UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON D.C. 20549

FORM 10-K

|X| ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE FISCAL YEAR ENDED DECEMBER 28, 2002

| | TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE TRANSITION PERIOD FROM _____ TO _____.

COMMISSION FILE NUMBER 0-27598

IRIDEX CORPORATION
(EXACT NAME OF REGISTRANT AS SPECIFIED IN ITS CHARTER)

DELAWARE	77-0210467
(STATE OR OTHER JURISDICTION OF INCORPORATION OR ORGANIZATION)	(I.R.S. EMPLOYER IDENTIFICATION NUMBER)

1212 TERRA BELLA AVENUE, MOUNTAIN VIEW CA 94043-1824
(ADDRESS OF PRINCIPAL EXECUTIVE OFFICES)
(ZIP CODE)

(650) 940-4700
(REGISTRANT'S TELEPHONE NUMBER, INCLUDING AREA CODE)

SECURITIES REGISTERED PURSUANT TO SECTION 12(b) OF THE ACT:
NONE

SECURITIES REGISTERED PURSUANT TO SECTION 12(g) OF THE ACT:
COMMON STOCK, $0.01 PAR VALUE

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (Section 229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. Yes |X| No | |

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Act.) Yes | | No |X|

The aggregate market value of the voting common equity held by non-affiliates of the Registrant was approximately $ 10,005,735 ,as of June 28, 2002, the last business day of the Registrant's most recently completed second fiscal quarter, based on the closing price reported for such date on the NASDAQ National Market System. The registrant did not have any non-voting common equity outstanding. For purposes of this disclosure, shares of common stock held by each executive officer and director and by each holder of 5% or more of the outstanding shares of common stock have been excluded from this calculation, because such persons may be deemed to be affiliates. This determination of affiliate status is not necessarily a conclusive determination for other purposes.

As of March 19, 2003, Registrant had 6,923,035 shares of common stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Certain parts of the Proxy Statement for the Registrant's 2003 Annual Meeting of Stockholders (the "Proxy Statement") are incorporated by reference into Part III of this Annual Report on Form 10-K.

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PART I

This Annual Report on Form 10-K contains certain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, such as statements relating to levels of future sales and operating results, actual order rate and market acceptance of our products; opportunities in the adjunctive visualization systems market and our efforts to provide total disease management solutions; expectations for future sales growth, generally, including expectations of additional sales from our new products and delivery devices and new applications of our existing products; the potential for production cost decreases and higher gross margins;our estimate of the size of our markets; levels of future investment in research and development efforts; our ability to develop and introduce new products through strategic alliances; favorable Center for Medicare and Medicaid coverage decisions regarding AMD procedures that use our products; expected reductions of employee-related costs as a result of our reduction in force in the second quarter of 2002; results of clinical studies and risks associated with bringing new products to market, general economic conditions and levels of international sales. In some cases, forward-looking statements can be identified by terminology, such as "may," "will," "should," "expects," "plans," "anticipates," "believes," "estimates," "predicts," "intends," "potential," "continue," or the negative of such terms or other comparable terminology. These statements involve known and unknown risks, uncertainties and other factors which may cause our actual results, performance or achievements to differ materially from those expressed or implied by such forward-looking statements. The reader is strongly urged to read the information contained under the captions "Part I, Item 1, Business," and "Part II, Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations-Factors That May Affect Future Results" in this Annual Report for a more detailed description of these significant risks and uncertainties. The reader is cautioned not to place undue reliance on these forward-looking statements, which reflect management's analysis only as of the date of this Form 10-K. We undertake no obligation to update such forward-looking statements to reflect events or circumstances occurring after the date of this report.

ITEM 1. BUSINESS

GENERAL

IRIDEX Corporation is a leading worldwide provider of semiconductor-based laser systems used to treat eye diseases in ophthalmology and skin afflictions in dermatology (also referred to as aesthetics). Our products are sold in the United States predominantly through a direct sales force and internationally through 66 independent distributors into 107 countries.

Our ophthalmology products treat serious eye diseases, including the three leading causes of irreversible blindness, age-related macular degeneration (AMD), diabetic retinopathy and glaucoma. The current family of OcuLight laser systems, used for ophthalmic applications, includes the IRIS Medical OcuLight Symphony, OcuLight SL, OcuLight SLx, OcuLight GL and OcuLight GLx Laser photocoagulation systems. In addition, in October 2002, we introduced the Millennium Endolase green laser photocoagulator module, which we sell exclusively to Bausch & Lomb for incorporation into their Millennium Microsurgical System. Our ophthalmology products contributed $24.2 million, $20.9 million and $27.1 million to our total revenues in 2002, 2001, and 2000, respectively. Our aesthetics products treat skin conditions, primarily vascular and pigmented lesions and remove unwanted hair. Our aesthetics laser systems are the IRIDERM DioLite 532 and the Apex 800 systems. Our aesthetics products contributed $6.5 million, $6.4 million and $5.8 million to our total revenues in 2002, 2001 and 2000, respectively. Each ophthalmic and aesthetics laser system consists of a small, portable laser console and interchangeable delivery devices, primarily for hospital and office-based use by ophthalmologists and dermatologists. We believe that our semiconductor-based systems are more portable, economical, reliable and flexible than competing systems. Since our first shipment in 1990, more than 5,600 IRIDEX medical laser systems have been sold worldwide.

IRIDEX Corporation was incorporated in California in February 1989 as IRIS Medical Instruments, Inc. In 1996, we changed our name to IRIDEX Corporation and reincorporated in Delaware. Our executive offices are located at 1212 Terra Bella Avenue, Mountain View, California 94043-1824, and our telephone number is (650) 940-4700. As used in this Form 10-K, the terms "Company," "IRIDEX," "we," "us" and "our" refer to IRIDEX Corporation, a Delaware corporation, and, when the context so requires, our wholly owned subsidiaries, IRIS Medical Instruments, Inc. and Light Solutions Corporation, both California corporations, and IRIDEX Foreign Sales Corporation, a Barbados corporation, and our aesthetics division, IRIDERM.

THE IRIDEX STRATEGY

We are one of the worldwide leaders in developing, manufacturing, marketing and selling innovative and cost-effective medical laser systems. The key elements of our strategy are:

Broaden Product Lines. One of our core strengths has been our regular introduction of new laser systems, delivery devices and product upgrades to enhance the benefits of our laser systems. We attempt to leverage our existing products and technology when developing new products. In 1997, we introduced the DioLite 532, based on the same visible light technology as the OcuLight GL, for the aesthetics market. In 1998, we introduced the OcuLight GLx, a new version of the OcuLight GL, with increased power and delivery device capability. In October 1999, we introduced the next generation of OcuLight SLx, which offers added features to our OcuLight SL, such as LongPulse and MicroPulse operating modes. These features enable the OcuLight SLx to perform the latest in clinical infrared applications. In October 2000, we introduced the EasyFit family of portable slit lamp adapters (or SLAs), which allow for improved viewing clarity of the retina by the physician. In 2001, we introduced the Apex 800, a high powered infrared laser for hair removal for the aesthetics market. In October 2002, we introduced the OcuLight Symphony Laser Delivery System which combines the clinical versatility and convenience of combined infrared and visible photocoagulation consoles into one delivery device. We also introduced an expanded EndoProbe product line and a 5 millimeter Large Spot Slit Lamp Adapter. In December 2002, we commenced shipment of the Millennium Endolase module, which we manufacture to be included in Bausch & Lomb's Millennium Microsurgical System. The characteristics of these new products are similar to those which have made our previous products successful, such as low cost ownership, reliability and portability. We intend to continue our investment in research and development to improve the performance of our systems. We also intend to develop additional technologies which can more cost effectively address the needs of the ophthalmic and aesthetics markets.

