ - =============== =============== =============== LIABILITIES AND STOCKHOLDERS' (DEFICIT) Current liabilities: Accounts payable $ 432,000 $ 432,000 $ - Accrued liabilities 732,000 732,000 - Current portion of capital lease obligations 5,000 5,000 - --------------- --------------- --------------- Total current liabilities 1,169,000 1,169,000 - --------------- --------------- --------------- Convertible notes payable, net of discount $1,741,000 2,343,000 602,000 (1,741,000)a Derivative liabilities - 816,000 816,000 b --------------- --------------- --------------- Total long-term liabilities 2,343,000 1,418,000 (925,000) =============== =============== =============== Total liabilities 3,512,000 2,587,000 (925,000) Commitments and contingencies - - - Stockholders' (Deficit): Preferred stock authorized: 5,000,000 shares, $0.001 par value 1,000 1,000 - Common stock authorized: 250,000,000 shares, $.001 par value, 160,800,324 shares issued and outstanding at March 31, 2006 161,000 161,000 - Additional paid-in capital 61,238,000 58,238,000 (3,000,000)c Accumulated deficit (62,952,000) (59,027,000) 3,925,000 d --------------- --------------- --------------- Total stockholders' (Deficit) (1,552,000) (627,000) 925,000 --------------- --------------- --------------- Total liabilities and stockholders' (Deficit) $ 1,960,000 $ 1,960,000 $ - =============== =============== =============== a To properly record convertible debenture b To properly record derivative liabilities c To reclassify additional paid-in capital d To reclassify derivative accumulated deficit -- F-63 PARADIGM MEDICAL INDUSTRIES, INC. NOTES TO FINANCIAL STATEMENTS CONTINUED -- PARADIGM MEDICAL INDUSTRIES, INC. STATEMENTS OF OPERATIONS AS PREVIOUSLY THREE MONTHS ENDED MARCH 31, 2006 REPORTED AS RESTATED CHANGE --------------- --------------- --------------- Sales $ 463,000 $ 463,000 $ - Cost of sales 222,000 222,000 - --------------- --------------- --------------- Gross profit 241,000 241,000 - --------------- --------------- --------------- Operating expenses: General and administrative (250,000) (250,000) - Marketing and selling (78,000) (78,000) - Research and development (124,000) (124,000) - --------------- --------------- --------------- Total operating expenses (452,000) (452,000) - --------------- --------------- --------------- Operating loss (211,000) (211,000) - --------------- --------------- --------------- Other income (expense): Other income 2,000 2,000 - Other expenses (544,000) - 544,000 a Interest expense-Accetion of debt discount - (349,000) (349,000)b Gain and loss on derivative valuation - (230,000) (230,000)c Interest expense (3,000) (47,000) (44,000)d --------------- --------------- --------------- Total other income (expense) (545,000) (624,000) (79,000) --------------- --------------- --------------- Income (loss) before provision for income taxes (756,000) (835,000) (79,000) Provision for income taxes - - - --------------- --------------- --------------- Net (loss) $ (756,000) $ (835,000) $ (79,000) =============== =============== =============== Earnings (loss) per common share - basic $ (0.01) $ (0.01) $ (0) --------------- --------------- --------------- Earnings (loss) per common share - diluted $ (0.01) $ (0.01) $ (0) =============== =============== =============== Weighted average common shares - basic 124,647,000 124,647,000 - --------------- --------------- --------------- Weighted average common shares - diluted 124,647,000 124,647,000 - =============== =============== =============== a To reclassify other expense of benefitial convertion feature b To propertly record Interest expense-Accetion of debt discount c To properly record Gain and loss on derivative valuation d To properly record Initial value fair value of derivative and warrant e To reclassify interest expense -- F-64 PARADIGM MEDICAL INDUSTRIES, INC. NOTES TO FINANCIAL STATEMENTS CONTINUED -- PARADIGM MEDICAL INDUSTRIES, INC. STATEMENTS OF CASH FLOWS AS PREVIOUSLY MARCH 31, 2006 REPORTED AS RESTATED CHANGE --------------- --------------- --------------- CASH FLOWS FROM OPERATING ACTIVITIES: Net income (loss) $ (756,000) $ (835,000) $ (79,000)a Adjustments to reconcile net income (loss) to net cash used in operating activities: Depreciation and amortization 16,000 16,000 - Stock option valuation 23,000 23,000 - Change in fair value of derivative liabilities - 230,000 230,000 b Beneficial conversion interest 482,000 349,000 (133,000)c Issuance of stock options and warrants for services 18,000 - (18,000)d Provision for losses on receivables 1,000 1,000 - Provision for losses on inventory 25,000 25,000 - (Increase) decrease in: Accounts Receivables 80,000 80,000 - Inventories 8,000 8,000 - Prepaid and other assets (50,000) (50,000) - Increase (decrease) in: Accounts payable (27,000) (27,000) - Accrued liabilities 28,000 28,000 - --------------- --------------- --------------- NET CASH USED IN OPERATING ACTIVITIES (152,000) (152,000) - --------------- --------------- --------------- CASH FLOWS FROM INVESTING ACTIVITIES: Acquisition of property and equipment (5,000) (5,000) - --------------- --------------- --------------- Net cash provided by (used in) investing activities (5,000) (5,000) - --------------- --------------- --------------- CASH FLOWS FROM FINANCING ACTIVITIES: Principal payments on notes payable and long-term debt (9,000) (9,000) - Proceeds from issuance of convertible notes 500,000 500,000 - --------------- --------------- --------------- NET CASH (USED IN) PROVIDED BY FINANCING ACTIVITIES 491,000 491,000 - --------------- --------------- --------------- Net change in cash 334,000 334,000 - Cash, beginning of period 66,000 66,000 - --------------- --------------- --------------- Cash, end of period $ 400,000 $ 400,000 $ - =============== =============== =============== Supplemental disclosure of cash flow information: Cash paid for interest $ 1,000 $ 1,000 --------------- --------------- Cash paid for income taxes $ - $ - --------------- --------------- a To reclassify net loos b To propertly record Change in fair value of derivative liabilities c To reclassify Beneficial conversion interest d To reclassigy Issuance of stock options and warrants for services -- F-65 PARADIGM MEDICAL INDUSTRIES, INC. NOTES TO FINANCIAL STATEMENTS CONTINUED -- PARADIGM MEDICAL INDUSTRIES, INC. BALANCE SHEET AS PREVIOUSLY JUNE 30, 2006 REPORTED AS RESTATED CHANGE --------------- --------------- --------------- ASSETS Current assets: Cash $ 591,000 $ 591,000 $ - Receivables, net 486,000 486,000 - Inventories, net 786,000 786,000 - Prepaid and other assets 49,000 49,000 - --------------- --------------- --------------- Total current assets 1,912,000 1,912,000 - Property and equipment, net 24,000 24,000 - Goodwill 339,000 339,000 - --------------- --------------- --------------- Total assets $ 2,275,000 $ 2,275,000 $ - =============== =============== =============== LIABILITIES AND STOCKHOLDERS' (DEFICIT) Current liabilities: Accounts payable $ 390,000

$ 390,000 $ - Accrued liabilities 848,000 848,000 - Current portion of capital lease obligations 1,000 1,000 - --------------- --------------- --------------- Total current liabilities 1,239,000 1,239,000 - --------------- --------------- --------------- Convertible notes payable, net of discount $1,579,000 2,670,000 1,091,000 (1,579,000) a Derivative liabilities - 440,000 440,000 b --------------- --------------- --------------- Total long-term liabilities 2,670,000 1,531,000 (1,139,000) --------------- --------------- --------------- Total liabilities 3,909,000 2,770,000 (1,139,000) Commitments and contingencies - - - Stockholders' (Deficit): Preferred stock authorized: 5,000,000 shares, $0.001 par value 1,000 1,000 - Common stock authorized: 250,000,000 shares, $.001 par value, 196,956,828 shares issued and outstanding at June 30, 2006 197,000 197,000 - Additional paid-in capital 61,873,000 58,373,000 (3,500,000)a Accumulated deficit (63,705,000) (59,066,000) 4,639,000 b --------------- --------------- --------------- Total stockholders' (Deficit) (1,634,000) (495,000) 1,139,000 --------------- --------------- --------------- Total liabilities and stockholders' (Deficit) $ 2,275,000 $ 2,275,000 $ - =============== =============== =============== a To properly record convertible debenture b To properly record derivative liabilities c To reclassify additional paid-in capital d To reclassify derivative accumulated deficit -- F-66 PARADIGM MEDICAL INDUSTRIES, INC. NOTES TO FINANCIAL STATEMENTS CONTINUED -- PARADIGM MEDICAL INDUSTRIES, INC. STATEMENTS OF OPERATIONS AS PREVIOUSLY THREE MONTHS ENDED JUNE 30, 2006 REPORTED AS RESTATED CHANGE --------------- --------------- --------------- Sales $ 718,000 $ 718,000 $ - Cost of sales 416,000 416,000 - --------------- --------------- --------------- Gross profit 302,000 302,000 - --------------- --------------- --------------- Operating expenses: General and administrative (263,000) (263,000) - Marketing and selling (108,000) (108,000) - Research and development (132,000) (132,000) - --------------- --------------- --------------- Total operating expenses (503,000) (503,000) - --------------- --------------- --------------- Operating loss (201,000) (201,000) - --------------- --------------- --------------- Other income (expense): Other expenses (Financing cost) (553,000) - 553,000 a Interest expense-Accetion of debt discount - (312,000) (312,000)b Gain and loss on derivative valuation - 526,000 526,000 c Interest expense (1,000) (54,000) (53,000)d --------------- --------------- --------------- Total other income (expense) (554,000) 160,000 714,000 --------------- --------------- --------------- Income (loss) before provision for income taxes (755,000) (41,000) 714,000 Provision for income taxes - - - --------------- --------------- --------------- Net (loss) $ (755,000) $ (41,000) $ 714,000 =============== =============== =============== Earnings (loss) per common share - basic $ (0.00) $ (0.00) $ 0 --------------- --------------- --------------- Earnings (loss) per common share - diluted $ (0.00) $ (0.00) $ 0 =============== =============== =============== Weighted average common shares - basic 175,402,000 175,402,000 - --------------- --------------- --------------- Weighted average common shares - diluted 175,402,000 175,402,000 - =============== =============== =============== a To reclassify other expense of benefitial convertion feature b To propertly record Interest expense-Accetion of debt discount c To properly record Gain and loss on derivative valuation d To properly record Initial value fair value of derivative and warrant e To reclassify interest expense -- F-67 PARADIGM MEDICAL INDUSTRIES, INC. NOTES TO FINANCIAL STATEMENTS CONTINUED -- PARADIGM MEDICAL INDUSTRIES, INC. STATEMENTS OF OPERATIONS AS PREVIOUSLY SIX MONTHS ENDED JUNE 30, 2006 REPORTED AS RESTATED CHANGE --------------- --------------- --------------- Sales $ 