Develop and Validate New Applications. We seek to develop and validate applications that are less costly, reduce side effects and achieve better clinical results than existing treatments. The objectives of developing new applications are to expand the number of patients who can be treated, to more effectively treat diseases, to treat patients earlier in the treatment regimen, and, to reduce the side-effects of treatment. An example of this is continued development of Minimum Intensity Photocoagulation (MIP) protocols. MIP is a laser treatment approach pioneered by IRIDEX, which uses our OcuLight SLX infrared lasers to maximize preservation of sensitive retinal tissues while stimulating a therapeutic effect. We believe that maintaining leadership in MIP will allow us to make a substantial contribution in the treatment of serious eye diseases such as age-related macular degeneration and diabetic retinopathy. Our products are currently being used in multiple studies in the United States and internationally to demonstrate the clinical benefits of MIP protocols. For example, our OcuLight SLx laser is being used in several studies to treat the various stages of both wet and dry forms of age-related macular degeneration (or AMD). We announced in October 1999 that a pilot clinical study on occult wet AMD produced results demonstrating that Transpupillary Thermotherapy (or TTT) was effective in improving or stabilizing vision in 75% of patients with a procedure using our OcuLight infrared laser photocoagulator. In November 2001, we announced that enrollment for the PTAMD study on dry AMD was stopped as sufficient enrollment had been achieved to detect a clinically relevant difference in the clinical outcomes of the study. In March 2003, we announced that the Executive Committee for the TTT4CNV clinical trial, studying TTT as a therapy for the treatment of wet AMD, accepted the recommendations of the independent Data and Safety Monitoring Committee that adequate patient enrollment in the study had been attained. We believe

that new applications increase laser usage and may ultimately increase the size of the market for laser photocoagulators. See "Management's Discussion and Analysis of Financial Condition and Results of Operations - Factors That May Affect Future Results - We are Dependent on the Successful Outcome of Clinical Trials of Our Products and New Applications Using Our Products."

Provide Total Disease Management. We intend to expand our product offerings utilizing a total disease management approach. We pursue this on the therapeutic side by increasing the number of delivery devices tailored to treat specific diseases. We are also pursuing this on the diagnostic side by developing adjunctive visualization systems which could be used to either identify patients who require therapy, target laser therapy more accurately, or assess the adequacy of therapy. Examples of products we have already introduced which may be utilized for both visualization and treatment include our TruFocus Laser Indirect Ophthalmoscope and our line of Slit Lamp Adapters. We believe that a significant opportunity exists to provide additional therapeutic delivery devices and adjunctive visualization systems. By pursuing both therapeutic and visualization systems, we intend to provide total disease management solutions for our customers.

Develop New Markets Through Strategic Alliances. We intend to establish strategic alliances in order to expedite and lower the cost of developing and bringing to market new products, both to the ophthalmology and aesthetics markets and to markets not currently addressed by our products. Through these alliances, we will seek access to technologies that we do not currently possess. In October 2002, we announced our collaboration with Bausch & Lomb to design and manufacture a solid-state green light laser photocoagulator module called the Millennium Endolase module. The Millennium Endolase module is designed to be a component of Bausch & Lomb's ophthalmic surgical suite product offering and is not expected to be sold as a stand-alone product. We intend to pursue additional strategic alliances in the future, which will provide access to new markets for our products. See "Management's Discussion and Analysis of Financial Condition and Results of Operations - Factors That May Affect Future Results - We Depend on Collaborative Relationships to Develop, Introduce and Market New Products, Product Enhancements and New Applications."

PRODUCTS

We utilize a systems approach to product design. Each system includes a console, which generates the laser energy, and a number of interchangeable peripheral delivery devices, including disposable delivery devices, for use in specific clinical applications. This approach allows our customers to purchase a basic console system and add additional delivery devices as their needs expand or as we develop new applications. We believe that this systems approach also brings economies-of-scale to our product development and manufacturing efforts since each application does not require the design and manufacture of complete stand-alone products. Our primary non-disposable products range in price from $2,000 to $75,000, and consist of laser consoles and peripheral delivery devices.

Consoles: Our laser consoles incorporate the economic and technical benefits of semiconductor laser technology.

Infrared Photocoagulator Consoles. These OcuLight photocoagulator consoles, used by ophthalmologists, are available in two infrared (810nm) output power ranges: the OcuLight SL at 2 Watts and the OcuLight SLx at 3 Watts. Each console weighs 14 pounds, has dimensions of 4"H x 12"W x 12"D, draws a maximum of 60 Watts of wall power, and requires no external air or water cooling. We also manufacture an aesthetics infrared laser product, the Apex 800. The Apex console weighs 27 pounds, has dimensions of 6"H x 12"W x 17"D, draws 700 Watts of wall power and has a closed loop integrated

water cooling system. We believe that the smaller overall sizes, lower weights and low power requirements to operate represent distinct advantages over competing products.

Visible Photocoagulator Consoles. Our OcuLight GL and OcuLight GLx semiconductor-based photocoagulator consoles, used in opthalmology, deliver visible (532nm) laser light. The OcuLight GLx has increased power and delivery device capability. Our visible laser light aesthetics product, the DioLite 532, is also based on semiconductor-based technology. The OcuLight GL/GLx/DioLite consoles weigh 15 pounds, have dimensions of 6"H x 12"W x 12"D, draw a maximum of 300 Watts of wall power and require no external air or water cooling. In December 2002, we commenced shipment of the Millennium Endolase module, which is sold exclusively to Bausch & Lomb for use with their Millennium Microsurgical System. It integrates 532nm photocoagulator capability into their array of microsurgical capabilities. It is compatible with the IRIDEX EndoProbe handpieces and Laser Indirect Ophthalmascope.

Combination Infrared/Visible Photocoagulator Consoles. The OcuLight Symphony Laser Delivery System, which we introduced in October 2002, is used by the opthalmologist and consists of an OcuLight SLx infrared (810nm) laser console, OcuLight GLx green (532 nm) laser, multi-fiber slit lamp adapter, slit lamp and a custom cart. It combines the clinical versatility and convenience of a 532 nm, 810 nm and large spot 810 nm into one delivery device for retinal photocoagulation and glaucoma procedures. We believe that this product offers a unique value-added proposition and the efficiency of multiple laser systems in a single product.

Peripheral Delivery Devices: Our versatile family of consoles and delivery devices has been designed to accommodate the addition of new capabilities with a minimal incremental investment. A user adds capabilities by simply purchasing a new interchangeable delivery device. We have developed both disposable and nondisposable delivery devices and expect to continue to develop additional devices.

Ophthalmic Delivery Devices:

TruFocus Laser Indirect Ophthalmoscope. The indirect ophthalmoscope is worn on the physician's head and is used to treat peripheral retinal disorders, particularly in infants or adults requiring treatment in the supine position. This product can be used both for diagnosis and treatment at the point-of-care.

Slit Lamp Adapter. These adapters allow the physician to utilize a standard slit lamp for both diagnosis and treatment. A slit lamp adapter can be installed by the doctor in several minutes, converting over 50 variations of standard diagnostic slit lamps into a therapeutic photocoagulator delivery system. Slit lamp adapters are used for treatment of both retinal and glaucoma diseases. These devices are available in a wide variety of spot diameters. In October 2002, we announced the availability of our Large Spot Size (5 millimeter) Slit Lamp Adapter designed for use with the OcuLight SLx and offering increased flexibility to the physician when using the TTT protocol to treat wet AMD.

Operating Microscope Adapter. These adapters allow the physician to utilize a standard operating microscope for both diagnosis and laser treatment. These devices are similar to slit lamp adapters, except they are oriented horizontally and therefore can be used to deliver retinal photocoagulation to a supine patient.

EndoProbe. The EndoProbe is used for endophotocoagulation, a retinal treatment performed in the hospital operating room or surgery center. These sterile disposable probes are available in tapered, angled, fluted, and illuminating styles. In October 2002, we introduced the BriteLight Illuminating EndoProbe providing increased illumination compared to existing devices.

G-Probe. The G-Probe is used to treat medically and surgically uncontrolled glaucoma, in many instances replacing cyclocryotherapy, or freezing of the eye. The G-Probe's non-invasive procedure takes about ten minutes, is done to an anesthetized eye in the doctor's office and results in less pain and fewer adverse side effects than cyclocryotherapy. The G-Probe is a sterile disposable product.

DioPexy Probe. The DioPexy Probe is a hand-held instrument which is used to treat retinal tears and breaks, noninvasively through the sclera, as an alternative method of attaching the retina. Our DioPexy Probe results in increased precision, less pain and less inflammation than traditional cryotherapy.

Aesthetics Delivery Devices:

DioLite Handpiece. The DioLite Handpiece is a hand held instrument that is used to treat vascular and pigmented skin lesions. These devices are available in 200, 500, 700, 1000 and 1400 micron spot diameters.

ScanLite Scanner. The ScanLite is a computer pattern generator with integrated controls designed to enhance the capabilities of the DioLite 532 laser system. It allows rapid and uniform treatment of large-area vascular and pigmented skin lesions including port wine stains, matted telangiectasia, and cafe au lait stains.

Apex 800 ColdTip Handpiece. The ColdTip Handpiece is a handheld instrument used with the Apex 800 for hair removal. It offers subzero contact cooling of the epidermis to allow the use of higher treatment fluences for improved treatment effectiveness and patient comfort.

Apex 800 Varispot Handpiece. The VariSpot Handpiece is a hand held instrument used with the Apex 800 for hair removal. It offers an aiming beam which aids visualization of the target area allowing precise treatment.

The following chart lists the eye diseases that can be treated using our photocoagulator systems, including the console and delivery devices that we offer to treat these diseases. The selection of delivery device is often determined by the severity and location of the disease. The chart also lists the skin diseases or conditions that can be treated with our aesthetics laser systems.

Condition	Procedure	Console	Delivery Devices
Ophthalmology Treatments:			
Age-related Macular Degeneration	Retinal Photocoagulation	Infrared & Visible	Slit Lamp Adapter
Diabetic Retinopathy			
Macular Edema	Grid Retinal Photocoagulation	Infrared & Visible	Slit Lamp Adapter & Operating Microscope Adapter
	Focal Retinal Photocoagulation	Visible	Slit Lamp Adapter

Condition	Procedure	Console	Delivery Devices
Proliferative	Pan-Retinal Photocoagulation	Infrared & Visible	Slit Lamp Adapter, Operating Microscope Adapter, Laser Indirect Ophthalmoscope, EndoProbe
Glaucoma			
Primary Open-Angle	Trabeculoplasty	Infrared & Visible	Slit Lamp Adapter
Angle-closure	Iridotomy	Infrared & Visible(1)	Slit Lamp Adapter
Uncontrolled	Transscleral Cyclophotocoagulation	Infrared	G-Probe
Retinal Detachment	Retinopexy Retinal Photocoagulation	Infrared & Visible	Slit Lamp Adapter, Laser Indirect Ophthalmoscope, Operating Microscope Adapter, EndoProbe
	Transscleral Retinal Photocoagulation	Infrared	DioPexy Probe
Retinopathy of Prematurity	Retinal Photocoagulation	Infrared	Laser Indirect Ophthalmoscope
Ocular Tumors	Retinal Photocoagulation	Infrared	Slit Lamp Adapter, Operating Microscope Adapter, Laser Indirect Ophthalmoscope
Aesthetics Treatments:			
Vascular Lesions	Selective Photothermolysis	Visible	DioLite Handpiece
Pigmented Lesions	Selective Photothermolysis	Visible	DioLite Handpiece
Hair Removal	Selective Photothermolysis	Infrared	Cold Tip Handpieces, Varispot Handpiece

(1) OcuLight GL/GLX is currently not cleared by the U.S. FDA for this indication.

RESEARCH AND DEVELOPMENT

Our research and development activities are performed internally by our research and development staff comprised of 17 individuals and is supplemented, from time to time, by consultants with specialized expertise. Research and development efforts are directed toward both development of new products and development of new applications using existing products, as well as the identification of markets not currently addressed by our products. Our expenditures for research and development totaled approximately $4,315,000, $4,808,000 and $5,265,000 in 2002, 2001 and 2000, respectively. We expect to continue to devote a significant portion of our resources to our research and development efforts for new products and new applications for existing products. We have close working relationships with researchers, clinicians and practicing physicians around the world who provide new ideas, test the feasibility of these new ideas, and assist us in validating new products and new applications before they are introduced.

We are continuing to develop Minimum Intensity Photocoagulation (MIP) protocols. MIP is a laser treatment approach pioneered by IRIDEX, which uses our OcuLight SLx infrared lasers to maximize preservation of sensitive retinal tissues while stimulating a therapeutic effect. We believe that maintaining leadership in MIP will allow us to make a substantial contribution in the treatment of serious eye diseases such as age-related macular degeneration, diabetic retinopathy, and glaucoma.

We are supporting pre-clinical and clinical studies to develop new photocoagulation treatments and applications using MIP protocols. The objectives of developing new applications are to expand the number of patients who can be treated, to more effectively treat diseases, to treat patients earlier in the treatment regimen and to reduce the side-effects of treatment. Examples of such studies with regard to particular eye afflictions are included in the following paragraphs.

Age-Related Macular Degeneration - Wet Form. AMD is a progressive disease that damages the central vision and affects a person's ability to read, see faces, and drive. About 50 million people worldwide have AMD and, of these, about 5 million have the more severe wet form. Though the wet form of AMD constitutes about 10% of all AMD, it accounts for about 80% of all severe vision loss associated with AMD. We are pursuing several approaches to treat wet AMD at different stages. All of these approaches close new blood vessels in the eye's macula caused by wet AMD with less damage than conventional laser treatments. One promising approach is Transpupillary Thermotherapy (TTT). TTT is a Minimum Intensity Photocoagulation (MIP) protocol that uses a milder form of retinal photocoagulation to treat wet AMD while sparing the sensory retina, as compared to conventional laser photocoagulation techniques. The protocol uses the OcuLight SLx laser and Large Spot Slit Lamp Adapter to produce favorable therapeutic responses with minimal side effects and preservation of vision in patients with occult choroidal neovascularization (CNV) secondary to AMD. Favorable results of a pilot TTT study were published in October 1999 and a multi-center randomized trial called the TTT4CNV Trial, which we are supporting, completed the required level of enrollment in March 2003. The Data and Safety Monitoring Committee (DSMC) for the TTT4CNV clinical trial meets semiannually to evaluate the status of the study.