1,182,000 $ 1,182,000 $ - Cost of sales 638,000 638,000 - --------------- --------------- --------------- Gross profit 544,000 544,000 - --------------- --------------- --------------- Operating expenses: General and administrative (514,000) (514,000) - Marketing and selling (185,000) (185,000) - Research and development (257,000) (257,000) - --------------- --------------- --------------- Total operating expenses (956,000) (956,000) - --------------- --------------- --------------- Operating loss (412,000) (412,000) - --------------- --------------- --------------- Other income (expense): Other income 2,000 2,000 - Other expenses (Financing cost) (1,097,000) - 1,097,000 a Interest expense-Accetion of debt discount - (661,000) (661,000)b Gain and loss on derivative valuation - 296,000 296,000 c Interest expense (4,000) (101,000) (97,000)d --------------- --------------- --------------- Total other income (expense) (1,099,000) (464,000) 635,000 --------------- --------------- --------------- Income (loss) before provision for income taxes (1,511,000) (876,000) 635,000 Provision for income taxes - - - --------------- --------------- --------------- Net (loss) $ (1,511,000) $ (876,000) $ 635,000 =============== =============== =============== Earnings (loss) per common share - basic $ (0.01) $ (0.01) $ 0 --------------- --------------- --------------- Earnings (loss) per common share - diluted $ (0.01) $ (0.01) $ 0 =============== =============== =============== Weighted average common shares - basic 150,164,000 150,164,000 - --------------- --------------- --------------- Weighted average common shares - diluted 150,164,000 150,164,000 - =============== =============== =============== a To reclassify other expense of benefitial convertion feature b To propertly record Interest expense-Accetion of debt discount c To properly record Gain and loss on derivative valuation d To properly record Initial value fair value of derivative and warrant e To reclassify interest expense -- F-68 PARADIGM MEDICAL INDUSTRIES, INC. NOTES TO FINANCIAL STATEMENTS CONTINUED -- PARADIGM MEDICAL INDUSTRIES, INC. STATEMENTS OF CASH FLOWS AS PREVIOUSLY JUNE 30, 2006 REPORTED AS RESTATED CHANGE --------------- --------------- --------------- CASH FLOWS FROM OPERATING ACTIVITIES: Net income (loss) $ (1,511,000) $ (876,000) $ 635,000 a Adjustments to reconcile net income (loss) to net cash used in operating activities: Depreciation and amortization 24,000 24,000 - Stock option valuation 23,000 23,000 - Change in fair value of derivative liabilities - (296,000) (296,000)b Beneficial conversion interest 964,000 661,000 (303,000)c Issuance of stock options and warrants for services 36,000 - (36,000)d Provision for losses on receivables 1,000 1,000 - (Increase) decrease in: Accounts Receivables (86,000) (86,000) - Inventories 67,000 67,000 - Prepaid and other assets (38,000) (38,000) - Increase (decrease) in: Accounts payable (69,000) (69,000) - Accrued liabilities 144,000 144,000 - --------------- --------------- --------------- NET CASH USED IN OPERATING ACTIVITIES (445,000) (445,000) - --------------- --------------- --------------- CASH FLOWS FROM INVESTING ACTIVITIES: Acquisition of property and equipment (16,000) (16,000) - --------------- --------------- --------------- NET CASH PROVIDED BY (USED IN) INVESTING ACTIVITIES (16,000) (16,000) - --------------- --------------- --------------- CASH FLOWS FROM FINANCING ACTIVITIES: Principal payments on notes payable and long-term debt (14,000) (14,000) - Proceeds from issuance of convertible notes

1,000,000 1,000,000 - --------------- --------------- --------------- NET CASH (USED IN) PROVIDED BY FINANCING ACTIVITIES 986,000 986,000 - --------------- --------------- --------------- Net change in cash 525,000 525,000 - Cash, beginning of period 66,000 66,000 - --------------- --------------- --------------- CASH, END OF PERIOD $ 591,000 $ 591,000 $ - =============== =============== =============== Supplemental disclosure of cash flow information: Cash paid for interest $ 2,000 $ 2,000 --------------- --------------- Cash paid for income taxes $ - $ - --------------- --------------- a To reclassify net loos b To propertly record Change in fair value of derivative liabilities c To reclassify Beneficial conversion interest d To reclassigy Issuance of stock options and warrants for services -- F-69 PARADIGM MEDICAL INDUSTRIES, INC. NOTES TO FINANCIAL STATEMENTS CONTINUED -- PARADIGM MEDICAL INDUSTRIES, INC. BALANCE SHEET AS PREVIOUSLY SEPTEMBER 30, 2006 REPORTED AS RESTATED CHANGE --------------- --------------- --------------- ASSETS Current assets: Cash $ 267,000 $ 267,000 $ - Receivables, net 292,000 292,000 - Inventories, net 873,000 873,000 - Prepaid and other assets 57,000 57,000 - --------------- --------------- --------------- Total current assets 1,489,000 1,489,000 - Property and equipment, net 24,000 24,000 - Goodwill 339,000 339,000 - --------------- --------------- --------------- Total assets $ 1,852,000 $ 1,852,000 $ - =============== =============== =============== LIABILITIES AND STOCKHOLDERS' (DEFICIT) Current liabilities: Accounts payable $ 336,000 $ 336,000 $ - Accrued liabilities 793,000 793,000 - --------------- --------------- --------------- Total current liabilities 1,129,000 1,129,000 - --------------- --------------- --------------- Convertible notes payable, net of discount $1,431,000 2,660,000 1,229,000 (1,431,000)a Derivative liabilities - 383,000 383,000 b --------------- --------------- --------------- Total long-term liabilities 2,660,000 1,612,000 (1,048,000) =============== =============== =============== Total liabilities 3,789,000 2,741,000 (1,048,000) Commitments and contingencies - - - Stockholders' (Deficit): Preferred stock authorized: 5,000,000 shares, $0.001 par value 1,000 1,000 - Common stock authorized: 800,000,000 shares, $.001 par value, 199,956,828 shares issued and outstanding at September 30, 2006 200,000 200,000 - Additional paid-in capital 61,881,000 58,381,000 (3,500,000)c Accumulated deficit (64,019,000) (59,471,000) 4,548,000 d --------------- --------------- --------------- Total stockholders' (Deficit) (1,937,000) (889,000) 1,048,000 --------------- --------------- --------------- Total liabilities and stockholders' (Deficit) $ 1,852,000 $ 1,852,000 $ - =============== =============== =============== a To properly record convertible debenture b To properly record derivative liabilities c To reclassify additional paid-in capital d To reclassify derivative accumulated deficit -- F-70 PARADIGM MEDICAL INDUSTRIES, INC. NOTES TO FINANCIAL STATEMENTS CONTINUED -- PARADIGM MEDICAL INDUSTRIES, INC. STATEMENTS OF OPERATIONS AS PREVIOUSLY THREE MONTHS ENDED SEPTEMBER 30, 2006 REPORTED AS RESTATED CHANGE --------------- --------------- --------------- Sales $ 418,000 $ 418,000 $ - Cost of sales 203,000 203,000 - --------------- --------------- --------------- Gross profit 215,000 215,000 - --------------- --------------- --------------- Operating expenses: General and administrative (258,000) (258,000) - Marketing and selling (123,000) (123,000) - Research and development (130,000) (130,000) - --------------- --------------- --------------- Total operating expenses (511,000) (511,000) - --------------- --------------- --------------- Operating loss (296,000) (296,000) - --------------- --------------- --------------- Other income (expense): Other income (interest) 5,000 5,000 - Other expenses (Financing cost) (54,000) - 54,000 a Interest expense-Accetion of debt discount - (148,000) (148,000)b Gain and loss on derivative valuation - 58,000 58,000 c Interest expense (3,000) (57,000) (54,000)d Gain on sale of investment 33,000 33,000 - --------------- --------------- --------------- Total other income (expense) (19,000) (109,000) (90,000) --------------- --------------- --------------- Income (loss) before provision for income taxes (315,000) (405,000) (90,000) Provision for income taxes - - - --------------- --------------- --------------- Net (loss) $ (315,000) $ (405,000) $ (90,000) =============== =============== =============== Earnings (loss) per common share - basic $ (0.00) $ (0.00) $ (0) --------------- --------------- --------------- Earnings (loss) per common share - diluted $ (0.00) $ (0.00) $ (0) =============== =============== =============== Weighted average common shares - basic 198,546,000 198,546,000 - --------------- --------------- --------------- Weighted average common shares - diluted 198,546,000 198,546,000 - =============== =============== =============== a To reclassify other expense of benefitial convertion feature b To propertly record Interest expense-Accetion of debt discount c To properly record Gain and loss on derivative valuation d To properly record Initial value fair value of derivative and warrant e To reclassify interest expense -- F-71 PARADIGM MEDICAL INDUSTRIES, INC. NOTES TO FINANCIAL STATEMENTS CONTINUED -- PARADIGM MEDICAL INDUSTRIES, INC. STATEMENTS OF OPERATIONS AS PREVIOUSLY NINE MONTHS ENDED SEPTEMBER 30, 2006 REPORTED AS RESTATED CHANGE --------------- --------------- --------------- Sales $ 1,600,000 $ 1,600,000 $ - Cost of sales 841,000 841,000 - --------------- --------------- --------------- Gross profit 759,000 759,000 - --------------- --------------- --------------- Operating expenses: General and administrative (772,000) (772,000) - Marketing and selling (307,000) (307,000) - Research and development (388,000) (388,000) - --------------- --------------- --------------- Total operating expenses (1,467,000) (1,467,000) - --------------- --------------- --------------- Operating loss (708,000) (708,000) - --------------- --------------- --------------- Other income (expense): Other income (interest) 5,000 5,000 - Other expenses (Financing cost) (1,152,000) - 1,152,000 a Interest expense-Accetion of debt discount - (809,000) (809,000)b Gain and loss on derivative valuation - 353,000 353,000 c Interest expense (7,000) (159,000) (152,000)d Gain on sale of investment 36,000 36,000 - --------------- --------------- --------------- Total other income (expense) (1,118,000) (574,000) 544,000 --------------- --------------- --------------- Income (loss) before provision for income taxes (1,826,000) (1,282,000) 544,000 Provision for income taxes - - - --------------- --------------- --------------- Net (loss) $ (1,826,000) $ (1,282,000) $ 544,000 =============== =============== =============== Earnings (loss) per common share - basic $ (0.01) $ (0.01) $ 0 --------------- --------------- --------------- Earnings (loss) per common share - diluted $ (0.01) $ (0.01) $ 0 =============== =============== =============== Weighted average common shares - basic 166,459,000 166,459,000 - --------------- --------------- --------------- Weighted average common shares - diluted 166,459,000 166,459,000 - =============== =============== =============== a To reclassify other expense of benefitial