Age-Related Macular Degeneration (AMD) - Dry Form. About 90% of AMD is the dry form. Our approach to treatment of dry AMD is to preserve or improve vision by following a MIP protocol using the OcuLight infrared laser to cause resorption of dry AMD deposits (drusen) which have accumulated in the macula and have impacted vision. We are supporting a multi-center clinical trial which is testing a treatment of eyes with dry age-related macular degeneration (PTAMD trial). In November 2001, we announced that enrollment for the PTAMD trial was stopped as sufficient enrollment had been achieved to detect a clinically relevant difference in the clinical outcomes of the study. This trial treats patients with dry AMD using our OcuLight infrared laser systems with the objective of determining whether patient vision is better as a result of treatment compared to no treatment; and secondarily, to determine whether treatment reduces the rate of progression of the disease from the dry form of AMD to the wet form of AMD.

Glaucoma. Preliminary studies are underway to evaluate the use of the G-Probe as a primary surgical treatment modality for glaucoma in various parts of the world.

Diabetic Retinopathy. Studies are underway to investigate the treatment of diabetic retinopathy using the MicroPulse infrared photocoagulation available in our OcuLight SLx product with the objective of causing regression of the disease with less loss of vision than conventional therapy.

Ocular Tumors. Clinical studies have reported successful treatment of ocular tumors using OcuLight infrared lasers using the TTT approach.

CUSTOMERS AND CUSTOMER SUPPORT

Our products are currently sold to comprehensive ophthalmologists, as well as those specializing in retina, glaucoma and pediatrics, dermatologists and plastic surgeons. Other customers include research and teaching hospitals, government installations, surgi-centers and hospitals. No customer or distributor accounted for 10% or more of total sales in 2002, 2001 or 2000. See Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations."

We are continuing our efforts to broaden our customer base through the development of new products and new applications for use by ophthalmologists and dermatologists. We currently estimate that there are approximately 20,000 ophthalmologists in the United States and 50,000 internationally who are each potential customers. We believe there are approximately 10,000 dermatologists and approximately 9,000 plastic surgeons in the U.S. who are potential customers. Additionally, we estimate that there are

approximately 4,900 and 18,000 hospitals in the United States and internationally, respectively, as well as approximately 2,300 ambulatory surgical centers in the United States which potentially represent multiple unit sales. Because independent ophthalmologists and dermatologists frequently practice at their own offices as well as through affiliation with hospitals or other medical centers, each independent ophthalmologist, dermatologist, plastic surgeon, hospital and medical center is a potential customer for our products. We are seeking to broaden our customer base by developing new products directed at addressing the needs of ophthalmologists and dermatologists.

We seek to provide superior customer support and service and recently restructured to create our Global Customer Care Group with the responsibility for our customer requests and product repairs, which has resulted in a significant improvement in our response times. We believe that our superior customer service and technical support distinguish our product offerings from those of our competitors. Our customer support representatives assists customers with orders, warranty returns and other administrative functions. Our technical support engineers provide customers with answers to technical and product-related questions. We maintain an "around-the-clock" telephone service line to service our customers. If a problem with a product cannot be diagnosed and resolved by telephone, a replacement unit is shipped overnight to any domestic customer and by the most rapid delivery means available to any international customer, and the problem unit is returned to us. The small size and rugged design of our products allows for economical shipment and quick response to customers almost anywhere in the world.

SALES AND MARKETING

We market our products in the United States predominantly through our direct sales force. As of December 28, 2002, our direct sales force consisted of 15 employees engaged in sales efforts within the United States. Our sales and marketing organization is based at our corporate headquarters in Mountain View, California with area sales managers located throughout the United States.

International product sales represented 36.1%, 41.3% and 35.6% of our sales in 2002, 2001 and 2000, respectively. We believe that our international sales will continue to represent a significant portion of our revenues for the foreseeable future. Our international sales are made principally to customers in Europe and the Asia/Pacific Rim region. Our products are sold internationally through our 66 independent distributors into 107 countries. International sales are administered through our corporate headquarters in Mountain View, California, along with four international area sales managers. Our distribution agreements with our international distributors are generally exclusive and typically can be terminated by either party without cause on 90 days notice. International sales may be adversely affected by the imposition of governmental controls, restrictions on export technology, political instability, trade restrictions, changes in tariffs and the economic condition in each country in which we sell our products. See Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations--Factors That May Affect Future Results--We Depend on International Sales."

To support our sales process, we conduct marketing programs which include direct mail, trade shows, public relations, and advertising in trade and academic journals and newsletters. We annually participate in approximately 76 trade shows or meetings in the United States and approximately 65 trade shows or meetings internationally. These meetings allow us to present our products to existing and prospective buyers.

We believe that educating patients and physicians at an early stage about the long-term health benefits and cost-effectiveness of diagnosis and treatment of diseases that cause blindness is critical to market acceptance of our ophthalmic products. We believe that the trend toward management of health care

costs in the United States will lead to increased awareness of and emphasis on disease prevention and cost-effective treatments and, as a result, will increase demand for our ophthalmic products.

We work with our customers to enhance our ability to identify new applications for our products, validate new procedures using our products, and expedite regulatory approvals of new products and applications. Customers include key opinion leaders who are often the heads of the departments or professors at universities. We believe that these luminaries in the field of ophthalmology and aesthetics are key to the successful introduction of new products and their subsequent acceptance by the general market. Acceptance of our products by these early adopters is key to our strategy in the validation of our new products.

OPERATIONS

The manufacture of our infrared and visible light photocoagulators and the related delivery devices is a highly complex and precise process. Completed systems must pass quality control and reliability tests before shipment. Our manufacturing activities consist of designing, assembling and testing of components and certain subassemblies for assembly into our final product. As of December 28, 2002, we had a total of 51 employees engaged in manufacturing activities.

The medical devices manufactured by us are subject to extensive regulation by numerous governmental authorities, including federal, state and foreign governmental agencies. The principal regulator in the United States of America is the Food and Drug Administration (or "FDA"). In April 1998, we received certification for ISO 9001/EN 46001. ISO 9001/EN 46001 is a documented international quality system demonstrating compliance to the European Medical Device Directive.

We rely on third parties to manufacture substantially all of the components used in our products, although we assemble critical subassemblies and the final product at our facility in Mountain View, California. Some of these suppliers and manufacturers are sole source. We have some long-term or volume purchase agreements with our suppliers and currently purchase most components on a purchase order basis. These components may not be available in the quantities required, on reasonable terms, or at all. Financial or other difficulties faced by our suppliers or significant changes in demand for these components or materials could limit their availability. Any failures by such third parties to adequately perform may delay the submission of products for regulatory approval, impair our ability to deliver products on a timely basis or otherwise impair our competitive position. See Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations--Factors That May Affect Future Results--We Face Risks of Manufacturing and We Depend on Key Manufacturers and Suppliers."

International regulatory bodies often establish varying product standards, packaging requirements, labeling requirements, tariff regulations, duties and tax requirements. As a result of our sales in Europe, we are required to have all products "CE" registered, an international symbol affixed to all products demonstrating compliance to the European Medical Device Directive and all applicable standards. In July 1998, we received CE registration under Annex II guidelines, the most stringent path to CE registration. With Annex II CE registration, we have demonstrated our ability to both understand and comply with all applicable European standards. This allows us to register any product upon our internal verification of compliance to all applicable European standards. Currently, all released products are CE registered. Continued registration is based on successful review of the process by our European Registrar during its annual audit. Any loss of registration would have a material adverse effect on our business, results of operations and financial condition. See Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations - Factors That May Affect Future Results-We Are Subject to Government Regulation."

COMPETITION

Competition in the market for devices used for ophthalmic and aesthetics treatments is intense and is expected to increase. This market is also characterized by rapid technological innovation and change, and our products could become obsolete as a result of future innovations. Our competitive position depends on a number of factors including product performance, characteristics and functionality, ease of use, scalability, durability and cost. In addition to other companies that manufacture photocoagulators and dermatological devices, we compete with pharmaceutical solutions, other technologies and other surgical techniques available in both the dermatologic and ophthalmic markets. Our principal competitors in ophthalmology are Lumenis Ltd., Nidek, Inc., Carl Zeiss, Inc., Alcon Inc. and Quantel. All of these companies currently offer a competitive, semiconductor-based laser system for ophthalmology. Our principal competitors in aesthetics are Lumenis Ltd., Laserscope, Candela Corporation, Altus Medical Inc. and Palomar Medical Technologies, Inc. Some competitors have substantially greater financial, engineering, product development, manufacturing, marketing and technical resources than we do. Some companies also have greater name recognition than us and long-standing customer relationships. In addition, other medical companies, academic and research institutions, or others, may develop new technologies or therapies, including medical devices, surgical procedures or pharmacological treatments and obtain regulatory approval for products utilizing such techniques that are more effective in treating the conditions targeted by us, or are less expensive than our current or future products. Our technologies and products could be rendered obsolete by such developments. Any such developments could have a material adverse effect on our business, financial condition and results of operations. See Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations--Factors That May Affect Future Results--Our Market is Competitive."

PATENTS AND PROPRIETARY RIGHTS

Our success and ability to compete is dependent in part upon our proprietary information. We rely on a combination of patents, trade secrets, copyright and trademark laws, nondisclosure and other contractual agreements and technical measures to protect our intellectual property rights. We file patent applications to protect technology, inventions and improvements that are significant to the development of our business. We have been issued thirteen United States patents and one foreign patent on the technologies related to our products and processes. We have approximately seven pending patent applications in the United States and six foreign pending patent applications that have been filed. Our patent applications may not be approved. Any patents granted now or in the future may offer only limited protection against potential infringement and development by competitors of competing products. Moreover, our competitors, many of which have substantial resources and have made substantial investments in competing technologies, may seek to apply for and obtain patents that will prevent, limit or interfere with our ability to make, use or sell our products either in the United States or in international markets.

In addition to patents, we rely on trade secrets and proprietary know-how which we seek to protect, in part, through proprietary information agreements with employees, consultants and other parties. Our proprietary information agreements with our employees and consultants contain provisions requiring such individuals to assign to us, without additional consideration, any inventions conceived or reduced to practice by them while employed or retained by us, subject to customary exceptions. Proprietary information agreements with employees, consultants and others may be breached, and we may not have adequate remedies for any breach. Our trade secrets may become known to or independently developed by competitors.

The laser and medical device industry is characterized by frequent litigation regarding patent and other intellectual property rights. Companies in the medical device industry have employed intellectual property litigation to gain a competitive advantage. Numerous patents are held by others, including academic

institutions and our competitors. Until recently, patent applications were maintained in secrecy in the United States until the patents issued. Patent applications filed in the United States after November 2000 generally will be published eighteen months after the filing date. However, since patent applications continue to be maintained in secrecy for at least some period of time both within the United States of America and with regard to international patent applications, we cannot assure you that our technology does not infringe any patents or patent applications held by third parties. We have, from time to time, been notified of, or have otherwise been made aware of, claims that we may be infringing upon patents or other proprietary intellectual property owned by others.

Any claims, with or without merit, and regardless of whether we are successful on the merits, would be time-consuming, result in costly litigation and diversion of technical and management personnel, cause shipment delays, require us to develop noninfringing technology or require us to enter into royalty or licensing agreements. An adverse determination in a judicial or administrative proceeding and failure to obtain necessary licenses or develop alternate technologies could prevent us from manufacturing and selling our products, which would have a material adverse effect on our business, results of operations and financial condition. Conversely, litigation may be necessary to enforce patents issued to us, to protect trade secrets or know-how owned by us or to determine the enforceability, scope and validity of the proprietary rights of others. Both the defense and prosecution of intellectual property suits or interference proceedings are costly and time consuming. See Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations - Factors That May Affect Future Results - We Rely on Patents and Proprietary Rights."

GOVERNMENT REGULATION

The medical devices to be marketed and manufactured by us are subject to extensive regulation by numerous governmental authorities, including federal, state, and foreign governmental agencies. Pursuant to the Federal Food, Drug, and Cosmetic Act, as amended, and the regulations promulgated thereunder (the "FDA Act"), the Food and Drug Administration (the "FDA") serves as the principal federal agency within the United States with authority over medical devices and regulates the research, clinical testing, manufacture, labeling, distribution, sale, marketing and promotion of such devices. Noncompliance with applicable requirements can result in, among other things, fines, injunctions, civil penalties, recall or seizures of products, total or partial suspension of production, failure of the government to grant premarket clearance or approval for devices, withdrawal of marketing approvals, and criminal prosecution. The FDA also has the authority to request repair, replacement or refund of the cost of any device manufactured or distributed by us.

In the United States, medical devices are classified into one of three classes (Class I, II or III), on the basis of the controls deemed necessary by the FDA to reasonably assure their safety and effectiveness. Under FDA regulations, Class I devices are subject to general controls (for example, labeling, premarket notification and adherence to Quality System Regulations ("QSRs") requirements). Class II devices are subject to general and special controls (for example, performance standards, postmarket surveillance, patient registries, and FDA guidelines). Generally, Class III devices are those which must receive premarket approval (or "PMA") by the FDA to ensure their safety and effectiveness.

Before a new Class III device can be introduced into the market, the manufacturer must generally obtain marketing clearance through either a 510(k) premarket notification or a PMA. A 510(k) clearance will be granted if the submitted information establishes that the proposed device is "substantially equivalent" to a legally marketed Class I or II medical device, or to a Class III medical device for which the FDA has not called for a PMA. The FDA may determine that a proposed device is not substantially equivalent to a legally marketed device, or that additional information or data are needed before a substantial equivalence determination can be made. A request for additional data may require that clinical studies of the device's safety and efficacy be performed.

Commercial distribution of a device for which a 510(k) notification is required can begin only after the FDA issues an order finding the device to be "substantially equivalent" to a previously approved device. The FDA has recently been requiring a more rigorous demonstration of substantial equivalence than in the past. Even in cases where the FDA grants a 510(k) clearance, it can take the FDA from four to twelve months from the date of submission to grant a 510(k) clearance, but it may take longer.

A "not substantially equivalent" determination, or a request for additional information, could delay the market introduction of new products that fall into this category and could have a materially adverse effect on our business, financial condition and results of operations. For any of our products that are cleared through the 510(k) process, such as our Apex 800 system, modifications or enhancements that could significantly affect the safety or efficacy of the device or that constitute a major change to the intended use of the device will require new 510(k) submissions.

A PMA application must be filed if a proposed device is not substantially equivalent to a legally marketed Class I or Class II device, or if it is a Class III device for which the FDA has called for PMAs. A PMA application must be supported by valid scientific evidence which typically includes extensive data, including human clinical trial data, to demonstrate the safety and effectiveness of the device. The PMA application must also contain the results of all relevant bench tests, laboratory and animal studies, a complete description of the device and its components, and a detailed description of the methods, facilities and controls used to manufacture the device. In addition, the submission may require the applicant to detail the proposed labeling, advertising literature and training methods.