convertion feature b To propertly record Interest expense-Accetion of debt discount c To properly record Gain and loss on derivative valuation d To properly record Initial value fair value of derivative and warrant e To reclassify interest expense -- F-72 PARADIGM MEDICAL INDUSTRIES, INC. NOTES TO FINANCIAL STATEMENTS CONTINUED --- PARADIGM MEDICAL INDUSTRIES, INC. STATEMENTS OF CASH FLOWS AS PREVIOUSLY SEPTEMBER 30, 2006 REPORTED AS RESTATED CHANGE --------------- --------------- --------------- CASH FLOWS FROM OPERATING ACTIVITIES: Net income (loss) $ (1,826,000) $ (1,282,000) $ 544,000 a Adjustments to reconcile net income (loss) to net cash used in operating activities: Depreciation and amortization 28,000 28,000 - Stock option valuation 23,000 23,000 - Change in fair value of derivative liabilities - (353,000) (353,000)b Beneficial conversion interest 964,000 809,000 (155,000)c Issuance of stock options and warrants for services 36,000 - (36,000)d Provision for losses on receivables (5,000) (5,000) - Provision for losses on inventory (24,000) (24,000) - (Increase) decrease in: Accounts Receivables 114,000 114,000 - Inventories 4,000 4,000 - Prepaid and other assets (46,000) (46,000) - Increase (decrease) in: Accounts payable (123,000) (123,000) - Accrued liabilities 89,000 89,000 - --------------- --------------- --------------- NET CASH USED IN OPERATING ACTIVITIES (766,000) (766,000) - --------------- --------------- --------------- Cash flows from investing activities: Acquisition of property and equipment (19,000) (19,000) - --------------- --------------- --------------- NET CASH PROVIDED BY (USED IN) INVESTING ACTIVITIES (19,000) (19,000) - --------------- --------------- --------------- CASH FLOWS FROM FINANCING ACTIVITIES: Principal payments on notes payable and long-term debt (14,000) (14,000) - Proceeds from issuance of convertible notes 1,000,000 1,000,000 - --------------- --------------- --------------- NET CASH (USED IN) PROVIDED BY FINANCING ACTIVITIES 986,000 986,000 - --------------- --------------- --------------- Net change in cash 201,000 201,000 - Cash, beginning of period 66,000 66,000 - --------------- --------------- --------------- CASH, END OF PERIOD $ 267,000 $ 267,000 $ - =============== =============== =============== Supplemental disclosure of cash flow information: Cash paid for interest $ 4,000 $ 4,000 --------------- --------------- Cash paid for income taxes $ - $ - --------------- --------------- a To reclassify net loos b To propertly record Change in fair value of derivative liabilities c To reclassify Beneficial conversion interest d To reclassigy Issuance of stock options and warrants for services --- F-73 PARADIGM MEDICAL INDUSTRIES, INC. NOTES TO FINANCIAL STATEMENTS CONTINUED --- PARADIGM MEDICAL INDUSTRIES, INC. BALANCE SHEET AS PREVIOUSLY DECEMBER 31, 2006 REPORTED AS RESTATED CHANGE --------------- --------------- --------------- ASSETS Current assets: Cash $ 206,000 $ 206,000 $ - Receivables, net 410,000 410,000 - Inventories, net 945,000 945,000 - Prepaid and other assets 11,000 11,000 - --------------- --------------- --------------- Total current assets 1,572,000 1,572,000 - Property and equipment, net 21,000 21,000 - Goodwill 339,000 339,000 - --------------- --------------- --------------- Total assets $ 1,932,000 $ 1,932,000 $ - =============== =============== =============== LIABILITIES AND STOCKHOLDERS' (DEFICIT) Current liabilities: Accounts payable $ 400,000 $ 400,000 $ - Accrued liabilities 802,000 802,000 - --------------- --------------- --------------- Total current liabilities 1,202,000 1,202,000 - --------------- --------------- --------------- Convertible notes payable, net of discount $1,288,000 2,655,000 1,367,000 (1,288,000)a Derivative liabilities - 166,000 166,000 b --------------- --------------- --------------- Total long-term liabilities 2,655,000 1,533,000 (1,122,000) =============== =============== =============== Total liabilities 3,857,000 2,735,000 (1,122,000) Commitments and contingencies - - - Stockholders' (Deficit): Preferred stock, $.001 par value, 5,000,000 shares authorized, 612,697 shares issued and outstanding (aggregate liquidation preference of $456,000) 1,000 1,000 - Common stock, $.001 par value, 250,000,000 shares authorized, 201,956,394 shares issued and outstanding 202,000 202,000 - Additional paid-in capital 61,884,000 58,384,000 (3,500,000)c Accumulated deficit (64,012,000) (59,390,000) 4,622,000 d --------------- --------------- --------------- Total stockholders' (Deficit) (1,925,000) (803,000) 1,122,000 --------------- --------------- --------------- Total liabilities and stockholders' (Deficit) $ 1,932,000 $ 1,932,000 $ - =============== =============== =============== a To properly record convertible debenture b To properly record derivative liabilities c To reclassify additional paid-in capital d To reclassify derivative accumulated deficit --- F-74 PARADIGM MEDICAL INDUSTRIES, INC. NOTES TO FINANCIAL STATEMENTS CONTINUED --- PARADIGM MEDICAL INDUSTRIES, INC. STATEMENTS OF OPERATIONS AS PREVIOUSLY TWELVE MONTHS ENDED DECEMBER 31, 2006 REPORTED AS RESTATED CHANGE --------------- --------------- --------------- Sales $ 2,195,000 $ 2,195,000 $ - Cost of sales 1,277,000 1,277,000 - --------------- --------------- --------------- Gross profit 918,000 918,000 - --------------- --------------- --------------- Operating expenses: General and administrative (792,000) (792,000) - Professional fees-related party (187,000) (187,000) Marketing and selling (434,000) (434,000) - Research and development (250,000) (250,000) - Gain on settlement of liabilities 34,000 34,000 - --------------- --------------- --------------- Total operating expenses (1,629,000) (1,629,000) - --------------- --------------- --------------- Operating loss (711,000) (711,000) - --------------- --------------- --------------- Other income (expense): Other income 109,000 109,000 - Other expenses (1,207,000) - 1,207,000 a Interest expense-Accetion of debt discount - (952,000) (952,000)b Gain and loss on derivative valuation - 570,000 570,000 c Interest expense (7,000) (214,000) (207,000)d --------------- --------------- --------------- Total other income (expense) (1,105,000) (487,000) 618,000 --------------- --------------- --------------- Income (loss) before provision for income taxes (1,816,000) (1,198,000) 618,000 Provision for income taxes - - - --------------- --------------- --------------- Net (loss) $ (1,816,000) $ (1,198,000) $ 618,000 =============== =============== =============== Earnings (loss) per common share - basic $ (0.01) $ (0.01) $ 0 --------------- --------------- --------------- Earnings (loss) per common share - diluted $ (0.01) $ (0.01) $ 0 =============== =============== =============== Weighted average common shares - basic 175,034,000 175,034,000 - --------------- --------------- --------------- Weighted average common shares - diluted 175,034,000 175,034,000 - =============== =============== =============== a To reclassify other expense of benefitial convertion feature b To propertly record Interest expense-Accetion of debt discount c To properly record Gain and loss on derivative valuation d To properly record Initial value fair value of derivative and warrant e To reclassify interest expense --- F-75 PARADIGM MEDICAL INDUSTRIES, INC. NOTES TO FINANCIAL STATEMENTS CONTINUED --- PARADIGM MEDICAL INDUSTRIES,

INC. STATEMENTS OF CASH FLOWS AS PREVIOUSLY DECEMBER 31, 2006 REPORTED AS RESTATED CHANGE --------------- --------------- --------------- Cash flows from operating activities: Net income (loss) $ (1,816,000) $ (1,198,000) $ 618,000 a Adjustments to reconcile net income (loss) to net cash used in operating activities: Depreciation and amortization 31,000 31,000 - Stock option valuation 23,000 23,000 - Change in fair value of derivative liabilities - (570,000) (570,000)b Beneficial conversion interest 964,000 952,000 (12,000)c Issuance of stock options and warrants for services 36,000 - (36,000)d Provision for losses on receivables (28,000) (28,000) - Provision for losses on inventory (37,000) (37,000) - (Gain) loss on settlement of liabilities (34,000) (34,000) - (Increase) decrease in: Accounts Receivables 19,000 19,000 - Inventories (55,000) (55,000) - Increase (decrease) in: Accounts payable (30,000) (30,000) - Accrued liabilities 99,000 99,000 - --------------- --------------- --------------- NET CASH USED IN OPERATING ACTIVITIES (828,000) (828,000) - --------------- --------------- --------------- CASH FLOWS FROM INVESTING ACTIVITIES: Acquisition of property and equipment (20,000) (20,000) - --------------- --------------- --------------- NET CASH PROVIDED BY (USED IN) INVESTING ACTIVITIES (20,000) (20,000) - --------------- --------------- --------------- CASH FLOWS FROM FINANCING ACTIVITIES: Principal payments on notes payable and long-term debt (12,000) (12,000) - Proceeds from issuance of convertible notes 1,000,000 1,000,000 - --------------- --------------- --------------- NET CASH (USED IN) PROVIDED BY FINANCING ACTIVITIES 988,000 988,000 - --------------- --------------- --------------- Net change in cash 140,000 140,000 - Cash, beginning of year 66,000 66,000 - --------------- --------------- --------------- CASH, END OF YEAR $ 206,000 $ 206,000 $ - =============== =============== =============== a To reclassify net loos b To propertly record Change in fair value of derivative liabilities c To reclassify Beneficial conversion interest d To reclassigy Issuance of stock options and warrants for services --- F-76 PARADIGM MEDICAL INDUSTRIES, INC. NOTES TO FINANCIAL STATEMENTS CONTINUED --- PARADIGM MEDICAL INDUSTRIES, INC. BALANCE SHEET AS PREVIOUSLY MARCH 31, 2007 REPORTED AS RESTATED CHANGE --------------- --------------- --------------- ASSETS Current assets: Cash $ 66,000 $ 66,000 $ - Receivables, net 471,000 471,000 - Inventories, net 841,000 841,000 - Prepaid and other assets 38,000 38,000 - --------------- --------------- --------------- Total current assets 1,416,000 1,416,000 - Property and equipment, net 19,000 19,000 - Goodwill 339,000 339,000 - --------------- --------------- --------------- Total assets $ 1,774,000 $ 1,774,000 $ - =============== =============== =============== LIABILITIES AND STOCKHOLDERS' (DEFICIT) Current liabilities: Accounts payable $ 411,000 $ 411,000 $ - Accrued liabilities 882,000 882,000 - --------------- --------------- --------------- Total current liabilities 1,293,000 1,293,000 - --------------- --------------- --------------- Convertible notes payable, net of discount $1,148,000 2,653,000 1,505,000 (1,148,000)a Derivative liabilities - 1,181,000 1,181,000 b --------------- --------------- --------------- Total long-term liabilities 2,653,000 2,686,000 33,000 =============== =============== =============== Total liabilities 3,946,000 3,979,000 33,000 Commitments and contingencies - - - Stockholders' (Deficit): Preferred stock