Upon receipt of a PMA application, the FDA makes a threshold determination as to whether the application is sufficiently complete to permit a substantive review. If the FDA determines that the PMA application is sufficiently complete to permit a substantive review, the FDA will accept the application for filing. Once the submission is accepted for filing, the FDA begins an in-depth review of the PMA. An FDA review of a PMA application generally takes one to two years from the date the PMA application is accepted for filing, but may take significantly longer. The review time is often significantly extended by the FDA asking for more information or clarification of information already provided in the submission. During the review period, an advisory committee, typically a panel of clinicians, will likely be convened to review and evaluate the application and provide recommendations to the FDA as to whether the device should be approved. The FDA is not bound by the recommendations of the advisory panel. Toward the end of the PMA review process, the FDA generally will conduct an inspection of the manufacturer's facilities to ensure that the facilities are in compliance with applicable QSR requirements, which include good manufacturing practices.

If the FDA's evaluations of both the PMA application and the manufacturing facilities are favorable, the FDA will either issue an approval letter or an approvable letter, which may contain a number of conditions which must be met in order to secure final approval of the PMA. When, and if, those conditions have been fulfilled to the satisfaction of the FDA, the agency will issue a PMA approval letter, authorizing commercial marketing of the device for certain indications. The FDA may also determine that additional clinical trials are necessary or other deficiencies exist in the PMA, in which case PMA approval may be delayed. The PMA process can be expensive, uncertain and lengthy, and a number of devices for which the FDA approval has been sought by other companies have never been approved for marketing.

If human clinical trials of a device are required in connection with either a 510(k) notification or a PMA, and the device presents a "significant risk," the sponsor of the trial (usually the manufacturer or the distributor of the device) is required to file an investigational device exemption ("IDE") application prior to commencing human clinical trials. The IDE application must be supported by data, typically including the results of animal and laboratory testing. If the IDE application is reviewed and approved by the FDA and one

or more appropriate institutional review boards ("IRBs"), human clinical trials may begin at a specific number of investigational sites with a specific number of patients, as approved by the FDA. If the device presents a "nonsignificant risk" to the patient, a sponsor may begin the clinical trial after obtaining approval for the study by one or more appropriate IRBs.

All of our products have obtained either an independent 510(k) clearance or are modifications of previously cleared 510(k) devices, which do not require the submission of a new 510(k) notification. However, the FDA may not agree with our determination that a 510(k) notification is not required for the modified devices and require us to submit a new 510(k) notification for the modification. If the FDA requires us to submit a new 510(k) notification for the modified devices, we may be prohibited from marketing the modified device until the 510(k) notification is cleared by the FDA.

Any products manufactured or distributed by us pursuant to FDA clearances or approvals are subject to pervasive and continuing regulation by the FDA, including recordkeeping requirements and reporting of adverse experiences with the use of the device. Device manufacturers are required to register their establishments and list their devices with the FDA and certain state agencies, and are subject to periodic inspections by the FDA and certain state agencies. The FDA Act requires devices to be manufactured to comply with applicable QSR regulations which impose certain procedural and documentation requirements upon us with respect to manufacturing, design, development and quality assurance activities.

Labeling and promotion activities are subject to scrutiny by the FDA and, in certain instances, by the Federal Trade Commission. The FDA actively enforces regulations prohibiting marketing of products for unapproved uses. We and our products are also subject to a variety of state laws and regulations in those states or localities where our products are or will be marketed. Any applicable state or local regulations may hinder our ability to market our products in those states or localities. Manufacturers are also subject to numerous federal, state and local laws relating to such matters as safe working conditions, manufacturing practices, environmental protection, fire hazard control and disposal of hazardous or potentially hazardous substances. We may be required to incur significant costs to comply with such laws and regulations now or in the future. Such laws or regulations may have a material adverse effect upon our ability to do business.

Exports of our products are regulated by the FDA and are covered by the Export Amendment of 1996, which greatly expanded the export of approved and unapproved United States medical devices. However, some foreign countries require manufacturers to provide an FDA certificate for products for export ("CPE") which requires the device manufacturer to certify to the FDA that the product has been granted premarket clearance in the United States and that the manufacturing facilities appeared to be in compliance with QSR at the time of the last QSR inspection. The FDA will refuse to issue a CPE if significant outstanding QSR violations exist.

The introduction of our products in foreign markets will also subject us to foreign regulatory clearances which may impose additional substantial costs and burdens. International sales of medical devices are subject to the regulatory requirements of each country. The regulatory review process varies from country to country. Many countries also impose product standards, packaging, requirements, labeling requirements and import restrictions on devices. In addition, each country has its own tariff regulations, duties and tax requirements. The approval by the FDA and foreign government authorities is unpredictable and uncertain. The necessary approvals or clearances may not be granted on a timely basis, if at all. Delays in receipt of, or a failure to receive, such approvals or clearances, or the loss of any previously received approvals or clearances, could have a material adverse effect on our business, financial condition and results of operations.

Changes in existing requirements or adoption of new requirements or policies by the FDA or other foreign and domestic regulatory authorities could adversely affect our ability to comply with regulatory requirements. Failure to comply with regulatory requirements could have a material adverse effect on our business, financial condition and results of operations. We may be required to incur significant costs to comply with laws and regulations in the future. These laws or regulations may have a material adverse effect upon our business, financial condition or results of operations.

REIMBURSEMENT

The cost of a significant portion of medical care in the United States is funded by government programs, health maintenance organizations and private insurance plans. Our products are typically purchased by doctors, clinics, hospitals and other users, which bill various third-party payers, such as government programs and private insurance plans, for the health care services provided to their patients. Government imposed limits on reimbursement of hospitals and other health care providers have significantly impacted the spending budgets of doctors, clinics and hospitals to acquire new equipment, including our products. Under certain government insurance programs, a health care provider is reimbursed for a fixed sum for services rendered in treating a patient, regardless of the actual charge for such treatment. The Center for Medicare and Medicaid Services (CMS) reimburses hospitals on a prospectively-determined fixed amount for the costs associated with an in-patient hospitalization based on the patient's discharge diagnosis. CMS reimburses physicians a prospectively-determined fixed amount based on the procedure performed, regardless of the actual costs incurred by the hospital or physician in furnishing the care and regardless of the specific devices used in that procedure. Reimbursement issues have affected sales of our ophthalmic products to a greater extent than sales of our dermatologic products since aesthetics procedures, in general, are not covered procedures under most insurance programs and the cost of these procedures are paid for by the patient.

Private third-party reimbursement plans are also developing increasingly sophisticated methods of controlling health-care costs through limitation on reimbursable procedures and the exploration of more cost-effective methods of delivering health care. In general, these government and private measures have caused health care providers, including our customers, to be more selective in the purchase of medical products. In addition, changes in government regulation or in private third-party payers' policies may limit or eliminate reimbursement for procedures employing our products, which could have a material adverse effect on our business, results of operations and financial condition. See Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations - Factors That May Affect Future Results - We Depend on Third Party Coverage and Reimbursement Policies."