authorized: 5,000,000 shares, $0.001 par value 1,000 1,000 - Common stock authorized: 800,000,000 shares, $.001 par value, 203,986,625 shares issued and outstanding at March 31, 2007 204,000 204,000 - Additional paid-in capital 61,883,000 58,383,000 (3,500,000) Accumulated deficit (64,260,000) (60,793,000) 3,467,000 --------------- --------------- --------------- Total stockholders' (Deficit) (2,172,000) (2,205,000) (33,000) --------------- --------------- --------------- Total liabilities and stockholders' (Deficit) $ 1,774,000 $ 1,774,000 $ - =============== =============== =============== a To properly record convertible debenture b To properly record derivative liabilities c To reclassify additional paid-in capital d To reclassify derivative accumulated deficit --- F-77 PARADIGM MEDICAL INDUSTRIES, INC. NOTES TO FINANCIAL STATEMENTS CONTINUED --- PARADIGM MEDICAL INDUSTRIES, INC. STATEMENTS OF OPERATIONS THREE AS PREVIOUSLY MONTHS ENDED MARCH 31, 2007 REPORTED AS RESTATED CHANGE --------------- --------------- --------------- Sales $ 397,000 $ 397,000 $ - Cost of sales 225,000 225,000 - --------------- --------------- --------------- Gross profit 172,000 172,000 - --------------- --------------- --------------- Operating expenses: General and administrative (189,000) (189,000) - Marketing and selling (115,000) (115,000) - Research and development (64,000) (64,000) - --------------- --------------- --------------- Total operating expenses (368,000) (368,000) - --------------- --------------- --------------- Operating loss (196,000) (196,000) - --------------- --------------- --------------- Other income (expense): Other income 1,000 1,000 - Other expenses (52,000) - 52,000 a Interest expense-Accetion of debt discount - (139,000) (139,000)b Gain and loss on derivative valuation - 1,015,000 1,015,000 c Interest expense (1,000) (53,000) (52,000)d --------------- --------------- --------------- Total other income (expense) (52,000) 824,000 876,000 --------------- --------------- --------------- Income (loss) before provision for income taxes (248,000) 628,000 876,000 Provision for income taxes - - - --------------- --------------- --------------- Net (loss) $ (248,000) $ 628,000 $ 876,000 =============== =============== =============== Earnings (loss) per common share - basic $ (0.00) $ 0.00 $ 0 --------------- --------------- --------------- Earnings (loss) per common share - diluted $ (0.00) $ 0.00 $ 0 =============== =============== =============== Weighted average common shares - basic 203,306,000 203,306,000 - --------------- --------------- --------------- Weighted average common shares - diluted 203,306,000 203,306,000 - =============== =============== =============== a To reclassify other expense of benefitial convertion feature b To propertly record Interest expense-Accetion of debt discount c To properly record Gain and loss on derivative valuation d To properly record Initial value fair value of derivative and warrant e To reclassify interest expense --- F-78 PARADIGM MEDICAL INDUSTRIES, INC. NOTES TO FINANCIAL STATEMENTS CONTINUED --- PARADIGM MEDICAL INDUSTRIES, INC. STATEMENTS OF CASH FLOWS AS PREVIOUSLY MARCH 31, 2007 REPORTED AS RESTATED CHANGE --------------- --------------- --------------- CASH FLOWS FROM OPERATING ACTIVITIES: Net income (loss) $ (248,000) $ (1,401,000) $ (1,153,000)a Adjustments to reconcile net income (loss) to net cash used in operating activities: Depreciation and amortization 2,000 2,000 - Beneficial conversion interest - 1,014,000 1,014,000 c Issuance of stock options and warrants for services - 139,000 139,000 d Provision for losses on receivables (10,000) (10,000) - (Increase) decrease in: Accounts Receivables (51,000) (51,000) - Inventories 104,000 104,000 - Prepaid and other assets (27,000) (27,000) - Increase (decrease) in: Accounts payable 11,000 11,000 - Accrued liabilities 79,000 79,000 - ---------------

--------------- --------------- NET CASH USED IN OPERATING ACTIVITIES (140,000) (140,000) - --------------- --------------- --------------- CASH FLOWS FROM INVESTING ACTIVITIES: --------------- --------------- --------------- NET CASH PROVIDED BY (USED IN) INVESTING ACTIVITIES - - - --------------- --------------- --------------- CASH FLOWS FROM FINANCING ACTIVITIES: --------------- --------------- --------------- NET CASH (USED IN) PROVIDED BY FINANCING ACTIVITIES - - - --------------- --------------- --------------- Net change in cash (140,000) (140,000) - Cash, beginning of period 206,000 206,000 - --------------- --------------- --------------- CASH, END OF PERIOD $ 66,000 $ 66,000 $ - =============== =============== =============== Supplemental disclosure of cash flow information: Cash paid for interest $ 1,000 $ 1,000 --------------- --------------- Cash paid for income taxes $ - $ - --------------- --------------- a To reclassify net loos b To propertly record Change in fair value of derivative liabilities c To reclassify Beneficial conversion interest d To reclassigy Issuance of stock options and warrants for services --- F-79 PARADIGM MEDICAL INDUSTRIES, INC. NOTES TO FINANCIAL STATEMENTS CONTINUED --- PARADIGM MEDICAL INDUSTRIES, INC. BALANCE SHEET AS PREVIOUSLY JUNE 30, 2007 REPORTED AS RESTATED CHANGE --------------- --------------- --------------- ASSETS Current assets: Cash $ 486,000 $ 486,000 $ - Receivables, net 388,000 388,000 - Inventories, net 1,002,000 1,002,000 - Prepaid and other assets 90,000 90,000 - --------------- --------------- --------------- Total current assets 1,966,000 1,966,000 - Property and equipment, net 18,000 18,000 - Goodwill 339,000 339,000 - --------------- --------------- --------------- Total assets $ 2,323,000 $ 2,323,000 $ - =============== =============== =============== LIABILITIES AND STOCKHOLDERS' (DEFICIT) Current liabilities: Accounts payable $ 332,000 $ 332,000 $ - Accrued liabilities 1,011,000 1,011,000 - --------------- --------------- --------------- Total current liabilities 1,343,000 1,343,000 - --------------- --------------- --------------- Convertible notes payable, net of discount $1,355,000 3,589,000 2,234,000 (1,355,000)a Derivative liabilities - 832,000 832,000 b --------------- --------------- --------------- Total long-term liabilities 3,589,000 3,066,000 (523,000) =============== =============== =============== Total liabilities 4,932,000 4,409,000 (523,000) Commitments and contingencies - - - Stockholders' (Deficit): Preferred stock authorized: 5,000,000 shares, $0.001 par value 1,000 1,000 - Common stock authorized: 800,000,000 shares, $.001 par value, 216,989,225 shares issued and outstanding at June 30, 2007 217,000 217,000 - Additional paid-in capital 62,935,000 58,435,000 (4,500,000)c Accumulated deficit (65,762,000) (60,739,000) 5,023,000 d --------------- --------------- --------------- Total stockholders' (Deficit) (2,609,000) (2,086,000) 523,000 --------------- --------------- --------------- Total liabilities and stockholders' (Deficit) $ 2,323,000 $ 2,323,000 $ - =============== =============== =============== a To properly record convertible debenture b To properly record derivative liabilities c To reclassify additional paid-in capital d To reclassify derivative accumulated deficit --- F-80 PARADIGM MEDICAL INDUSTRIES, INC. NOTES TO FINANCIAL STATEMENTS CONTINUED --- PARADIGM MEDICAL INDUSTRIES, INC. STATEMENTS OF OPERATIONS THREE MONTHS AS PREVIOUSLY ENDED JUNE 30, 2007 REPORTED AS RESTATED CHANGE --------------- --------------- --------------- Sales $ 260,000 $ 260,000 $ - Cost of sales 149,000 149,000 - --------------- --------------- --------------- Gross profit 111,000 111,000 - --------------- --------------- --------------- Operating expenses: General and administrative (309,000) (309,000) - Marketing and selling (159,000) (159,000) - Research and development (126,000) (126,000) - --------------- --------------- --------------- Total operating expenses (594,000) (594,000) - --------------- --------------- --------------- Operating loss (483,000) (483,000) - --------------- --------------- --------------- Other income (expense): Other income (interest) 3,000 3,000 - Other expenses (1,062,000) - 1,062,000 a Interest expense-Accetion of debt discount - (197,000) (197,000)b Gain and loss on derivative valuation - 752,000 752,000 c Interest expense (1,000) (63,000) (62,000)d Gain on sale of investment 41,000 41,000 - --------------- --------------- --------------- Total other income (expense) (1,019,000) 536,000 1,555,000 --------------- --------------- --------------- Income (loss) before provision for income taxes (1,502,000) 53,000 1,555,000 Provision for income taxes - - - --------------- --------------- --------------- Net (loss) $ (1,502,000) $ 53,000 $ 1,555,000 =============== =============== =============== Earnings (loss) per common share - basic $ (0.01) $ 0.00 $ 0 --------------- --------------- --------------- Earnings (loss) per common share - diluted $ (0.01) $ 0.00 $ 0 =============== =============== =============== Weighted average common shares - basic 206,228,000 206,228,000 - --------------- --------------- --------------- Weighted average common shares - diluted 206,228,000 206,228,000 - =============== =============== =============== a To reclassify other expense of benefitial convertion feature b To propertly record Interest expense-Accetion of debt discount c To properly record Gain and loss on derivative valuation d To properly record Initial value fair value of derivative and warrant e To reclassify interest expense --- F-81 PARADIGM MEDICAL INDUSTRIES, INC. NOTES TO FINANCIAL STATEMENTS CONTINUED --- PARADIGM MEDICAL INDUSTRIES, INC. STATEMENTS OF OPERATIONS SIX MONTHS AS PREVIOUSLY ENDED JUNE 30, 2007 REPORTED AS RESTATED CHANGE --------------- --------------- --------------- Sales $ 656,000 $ 656,000 $ - Cost of sales 375,000 375,000 - --------------- --------------- --------------- Gross profit 281,000 281,000 - --------------- --------------- --------------- Operating expenses: General and administrative (496,000) (496,000) - Marketing and selling (273,000) (273,000) - Research and development (190,000) (190,000) - --------------- --------------- --------------- Total operating expenses (959,000) (959,000) - --------------- --------------- --------------- Operating loss (678,000) (678,000) - --------------- --------------- --------------- Other income (expense): Other income (interest) 5,000 5,000 - Other expenses (1,115,000) - 1,115,000 a Interest expense-Accetion of debt discount - (337,000) (337,000)b Gain and loss on derivative valuation - (262,000) (262,000)c Interest expense (1,000) (116,000) (115,000)d Gain on sale of investment 41,000 41,000 - --------------- --------------- --------------- Total other income (expense) (1,070,000) (669,000) 401,000 --------------- --------------- --------------- Income (loss) before provision for income taxes (1,748,000) (1,347,000) 401,000 Provision for income taxes - - - --------------- --------------- --------------- Net (loss) $ (1,748,000) $ (1,347,000) $ 401,000 =============== =============== =============== Earnings (loss) per common share - basic $ (0.01) $ (0.01) $ 0 --------------- --------------- --------------- Earnings (loss) per common share - diluted $ (0.01) $ (0.01) $ 0 =============== =============== =============== Weighted average common shares - basic 204,775,000 204,775,000 - --------------- --------------- --------------- Weighted average common shares - diluted