Doctors, clinics, hospitals and other users of our products may not obtain adequate reimbursement for use of our products from third-party payers. While we believe that the laser procedures using our products have generally been reimbursed, payers may deny coverage and reimbursement for our products if they determine that the device was not reasonable and necessary for the purpose used, was investigational or was not cost-effective. For example, during July 2000, the CMS advised that claims for reimbursement for certain AMD procedures that use our OcuLight SLx laser system would not be reimbursed by CMS. As a result, since July 2000, sales of the OcuLight SLx laser system have dropped significantly. In September 2000, CMS changed its position and advised that claims for reimbursement for two of the AMD procedures can be submitted for reimbursement with coverage and payment to be determined by the local medical carriers at their discretion. Sales of the OcuLight SLx continue, albeit at a lower level, because the OcuLight SLx can also be used for other retinal procedures that are reimbursable by the CMS. Furthermore, since CMS advisories are for domestic third party CMS payers, they are not likely to affect international sales. We believe domestic sales of the OcuLight SLx laser system will continue at these lower levels until more medical carriers reimburse for performing such AMD procedures or until CMS advises that claims for these

procedures may be submitted directly to CMS at the national level. Two carriers, Noridian Mutual Insurance, which is the CMS Part B carrier for Alaska, Arizona, Colorado, Hawaii, Iowa, Nevada, North Dakota, Oregon, South Dakota, Washington and Wyoming, as well as Cigna, which is the carrier for North Carolina, Tennessee and Idaho, have made coverage decisions approving the use of Transpupillary Thermotherapy, or TTT, protocol for the treatment of wet AMD. We believe that more medical carriers will reimburse for these procedures when they are further validated by clinical studies. We are supporting a randomized clinical trial (TTT4CNV) which may further validate the position TTT will have in the overall treatment regimen of AMD.

PRODUCT LIABILITY AND INSURANCE

We may be subject to product liability claims in the future. Our products are highly complex and are used to treat extremely delicate eye tissue and skin conditions on and near a patient's face. Our products are often used in situations where there is a high risk of serious injury or adverse side effects. In addition, although we recommend that our disposable products only be used once and prominently label these disposables, we believe that certain customers may nevertheless reuse these disposable products. If a disposable product is not adequately sterilized by the customer between such uses, a patient could suffer serious consequences, possibly resulting in a suit against us for damages. Accordingly, the manufacture and sale of medical products entails significant risk of product liability claims. Although we maintain product liability insurance with coverage limits of $11.0 million per occurrence and an annual aggregate maximum of $12.0 million, the coverage of our insurance policies may not be adequate. Such insurance is expensive and in the future may not be available on acceptable terms, if at all. A successful claim brought against us in excess of our insurance coverage could have a material adverse effect on our business, results of operations and financial condition. To date, we have not experienced any product liability claims which would result in payments in excess of our policy limits.

BACKLOG

We generally ship our products within a few days after acceptance of a customer's purchase order. Accordingly, we do not believe that our backlog at any particular time is indicative of future sales levels.

EMPLOYEES

At December 28, 2002, we had a total of 108 full-time employees, including 51 in operations, 29 in sales and marketing, 17 in research and development and 11 in finance and administration. We also employ, from time to time, a number of temporary and part-time employees as well as consultants on a contract basis. At December 28, 2002, we employed 2 such persons. We intend to hire additional personnel during the next twelve months primarily in the direct sales and production areas. Our future success will depend in part on our ability to attract, train, retain and motivate highly qualified employees, who are in great demand. We may not be successful in attracting and retaining such personnel. Our employees are not represented by a collective bargaining organization, and we have never experienced a work stoppage or strike. We consider our employee relations to be good.

ITEM 2. PROPERTIES

Our operating facilities are located in 37,000 square feet of space in Mountain View, California. This facility is being substantially utilized for all of our manufacturing and research and development efforts and serves as our headquarter offices. The lease agreement for this facility expires in February 2004.

Management believes that our facility has capacity adequate for our current needs and that suitable additional space or alternative space will be available as needed in the future on commercially reasonable terms.

ITEM 3. LEGAL PROCEEDINGS

None.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

No matters were submitted to a vote of security holders during the fourth quarter of the fiscal year covered by this report.

PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

MARKET INFORMATION FOR COMMON EQUITY

Our common stock is quoted on NASDAQ National Market System under the symbol "IRIX" since our initial public offering on February 15, 1996. The following table sets forth for the periods indicated the high and low closing prices for our common stock, as reported on the NASDAQ National Market.

	HIGH	LOW
FISCAL 2003		
First Quarter (through March 19, 2003) ...	$4.100	$2.750
FISCAL 2002		
First Quarter	$6.050	$4.170
Second Quarter	4.690	3.400
Third Quarter	3.920	2.310
Fourth Quarter	4.020	2.780
FISCAL 2001		
First Quarter	$6.313	$4.125
Second Quarter	4.400	3.000
Third Quarter	4.250	3.250
Fourth Quarter	5.446	3.850

FISCAL 2003

On March 19, 2003, the closing price on the NASDAQ National Market for our common stock was $3.770 per share. As of March 19, 2003, there were approximately 87 holders of record of our common stock.

DIVIDEND POLICY

We have never paid cash dividends on our common stock. We currently intend to retain any earnings for use in our business and do not anticipate paying cash dividends in the foreseeable future. In addition, the payment of cash dividends to our stockholders is currently prohibited by our bank line of credit. See Note 4 of Notes to Consolidated Financial Statements.

SECURITIES AUTHORIZED FOR ISSUANCE UNDER EQUITY COMPENSATION PLANS

As of December 28, 2002, we had three equity compensation plans. These plans are the 1995 Employee Stock Purchase Plan, 1995 Director Option Plan and 1998 Stock Option Plan, all of which have been approved by our stockholders. The following table summarizes our equity compensation plans as of December 28, 2002:

Plan category	(a) Number of securities to be issued upon exercise of outstanding options, warrants and rights	(b) Weighted-average exercise price of outstanding options, warrants and rights	(c) Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a))
Equity compensation plans approved by security holders	1,700,863	$5.11	399,747
Equity compensation plans not approved by security holders	0	0	0
Total	1,700,863	$5.11	399,747

ITEM 6. SELECTED FINANCIAL DATA

The following selected consolidated financial data as of December 28, 2002 and December 29, 2001, and for the years ended December 28, 2002, December 29, 2001 and December 30, 2000, has been derived from, and are qualified by reference to, our audited consolidated financial statements included herein. The selected consolidated statement of operations data for the years ended January 2, 1999 and December 31, 1997 and the consolidated balance sheet data as of December 30, 2000, January 1, 2000 and January 2, 1999 has been derived from our audited financial statements not included herein. These historical results are not necessarily indicative of the results of operations to be expected for any future period.

The data set forth below (in thousands, except per share data) are qualified by reference to, and should be read in conjunction with Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations," and our consolidated financial statements, related financial statement notes and other financial information included in Item 8, "Financial Statements and Supplementary Data."