204,775,000 204,775,000 - =============== =============== =============== a To reclassify other expense of benefitial convertion feature b To propertly record Interest expense-Accetion of debt discount c To properly record Gain and loss on derivative valuation d To properly record Initial value fair value of derivative and warrant e To reclassify interest expense -- F-82 PARADIGM MEDICAL INDUSTRIES, INC. NOTES TO FINANCIAL STATEMENTS CONTINUED -- PARADIGM MEDICAL INDUSTRIES, INC. STATEMENTS OF CASH FLOWS AS PREVIOUSLY JUNE 30, 2007 REPORTED AS RESTATED CHANGE --------------- -------------- --------------- CASH FLOWS FROM OPERATING ACTIVITIES: Net income (loss) $ (1,748,000) $ (1,346,000) $ 402,000 a Adjustments to reconcile net income (loss) to net cash used in operating activities: Depreciation and amortization 3,000 3,000 - Change in fair value of derivative liabilities - 262,000 262,000 b Beneficial conversion interest 939,000 336,000 (603,000)c Issuance of stock options and warrants for services 61,000 - (61,000)d Provision for losses on inventory (22,000) (22,000) - (Increase) decrease in: Accounts Receivables 44,000 44,000 - Inventories (57,000) (57,000) - Prepaid and other assets (79,000) (79,000) - Increase (decrease) in: Accounts payable (69,000) (69,000) - Accrued liabilities 208,000 208,000 - --------------- -------------- --------------- NET CASH USED IN OPERATING ACTIVITIES (720,000) (720,000) - --------------- -------------- --------------- CASH FLOWS FROM INVESTING ACTIVITIES: --------------- -------------- -------------- NET CASH PROVIDED BY (USED IN) INVESTING ACTIVITIES - - - --------------- -------------- --------------- CASH FLOWS FROM FINANCING ACTIVITIES: Proceeds from issuance of convertible notes 1,000,000 1,000,000 - --------------- -------------- --------------- NET CASH (USED IN) PROVIDED BY FINANCING ACTIVITIES 1,000,000 1,000,000 - --------------- -------------- --------------- Net change in cash 280,000 280,000 - Cash, beginning of period 206,000 206,000 - --------------- -------------- --------------- CASH, END OF PERIOD $ 486,000 $ 486,000 $ - =============== =============== =============== Supplemental disclosure of cash flow information: Cash paid for interest $ 1,000 $ 1,000 --------------- -------------- Cash paid for income taxes $ - $ - --------------- -------------- a To reclassify net loos b To propertly record Change in fair value of derivative liabilities c To reclassify Beneficial conversion interest d To reclassigy Issuance of stock options and warrants for services -- F-83 PARADIGM MEDICAL INDUSTRIES, INC. NOTES TO FINANCIAL STATEMENTS CONTINUED -- PARADIGM MEDICAL INDUSTRIES, INC. BALANCE SHEET AS PREVIOUSLY SEPTEMBER 30, 2007 REPORTED AS RESTATED CHANGE --------------- --------------- -------------- ASSETS Current assets: Cash $ 129,000 $ 129,000 $ - Receivables, net 515,000 515,000 - Inventories, net 1,095,000 1,095,000 - Prepaid and other assets 73,000 73,000 - --------------- -------------- --------------- Total current assets 1,812,000 1,812,000 - Property and equipment, net 17,000 17,000 - Goodwill 339,000 339,000 - --------------- -------------- --------------- Total assets $ 2,168,000 $ 2,168,000 $ - =============== =============== =============== LIABILITIES AND STOCKHOLDERS' (DEFICIT) Current liabilities: Accounts payable $ 347,000 $ 347,000 $ - Accrued liabilities 1,075,000 1,075,000 - --------------- -------------- --------------- Total current liabilities 1,422,000 1,422,000 - --------------- -------------- --------------- Convertible notes payable, net of discount $1,099,000 3,455,000 2,355,000 (1,100,000)a Derivative liabilities - 228,000 228,000 b --------------- -------------- --------------- Total long-term liabilities 3,455,000 2,583,000 (872,000) =============== =============== =============== Total liabilities 4,877,000 4,005,000 (872,000) Commitments and contingencies - - - Stockholders' (Deficit): Preferred stock authorized: 5,000,000 shares, $0.001 par value 1,000 1,000 - Common stock authorized: 800,000,000 shares, $.001 par value, 281,085,819 shares issued and outstanding at September 30, 2007 281,000 281,000 - Additional paid-in capital 63,005,000 58,505,000 (4,500,000)c Accumulated deficit (65,996,000) (60,624,000) 5,372,000 d --------------- -------------- --------------- Total stockholders' (Deficit) (2,709,000) (1,837,000) 872,000 --------------- -------------- --------------- Total liabilities and stockholders' (Deficit) $ 2,168,000 $ 2,168,000 $ - =============== =============== =============== a To properly record convertible debenture b To properly record derivative liabilities c To reclassify additional paid-in capital d To reclassify derivative accumulated deficit -- F-84 PARADIGM MEDICAL INDUSTRIES, INC. NOTES TO FINANCIAL STATEMENTS CONTINUED -- PARADIGM MEDICAL INDUSTRIES, INC. STATEMENTS OF OPERATIONS THREE MONTHS ENDED AS PREVIOUSLY SEPTEMBER 30, 2007 REPORTED AS RESTATED CHANGE --------------- --------------- --------------- Sales $ 534,000 $ 534,000 $ - Cost of sales 270,000 270,000 - --------------- -------------- --------------- Gross profit 264,000 264,000 - --------------- -------------- --------------- Operating expenses: General and administrative (191,000) (191,000) - Marketing and selling (168,000) (168,000) - Research and development (71,000) (71,000) - --------------- -------------- -------------- Total operating expenses (430,000) (430,000) - --------------- -------------- --------------- Operating loss (166,000) (166,000) - --------------- -------------- --------------- Other income (expense): Other income (interest) 3,000 3,000 - Other expenses (financing cost) (70,000) - 70,000 a Interest expense-Accetion of debt discount - (255,000) (255,000)b Gain and loss on derivative valuation - 605,000 605,000 c Interest expense (1,000) (71,000) (70,000)d --------------- -------------- --------------- Total other income (expense) (68,000) 282,000 350,000 --------------- -------------- --------------- Income (loss) before provision for income taxes (234,000) 116,000 350,000 Provision for income taxes - - - --------------- --------------- --------------- Net (loss) $ (234,000) $ 116,000 $ 350,000 =============== =============== =============== Earnings (loss) per common share - basic $ (0.00) $ 0.00 $ 0 --------------- -------------- --------------- Earnings (loss) per common share - diluted $ (0.00) $ 0.00 $ 0 =============== =============== =============== Weighted average common shares - basic 247,755,000 247,755,000 - --------------- -------------- --------------- Weighted average common shares - diluted 247,755,000 247,755,000 - =============== =============== =============== a To reclassify other expense of benefitial convertion feature b To propertly record Interest expense-Accetion of debt discount c To properly record Gain and loss on derivative valuation d To properly record Initial value fair value of derivative and warrant e To reclassify interest expense -- F-85 PARADIGM MEDICAL INDUSTRIES, INC. NOTES TO FINANCIAL STATEMENTS CONTINUED -- PARADIGM MEDICAL INDUSTRIES, INC. STATEMENTS OF OPERATIONS NINE MONTHS ENDED AS PREVIOUSLY SEPTEMBER 30, 2007 REPORTED AS RESTATED

CHANGE --------------- --------------- --------------- Sales $ 1,190,000 $ 1,190,000 $ - Cost of sales 645,000 645,000 - --------------- --------------- --------------- Gross profit 545,000 545,000 - --------------- --------------- --------------- Operating expenses: General and administrative (688,000) (688,000) - Marketing and selling (442,000) (442,000) - Research and development (261,000) (261,000) - --------------- --------------- --------------- Total operating expenses (1,391,000) (1,391,000) - --------------- --------------- --------------- Operating loss (846,000) (846,000) - --------------- --------------- --------------- Other income (expense): Other income (interest) 8,000 8,000 - Other expenses (financing cost) (1,185,000) - 1,185,000 a Interest expense-Accetion of debt discount - (592,000) (592,000)b Gain and loss on derivative valuation - 342,000 342,000 c Interest expense (2,000) (187,000) (185,000)d Gain on sale of investment 41,000 41,000 - --------------- --------------- --------------- Total other income (expense) (1,138,000) (388,000) 750,000 --------------- --------------- --------------- Income (loss) before provision for income taxes (1,984,000) (1,234,000) 750,000 Provision for income taxes - - - --------------- --------------- --------------- Net (loss) $ (1,984,000) $ (1,234,000) $ 750,000 =============== =============== =============== Earnings (loss) per common share - basic $ (0.01) $ (0.01) $ 0 --------------- --------------- --------------- Earnings (loss) per common share - diluted $ (0.01) $ (0.01) $ 0 =============== =============== =============== Weighted average common shares - basic 219,259,000 219,259,000 - --------------- --------------- --------------- Weighted average common shares - diluted 219,259,000 219,259,000 - =============== =============== =============== a To reclassify other expense of benefitial convertion feature b To propertly record Interest expense-Accetion of debt discount c To properly record Gain and loss on derivative valuation d To properly record Initial value fair value of derivative and warrant e To reclassify interest expense -- F-86 PARADIGM MEDICAL INDUSTRIES, INC. NOTES TO FINANCIAL STATEMENTS CONTINUED -- PARADIGM MEDICAL INDUSTRIES, INC. STATEMENTS OF CASH FLOWS AS PREVIOUSLY SEPTEMBER 30, 2007 REPORTED AS RESTATED CHANGE --------------- --------------- --------------- CASH FLOWS FROM OPERATING ACTIVITIES: Net income (loss) $ (1,984,000) $ (1,233,000) $ 751,000 a Adjustments to reconcile net income (loss) to net cash used in operating activities: Depreciation and amortization 4,000 4,000 - Change in fair value of derivative liabilities - (343,000) (343,000)b Beneficial conversion interest 939,000 592,000 (347,000)c Issuance of stock options and warrants for services 61,000 - (61,000)d Provision for losses on inventory (22,000) (22,000) - (Increase) decrease in: Accounts Receivables (83,000) (83,000) - Inventories (150,000) (150,000) - Prepaid and other assets (62,000) (62,000) - Increase (decrease) in: Accounts payable (54,000) (54,000) - Accrued liabilities 274,000 274,000 - --------------- --------------- --------------- NET CASH USED IN OPERATING ACTIVITIES (1,077,000) (1,077,000) - --------------- --------------- --------------- CASH FLOWS FROM INVESTING ACTIVITIES: --------------- --------------- --------------- NET CASH PROVIDED BY (USED IN) INVESTING ACTIVITIES - - - --------------- --------------- --------------- CASH FLOWS FROM FINANCING ACTIVITIES: Proceeds from issuance of convertible notes 1,000,000 1,000,000 - --------------- --------------- --------------- NET CASH (USED IN) PROVIDED BY FINANCING ACTIVITIES 1,000,000 1,000,000 - --------------- --------------- --------------- Net change in cash (77,000) (77,000) - Cash, beginning of period 206,000 206,000 - --------------- --------------- --------------- CASH, END OF PERIOD $ 129,000 $ 129,000 $ - =============== =============== =============== Supplemental disclosure of cash flow information: Cash paid for interest $ 2,000 $ 2,000 --------------- --------------- Cash paid for income taxes $ - $ - --------------- --------------- a To reclassify net loos b To propertly record Change in fair value of derivative liabilities c To reclassify Beneficial conversion interest d To reclassigy Issuance of stock options and warrants for services -- F-87 Item 8. Changes in and Disagreements with Accountants on Accounting and Financial Disclosures None. Item 8A. Controls and Procedures Under the supervision and with the participation of the Company's management, including its principal executive officer and principal financial officer, the Company evaluated the effectiveness of the design and operation of its disclosure controls and procedures (as defined in Rule 13a-15(e) or 15d-15(e) under the Securities Exchange Act of 1934 (the "Exchange Act"). Based upon that evaluation, the principal executive officer and principal financial officer concluded that, as of the end of the period covered by this report, the Company's disclosure controls and procedures were effective and adequately designed to ensure that information required to be disclosed by the Company in the reports it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in applicable rules and forms. During the fourth fiscal quarter, there has been no change in the Company's internal control over financial reporting (as defined in Rule 13a-15(f) or 15d-15(f) under the Exchange Act) that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting. PART III Item 9. Directors, Executive Officers, Promoters and Control Persons; Compliance with Section 16(a) of the Exchange Act. As of March 31, 2007, the Company's executive officers and directors, their ages and their positions are set forth below: Name Age Position ---- --- -------- Raymond P.L. Cannefax 59 President and Chief Executive Officer Randall A. Mackey, Esq. 62 Chairman of the Board and Director David M. Silver, PhD. 66 Director Keith D. Ignotz 61 Director John C. Pingree 67 Director The directors are elected for one year terms that expire at the next annual meeting of shareholders. Executive officers are elected annually by the Board of Directors to hold office until the first meeting of the Board following the next annual meeting of shareholders and until their successors have been elected and qualified. Raymond P.L. Cannefax has served as the Company's President and Chief Executive Officer since January 5, 2006. Mr. Cannefax previously served as the Company's Vice President of Sales and Marketing from January 2003 to May 2005. From May 2005 to January 2006, Mr. Cannefax served as Vice President of the Asia/Pacific Region for Sonomed, Inc., a manufacturer of ophthalmic products and a wholly owned subsidiary of Escalon Medical Corp. From 2002 to 2003, Mr. Cannefax was Vice President of Business Development and Sales for Vermax, Inc., a manufacturer of products for hotel properties. From 1996 to 2002, he was President, Chief Operating Officer and founder of Aspen Network, Inc., a 39 software development and ecommerce company. From 1992 to 1996, Mr. Cannefax was President and Chief Executive Officer of Apollo Telecom, Inc., a telecommunications company. From 1986 to 1992, he was a Regional Sales Director and a Senior District Manager of Sprint Communications Corporation. Mr. Cannefax received a B.S. degree in Psychology and Zoology from the University of Utah in 1976. Randall A. Mackey, Esq. has been the Company's Chairman of the Board since August 20, 2002, and a director since January 2000. He had served as a director of the Company from 1995 to 1998. Mr. Mackey has been President of the Salt Lake City law firm of Mackey Price Thompson & Ostler since 1992, and a shareholder and director of the firm and its predecessor firms since 1989. Mr. Mackey received a B.S. degree in Economics from the University of Utah in 1968, an M.B.A. degree from the Harvard Business School in 1970, a J.D. degree from Columbia Law School in 1975 and a B.C.L. degree from Oxford University in 1977. Mr. Mackey has also served as Chairman of the Board from 2001 to 2003, and as a director from 1998 to 2003 of Cimetrix, Incorporated, a software development company. Mr. Mackey has additionally served as Chairman of the Board from 2000 to 2003 and as a trustee from 1993 to 2003 of Salt Lake Community College and as a member of the Utah State Board of Education since 2005. David M. Silver, Ph.D. has been a director since January 2000. He had served as a director of the company from 1995 to 1998. Dr. Silver is a Principal Senior Scientist in the Milton S. Eisenhower Research and Technology Development Center at the Johns Hopkins University Applied Physics Laboratory, where he has been employed since 1970. He served as the J. H. Fitzgerald Dunning Professor of Ophthalmology in the Johns Hopkins Wilmer Eye Institute in Baltimore during 1998-99. He received a B.S. degree from Illinois Institute of Technology, an M.A. degree from Johns Hopkins University and a Ph.D. degree from Iowa State University before holding a postdoctoral fellowship at Harvard University and a visiting scientist position at the University of Paris. Keith D. Ignotz has been a director since November 2000. Since March 2005, Mr. Ignotz has been President and Chief Executive Officer of Diakine Therapeutics, Inc., a pharmaceutical therapeutics company. From 1992 to 2004, Mr. Ignotz was with SpectRx, Inc., a medical technology company that he founded, which develops, manufactures and markets alternatives to traditional blood based medical tests, serving from 2002 to 2004 as the Chief Executive Officer of Guided Therapeutics, Inc., a wholly-owned subsidiary of SpectRx, Inc., and from 1992 to 2002 as President and Chief Operating Officer of SpectRx, Inc. From 1986 to 1992, Mr. Ignotz was Senior Vice President of Allergan Humphrey, Inc., a medical electronics company. From 1985 to 1986, he was President of Humphrey Instruments Limited-SKB, a medical electronics company, and from 1980 to 1985, Mr. Ignotz was President of Humphrey Instruments GmbH, also a medical electronics company. Mr. Ignotz also served on the Board of Directors of Vismed, Inc., d/b/a Dicon from 1992 to 2000. Mr. Ignotz received a B.A. degree in Sociology and Political Science from San Jose University and an M.B.A. degree from Pepperdine University. Mr. Ignotz has served as a trustee of Pennsylvania College of Optometry and Audiology since 1990, a director of AeroVectrix, Inc., a drug delivery company, since August 2005, and as a member of the American Diabetes Association and the American Marketing Association of the American Association of Diabetes Education. John C. Pingree has been a director since April 2004. From 2001 to 2004, Mr. Pingree was the Executive Director of the Semnani Foundation, which funds projects to assist women and children in developing countries. From 1998 to 2001, Mr. Pingree was a Mission President for the Church of Jesus Christ of Latter-day Saints, serving in Mexico City, Mexico. From 1977 to 1997, Mr. Pingree was General Manager and Chief Executive Officer of Utah Transit Authority. From 1970 to 1975, he was Director of Marketing for Memorex Corporation. From 1967 to 1970, Mr. Pingree was Regional Manager, Sales Planning at Xerox Corporation. He also currently serves as a member of the Utah State Board of Education. Mr. Pingree received a B.A. degree in Economics from the University of Utah and an M.B.A. degree from the Harvard Business School. Appointment of New President and Chief Executive Officer On January 5, 2006, Raymond P.L. Cannefax was appointed as the Company's President and Chief Executive Officer, replacing John Y. Yoon who had served in those positions from March 18, 2004 to December 31, 2005. Mr. Yoon resigned as the Company's President and Chief Executive Officer, effective December 31, 2005, to pursue other opportunities. Appointment of New Vice President of Finance, New Vice President of International Sales, New Vice President of Operations, and New Vice President of Domestic Sales 40 On March 20, 2006, Luis A. Mostacero was appointed as the Vice President of Finance. Mr. Mostacero previously served as the Controller from June 2000 to August 2005. On January 8, 2008, Mr. Mostacero was also appointed as Chief Financial Officer. On October 11, 2006, Christina M. O'Connor was appointed as Vice President of International Sales and Julio C. Maximo was appointed as Vice President of Operations. On January 4, 2007, Alfred B. Franklin was appointed as Vice President of Domestic Sales, replacing Michael S. Austin who resigned on November 28, 2006, to pursue other opportunities. Mr. Franklin resigned on May 10, 2007, to pursue other opportunities. On May 10, 2007, Stephen L. Davis was appointed as Vice President of Domestic Sales and Marketing. Mr. Davis resigned on February 14, 2008, to pursue other opportunities. Board Meetings and Committees The Board of Directors held a total of four meetings during the fiscal year ended December 31, 20076. No director attended fewer than 75% of all meetings of the Board of Directors during the 2006 fiscal year. The Audit Committee of the Board of Directors consists of directors Dr. David M. Silver, Randall A. Mackey, Keith D. Ignotz and John C. Pingree. The Audit Committee met one time during the fiscal year. The Audit Committee is primarily responsible for reviewing the services performed by its independent public accountants and internal audit department and evaluating its accounting principles and its system of internal accounting controls. The Compensation Committee of the Board of Directors consists of directors Dr. David M. Silver, Randall A. Mackey, Keith D. Ignotz and John C. Pingree. The Compensation Committee met two times during the fiscal year. The Compensation Committee is primarily responsible for reviewing compensation of executive officers and overseeing the granting of stock options. Pursuant to Item 406 of Regulation S-K under the Securities Exchange Act of 1934, the Company has not yet adopted a code of ethics that applies to its principle executive officer, principal financial officer, controller or persons performing similar functions. The Company is still in the process of studying this issue and intends to adopt a code of ethics in the near future. The Company's Board of Directors has determined that Keith D. Ignotz and John C. Pingree, who currently serve as directors of the Company as well as a member of the Company's audit committee, are independent audit committee financial experts. Item 10. Executive Compensation The following table sets forth, for each of the last three fiscal years, the compensation received by Raymond P.L. Cannefax, President and Chief Executive Officer, and other executive officers whose salary and bonus for all services in all capacities exceed $100,000 for the fiscal years ended December 31, 2007, 2006 and 2005. Summary Compensation Table Change in Pension Value and Non-Equity Non-qualified Incentive Deferred Plan Compen- All Other Name and Stock Option Compen- sation Compen- Principal Position Year Salary$ Bonus($) Awards Awards($) sation Earnings sation Total ----------------- ---- ------- -------- ------ --------- ------ -------- ------ ----- Raymond P.L. 2007 $143,330 - - - - - - $143,330 Cannefax President 2006 127,940 - - - - - - 127,940 and Chief Executive 2005 64,285 - - - - - - 64,285 Officer(1) --------------------- (1) Mr. Cannefax has served as President and Chief Executive Officer since January 5, 2006. 41 Supplemental All Other Compensation Table Registrant Contribu- Dividends Perks tions to or and Payments/ Defined Earnings Other Tax Discounted Accruals Contribu- on Stock Personal Reimburse- Securities on Termin- tion Insurance or Option Name Year Benefits ments Purchases ation Plans Plans Premiums Awards Other ---- ---- -------- ----- --------- ---------- ----- -------- ------ ----- Raymond P.L. 2007 - - - - - - - - Cannefax 2006 - - - - - - - - 2005 - - - - - - - - Grants of Plan-Based Awards Estimated Future Payouts Under Estimated Future Payouts Non-Equity Incentive Plan Under Equity Incentive Plan Awards Awards All Other All Other Option Stock Awards: Awards: Number of Exercise Number of Securities or Base Shares of Under- Price of Stock or lying Option Grant Threshold Target Maximum Threshold Target Maximum Units Options Awards Name Date ($) ($) ($) (#) (#) ($) (#) (#) ($/Sh) ---- ---- --- ---- --- --- --- --- --- --- ------ Raymond P.L. 5/1/07 - -

- - - - - 4,500,000 $.01 Cannefax 1/5/06 - - - - - - - 4,500,000 $.01 42 Outstanding Equity Awards At Fiscal Year End Equity Equity Incentive Incentive Plan Plan Awards: Awards Market or Equity Number of Payout Incentive Market Unearned Value of Number of Pan Awards Number Value of Shares, Unearned Number of Securities Number of of Shares or Units or Shares, Securities Underlying Securities Shares or Units of Other Units or Underlying Unexercised Underlying Units of Stock Rights Other Unexercised Options: Unexercised Option Stock That Have That Have Rights That Options (#) Unearned Exercise Option Held That Not Not Have Not (#) Unexer- Options Price Expiration Have Not Vested Vested Vested Name Exercisable cisable (#) ($) Date Vested(#) ($) (#) ($) ---- ----------- ------- --- --- ---- --------- --- --- --- Raymond P.L. 0 0 - - - - - - - Cannefax Option Exercises and Stock Vested for Fiscal 2007 Option Awards Stock Awards Number of Value Number of Value Shares Acquired Realized Shares Acquired Realized on Exercise on Exercise on Vesting on Vesting Name (#) ($) (#) ($) ----- ----- ----- ---- Raymond P.L. 0 - 0 - Cannefax Pension Benefits for Fiscal 2007 Number of Years Present Value of Credited Accumulated Payments During Service Benefit Last Fiscal Year Name Plan Name (#) ($) ($) ---- --------- ----- ----- ---- Raymond P.L. None - - - Cannefax Director Compensation Outside directors are currently not paid a director's fee for their services but are reimbursed for their expenses in attending board and committee meetings. Directors are not precluded from serving the Company in any other capacity and receiving compensation therefore. The directors were not granted any options to purchase shares of the Company's common stock during 2006 or 2007. 43 Director Compensation for Fiscal 2007 Change in Pension Value Fees and Earned or Non-Equity Nonqualified Paid In Stock Option Incentive Plan Deferred All Other Cash Awards Awards Compensation Compensation Compensation Total Name ($) ($) ($) ($) Earnings ($) ($) ---- --- --- --- --- -------- --- --- Keith D. Ignotz 0 - - - - - 0 Randall A. Mackey 0 - - - - - 0 John C. Pingree 0 - - - - - 0 David M. Silver, PhD. 0 - - - - - 0 Employee 401(k) Plan In October 1996, the Company's Board of Directors adopted a 401(k) Retirement Savings Plan. Under the terms of the 401(k) plan, effective as of November 1, 1996, the Company may make discretionary employer matching contributions to its employees who choose to participate in the plan. The plan allows the board to determine the amount of the contribution at the beginning of each year. The board adopted a contribution formula specifying that such discretionary employer matching contributions would equal 100% of the participating employee's contribution to the plan up to a maximum discretionary employee contribution of 3% of a participating employee's compensation, as defined by the plan. All persons who have completed at least six months' service with the Company and satisfy other plan requirements are eligible to participate in the plan. The plan is currently available to the Company's employees at the employees' expense with no matching contribution from the Company. 1995 Stock Option Plan The Company adopted a 1995 Stock Option Plan, for the officers, employees, directors and consultants of its company on November 7, 1995. The plan authorized the granting of stock options to purchase an aggregate of not more than 300,000 shares of its common stock. On February 16, 1996, options for substantially all 300,000 shares were granted. On June 9, 1997, its shareholders approved an amendment to the plan to increase the number of shares of common stock reserved for issuance thereunder from 300,000 shares to 600,000 shares. On September 3, 1998, its shareholders approved an amendment to the plan to increase the number of shares of common stock reserved for issuance thereunder from 600,000 shares to 1,200,000 shares. On November 29, 2000, its shareholders approved an amendment to the plan to increase the number of shares of common stock reserved for issuance thereunder from 1,200,000 shares to 1,700,000 shares. On September 11, 2001, its shareholders approved an amendment to the plan to increase the number of shares of common stock reserved for issuance thereunder from 1,700,000 shares to 2,700,000 shares. On June 13, 2003, its shareholders approved an amendment to the plan to increase the number of shares of common stock reserved for issuance thereunder from 2,700,000 shares to 3,700,000 shares. On July 11, 2005, its shareholders approved an amendment to the plan to increase the number of shares of common stock reserved for issuance thereunder from 3,700,000 shares to 5,000,000 shares. The compensation committee administers the 1995 Stock Option Plan. In general, the compensation committee will select the person to whom options will be granted and will determine, subject to the terms of the plan, the number, exercise, and other provisions of such options. Options granted under the plan will become exercisable at such times as may be determined by the compensation committee. Options granted under the plan may be either incentive stock options, as such term is defined in the Internal Revenue Code, or non-incentive stock options. Incentive stock options may only be granted to persons who are employees. Non-incentive stock options may be granted to any person, including, but not limited to, its employees, independent agents, consultants as the compensation committee believes has contributed, or will contribute, to its success as the compensation committee believes has contributed, or will contribute, to its success. The compensation committee determines the exercise price of options granted under the 1995 Stock Option Plan, provided that, in the case of incentive stock options, such price is not less than 100% (110% in the case of incentive stock options granted to holders of 10% of voting power of its stock) of the fair market value (as defined in the plan) of the common stock on the date of grant. The aggregate fair market value (determined at the time of option grant) of stock with respect to which incentive stock options become exercisable for the first time in any year cannot exceed $100,000. 44 The term of each option shall not be more than ten years (five years in the case of incentive stock options granted to holders of 10% of the voting power of its stock) from the date of grant. The Board of Directors has a right to amend, suspend or terminate the 1995 Stock Option Plan at any time; provided, however, that unless ratified by its shareholders, no amendment or change in the plan will be effective that would increase the total number of shares that may be issued under the plan, materially increase the benefits accruing to persons granted under the plan or materially modify the requirements as to eligibility and participation in the plan. No amendment, supervision or termination of the plan shall, without the consent of an employee to whom an option shall heretofore have been granted, affect the rights of such employee under such option. Employment Agreement The Company entered into an employment agreement with Raymond P.L. Cannefax, which commenced on January 5, 2006 and expired on January 5, 2007. The employment agreement requires Mr. Cannefax to devote substantially all of his working time as the Company's President and Chief Executive Officer, providing that he may be terminated for "cause" (as provided in the agreement) and prohibits him from competing with the Company for two years following the termination of his employment agreement. The employment agreement provides for the payment of an initial base salary of $125,000. The employment agreement also provides for salary increases and bonuses as shall be determined at the discretion of the Board of Directors, with the first review of the annual salary to be made as of June 30, 2006. The employment agreement further provides for the issuance of stock options to purchase 4,500,000 shares of the Company's common stock at $.01 per share. The options vest in twelve equal monthly installments of 375,000 shares, beginning on February 5, 2006 until such shares are vested. In the event of a change of control of the Company, then all outstanding stock options granted to Mr. Cannefax shall be immediately vested. A change of control shall be deemed to have occurred if (i) a tender offer shall be made and consummated for the ownership of more than 25% of the Company's outstanding shares; (ii) the Company shall be merged or consolidated with another corporation and, as a result, less than 25% of the outstanding common shares of the surviving corporation shall be owned in the aggregate by the Company's former shareholders, as the same shall have listed prior to such merger or consolidation; (iii) the Company shall sell all or substantially all of its assets to another corporation that is not a wholly owned subsidiary or affiliate; (iv) as a result of any contested election for the Board of Directors, or any tender or exchange offer, merger of business combination or sale of assets, the persons who were directors of the Company before such a transaction shall cease to constitute a majority of the Board of Directors; or (v) a person other than an officer or director of the Company shall acquire more than 20% of the outstanding shares of common stock of the Company. Effective July 1, 2007, the Company entered into an amendment of the employment agreement with Mr. Cannefax, which extends the term of the employment agreement until January 5, 2009. Under the terms of the amendment, Mr. Cannefax's annual base salary increased to $150,000. The initial base salary in the employment agreement dated January 5, 2006 was $125,000, which the Board of Directors increased to $140,000 as of July 1, 2006. The amendment also provides for the granting of additional stock options to Mr. Cannefax to purchase an additional 4,500,000 shares of the Company's common stock at $.01 per share. These options vest in twelve equal monthly installments of 375,000 shares beginning on June 1, 2007 until such shares are vested. Item 11. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters The following table sets forth certain information with respect to beneficial ownership of the Company's common stock as of March 31, 2008 for (i) each executive officer (ii) each director, (iii) each person known to the Company to be the beneficial owner of more than 5% of the outstanding shares, and (iv) all directors and officers as a group. Percentage of Name and Address(1) Number of Shares Ownership ------------------ --------------- ------------- Raymond P.L. Cannefax (2) 10,000,000 1.3% Dr. David M. Silver (2) 761,166 * Randall A. Mackey (2) 725,000 * Keith D. Ignotz (2) 525,709 * John C. Pingree (2) 431,500 * ---------- Executive officers and directors as a group (five persons) 12,443,375 1.6% ----------------- *Less than 1%. (1) Unless otherwise indicated, the address of each listed stockholder is c/o Paradigm Medical Industries, Inc., 2355 South 1070 West, Salt Lake City, Utah, 84119. (2) The amounts shown include shares that may be acquired currently, or within 60 days after March 31, 2007 through the exercise of stock options are follows: Mr. Cannefax, 9,000,000 shares; Dr. Silver, 725,000 shares; Mr. Mackey, 725,000 shares; Mr. Ignotz, 525,851 shares; and Mr. Pingree, 275,000 shares. Item 12. Certain Relationships and Related Transactions The information set forth herein describes certain transactions between the Company and certain affiliated parties. Future transactions, if any, will be approved by a majority of the disinterested members and will be on terms no less favorable to the Company than those that could be obtained from unaffiliated parties. Randall A. Mackey, a director since January 21, 2000, and from 1995 to 1998 and Chairman of the Board since August 30, 2002, is president and a shareholder of the law firm of Mackey Price Thompson & Ostler, which rendered legal services in connection with various corporate matters. Legal fees and expenses paid to Mackey Price Thompson & Ostler for the fiscal years ended December 31, 2007 and 2006, totaled $156,000 and $148,000, respectively. As of December 31, 2007, the Company owed this firm $46,400, which is included in accounts payable. PART IV Item 13. Exhibits and Reports on Form 8-K (a) Exhibits ----------- The following Exhibits are filed herewith pursuant to Rule 601 of Regulation S-B or are incorporated by reference to previous filings. Exhibit No. Document Description ------- ------------------- 2.1 Amended Agreement and Plan of Merger between Paradigm Medical Industries, Inc., a California corporation and Paradigm Medical Industries, Inc., a Delaware corporation(1) 3.1 Certificate of Incorporation(1) 3.2 Amended Certificate of Incorporation 3.3 Bylaws(1) 4.1 Specimen Common Stock Certificate (2) 4.2 Specimen Series C Convertible Preferred Stock Certificate(3) 4.3 Certificate of the Designations, Powers, Preferences and Rights of the Series C Convertible Preferred Stock(3) 4.4 Specimen Series D Convertible Preferred Stock Certificate (4) 4.5 Certificate of the Designations, Powers, Preferences and Rights of the Series D Convertible Preferred Stock (5) 4.6 Certificate of Designations, Powers, Preferences and Rights of the Series G Convertible Preferred Stock (6) 10.1 Exclusive Patent License Agreement with PhotoMed(1) 10.2 1995 Stock Option Plan (1) 45 10.3 April 2005 Securities Purchase Agreement with AJW Partners, LLC, AJW Offshore, Ltd., AJW Qualified Partners, LLC, and New Millennium Capital Partners II, LLP (the "Purchasers")(7) 10.4 Form of Convertible Note with each Purchaser(7) 10.5 Form of Stock Purchase Warrant with each Purchaser(7) 10.6 Security Agreement with Purchasers(7) 10.7 Intellectual Property Security Agreement with Purchasers(7) 10.8 Registration Rights Agreement with Purchasers(7) 10.9 Employment Agreement with Raymond P.L. Cannefax(8) 10.10 February 2006 Securities Purchase Agreement with AJW Partners, LLC, AJW Offshore, Ltd., AJW Qualified Partners, LLC, and New Millennium Capital Partners II, LLP(9) 10.11 Form of Callable Secured Convertible Note with each Purchaser(9) 10.12 Form of Stock Purchase Warrant with each Purchaser(9) 10.13 Security Agreement with Purchasers(9) 10.14 Intellectual Property Security Agreement with Purchasers(9) 10.15 Registration Rights Agreement with Purchasers(9) 10.16 Settlement Agreement with Dr. Joseph W. Spadafora (10) 10.17 Worldwide OEM Agreement with MEDA Co., Ltd. (11) 10.18 Second Amendment to the Registration Rights Agreement dated April 27, 2005 (12) 10.19 Second Amendment to the Registration Rights Agreement dated February 28, 2006 (12) 10.20 June 2007 Securities Purchase Agreement with AJW Partners, LLC, AJW Offshore, Ltd., AJW Qualified Partners, LLC, and New Millennium Capital Partners II, LLP (13) 10.21 Form of Convertible Note with each Purchaser (13) 10.22 Form of Stock Purchase Warrant with each Purchaser (13) 10.23 Security Agreement with Purchasers (13) 10.24 Intellectual Property Agreement with Purchasers (13) 10.25 Registration Rights Agreement with Purchasers (13) 10.26 December 2007 Securities Purchase Agreement with AJW Partners, LLC, AJW Offshore, Ltd., AJW Qualified Partners, LLC, and New Millennium Capital Partners II, LLP (14) 10.27 Form of Convertible Note with each Purchaser (14) 10.28 Form of Stock Purchase Warrant with each Purchaser (14) 10.29 Security Agreement with Purchasers (14) 10.30 Intellectual Property Agreement with Purchasers (14) 10.31 Registration Rights Agreement with Purchasers (14) 10.32 Agreement with Equity Source Partners, LLC 10.33 Distribution Agreement with LACE Elettronica srl 31.1 Certification pursuant to 18 U.S.C. Section 1350, as enacted by Section 302 of the Sarbanes-Oxley Act of 2002 31.2 Certification pursuant to 18 U.S.C. Section 1350, as enacted by Section 302 of the Sarbanes-Oxley Act of 2002 32.1 Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 32.2 Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 ---------------- (1) Incorporated by reference from Registration Statement on Form SB-2, as filed on March 19, 1996. (2) Incorporated by reference from Amendment No. 1 to Registration Statement on Form SB-2, as filed on May 14, 1996. (3) Incorporated by reference from Annual Report on Form 10-KSB, as filed on April 16, 1998. (4) Incorporated by reference from Registration Statement on Form SB-2, as filed on April 29, 1999. (5) Incorporated by reference from Report on Form 10-QSB, as filed on August 16, 2000. (6) Incorporated by reference from Report on Form 10-QSB, as filed on November 14, 2003. (7) Incorporated by reference from Current Report on Form 8-K, as filed on May 18, 2005. (8) Incorporated by reference from Current Report on Form 8-K, as filed on January 18, 2006. (9) Incorporated by reference from Current Report on

Form 8-K, as filed on March 1, 2006. (10) Incorporated by reference from Registration Statement on Form SB-2, as filed on June 15, 2006. (11) Incorporated by reference from Current Report on Form 8-K, as filed on June 19, 2006. (12) Incorporated by reference from Registration Statement on Form SB-2, as filed on April 16, 2007. (13) Incorporated by reference from Report on Form 10-QSB, as filed on August 17, 2007. 46 (14) Incorporated by reference from Current Report on Form 8-K, as filed on January 7, 2008. (b) Reports on Form 8-K ------------------- Current report on Form 8-K, as filed on January 7, 2008. Item 14. Principal Accountant Fees and Services Fees for the 2007 annual audit of the financial statements and related quarterly review services were $31,893. Fees in 2007 related to the review of registration statements and assistance in responding to SEC comments were $675. Fees in 2007 for edgarization of filings were $4,565. Fees in 2007 for tax return preparation were $2,350. There were no other fees in 2007 for meetings and other consultation. Fees for the 2006 annual audit of the financial statements and related quarterly review services were $28,600. Fees in 2006 related to the review of registration statements and assistance in responding to SEC comments were $1,300. Fees in 2006 for edgarization of filings were $2,600. Fees in 2006 for tax return preparation were $3,500. There were no fees in 2006 for meetings and other consultation. 47 SIGNATURES Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, there unto duly authorized. PARADIGM MEDICAL INDUSTRIES, INC. Dated: May 15, 2008 By: /s/ Raymond P.L. Cannefax --------------------------------------- Raymond P.L. Cannefax, President and Chief Executive Officer Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed by the following persons in counterpart on behalf of the Company on the dates indicated. Signature Title Date /s/ Raymond P.L. Cannefax President and Chief Executive May 15, 2008 --------------------------- Officer(Principal Executive Raymond P.L. Cannefax Officer) /s/ Randall A. Mackey Chairman of the Board and May 15, 2008 -------------------------- Director Randall A. Mackey /s/ David M. Silver Director May 15, 2008 -------------------------- David M. Silver, Ph.D. /s/ Keith D. Ignotz Director May 15, 2008 -------------------------- Keith D. Ignotz /s/ John C. Pingree Director May 15, 2008 -------------------------- John C. Pingree /s/ Luis A. Mostacero Vice President of Finance, May 15, 2008 -------------------------- Treasurer and Chief Financial Luis A. Mostacero Officer, (Principal Financial and Accounting Officer) 48 --