	Fiscal Year 2002	Fiscal Year 2001	Fiscal Year 2000	Fiscal Year 1999	Fiscal Year 1998
CONSOLIDATED STATEMENT OF OPERATIONS DATA:					
Sales	$ 30,634	$ 27,275	$ 32,838	$ 26,391	$ 22,338
Cost of sales	17,046	14,205	14,506	11,669	9,915
Gross profit	13,588	13,070	18,332	14,722	12,423
Operating expenses:					
Research and development	4,315	4,808	5,265	3,925	3,099
Selling, general and administrative	9,454	10,251	10,747	9,224	8,358
Total operating expenses	13,769	15,059	16,012	13,149	11,457
Income (loss) from operations	(181)	(1,989)	2,320	1,573	966
Interest and other income (expense), net	122	426	569	556	511
Income (loss) before provision for income taxes	(59)	(1,563)	2,889	2,129	1,477
Benefit from (provision for) income taxes	209	962	(809)	(682)	(369)
Income (loss) from continuing operations	150	(601)	2,080	1,447	1,108
Income (loss) from operations of discontinued Laser Research segment (net of applicable income tax benefit(provision) of $0, $124, $(131), $(80) and $(213) respectively)	0	(204)	336	171	640
Income (loss) on disposal of Laser Research segment (net of applicable income tax benefit of $0, $315, $0, $0 and $0 respectively)	0	(468)	0	0	0
Net income (loss)	$ 150	$ (1,273)	$ 2,416	$ 1,618	$ 1,748
Basic net income (loss) per share:					
Continuing Operations	$ 0.02	$ (0.09)	$ 0.31	$ 0.22	$ 0.17
Discontinued Operations	0.00	(0.10)	0.05	0.03	0.10
Basic net income (loss) per common share	$ 0.02	$ (0.19)	$ 0.36	$ 0.25	$ 0.27
Diluted net income (loss) per share:					
Continuing Operations	$ 0.02	$ (0.09)	$ 0.29	$ 0.21	$ 0.16
Discontinued Operations	0.00	(0.10)	0.04	0.03	0.10
Diluted net income (loss) per share	$ 0.02	$ (0.19)	$ 0.33	$ 0.24	$ 0.26
Shares used in net income (loss) per common share basic calculations	6,870	6,757	6,637	6,503	6,480
Shares used in net income (loss) per common share diluted calculations	6,928	6,757	7,285	6,849	6,765

	December 28, 2002	December 29, 2001	December 30, 2000	January 1, 2000	January 2, 1999
CONSOLIDATED BALANCE SHEET DATA:					
Cash, cash equivalents and available-for-sale securities	$11,542	$ 9,102	$12,994	$13,148	$10,876
Working capital	26,981	26,374	27,005	23,842	23,450
Total assets	34,272	33,788	35,025	32,763	28,377
Total stockholders' equity	30,198	29,833	30,500	27,504	25,885

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

OVERVIEW

IRIDEX Corporation is a leading worldwide provider of semiconductor-based laser systems used to treat eye diseases in ophthalmology and skin afflictions in aesthetics. Our products are sold in the United States predominantly through a direct sales force and internationally through 66 independent distributors into 107 countries.

Our revenues arise primarily from the sale of our IRIS Medical OcuLight Systems, IRIDERM DioLite 532 and Apex 800 systems, delivery devices, disposables and, to a lesser extent, revenues from service and support activities. Our current family of OcuLight systems includes the IRIS Medical OcuLight Symphony, OcuLight SL, OcuLight SLx, OcuLight GL and OcuLight GLx Laser photocoagulation systems. In December 2002, we commenced shipment of the Millennium Endolase module which is sold exclusively to Bausch & Lomb and incorporated into their Millennium Microsurgical System. We believe that future growth in unit sales will be derived from growth in sales of peripheral delivery devices, our new product introductions and from the adoption of new procedures using our existing products, such as Transpupillary Thermotherapy.

Sales to international distributors are made on open credit terms or letters of credit. Sales of our products internationally currently are denominated in United States dollars and, accordingly, are subject to risks associated with international monetary conditions and currency fluctuations. In general, strengthening of the U.S. dollar relative to a foreign currency increases the cost of our product to our customers. Other risks that international sales are subject to include shipping delays, generally longer receivable collection periods, changes in applicable regulatory policies, domestic and foreign tax policies, trade restrictions, duties and tariffs and economic and political instability. Future currency fluctuations or other factors discussed above may have a material adverse effect on our business, financial condition or results of operation. See "--Factors That May Affect Future Results--We Depend on International Sales for a Significant Portion of Our Operating Results."

Cost of sales consists primarily of the cost of purchasing components and sub-systems, assembling, packaging, shipping and testing components at our facility, and the direct labor and associated overhead. Research and development expenses consist primarily of personnel costs, materials and research support provided to clinicians at medical institutions developing new applications which utilize our products. Research and development costs have been expensed as incurred. Sales, general and administrative expenses consist primarily of costs of personnel, sales commissions, travel expenses, advertising and promotional expenses, facilities, legal and accounting, insurance and other expenses which are not allocated to other departments.

RESULTS OF OPERATIONS

The following table sets forth certain operating data as a percentage of sales for the periods indicated:

	Fiscal Year Ended 2002	Fiscal Year Ended 2001	Fiscal Year Ended 2000
Sales	100.0%	100.0%	100.0%
Cost of sales	55.6	52.1	44.2
Gross profit	44.4	47.9	55.8
Operating expenses:			
Research and development	14.1	17.6	16.0
Sales, general and administrative	30.9	37.6	32.7
Total operating expenses	45.0	55.2	48.7
Operating income (loss) from continuing operations	(0.6)	(7.3)	7.1
Other income, net	0.4	1.6	1.7
Income (loss) from continuing operations before provision for income taxes	(0.2)	(5.7)	8.8
Benefit (provision) for income taxes	0.7	3.5	(2.5)
Income (loss) from continuing operations	0.5	(2.2)	6.3
Income (loss) from discontinued operations (net of tax).	0.0	(2.5)	1.0
Net income (loss)	0.5%	(4.7)%	7.3%

The following table sets forth for the periods indicated the amount of sales for our operating segments and sales as a percentage of total sales.

	Year Ending December 28, 2002		Year Ending December 29, 2001		Year Ending December 30, 2000	
	Amount	Percentage of total sales	Amount	Percentage of total sales	Amount	Percentage of total sales
Domestic	$19,564	63.9%	$16,004	58.7%	$21,133	64.4%
International	11,070	36.1%	11,271	41.3%	11,705	35.6%
Total	$30,634	100.0%	$27,275	100.0%	$32,838	100.0%
Ophthalmology:						
Domestic	$14,326	46.8%	$10,976	40.2%	$16,559	50.4%
International	9,843	32.1%	9,946	36.5%	10,506	32.0%
Total	$24,169	78.9%	$20,922	76.7%	$27,065	82.4%
Aesthetics:						
Domestic	$ 5,238	17.1%	$ 5,028	18.4%	$ 4,574	13.9%
International	1,227	4.0%	1,325	4.9%	1,199	3.7%
Total	$ 6,465	21.1%	$ 6,353	23.3%	$ 5,773	17.6%

During fiscal 2002, we continued to face downturns in our market, which started early in calendar year 2001, and are due to the worldwide economic slowdown and related uncertainties. For several quarters during 2002, we experienced reduced demand for our products as a result of these weakened economic conditions.

Combined Ophthalmology and Aesthetics Sales

In 2002, sales increased by 12.3% to $30.6 million from $27.3 million in 2001. Domestic sales, which represented 63.9% of total sales, increased by $3.6 million or 22.2%. The increase in domestic sales was primarily a result of $2.6 million in unit sales improvements, particularly for visible lasers, including sales of the new Millenium EndoLase module to Bausch & Lomb, a $1.2 million increase in unit sales of delivery devices for our ophthalmology products, $0.2 million in increased domestic aesthetic sales and $0.1 million in increased service revenue offset, in part, by $0.5 million in lower average selling prices. International sales, which were 36.1% of total sales, decreased by $0.2 million or 1.8%. The decrease in international sales in 2002 was due mainly to the strength of the U.S. dollar for most of 2002. This made our products cost more in foreign markets, since sales of our products internationally are denominated in U.S. dollars, thereby decreasing international sales by $0.2 million. We face challenges marketing and selling our products in the current difficult economic environment, both domestically and internationally, and expect to continue to face these challenges for the foreseeable future. See "-Factors That May Affect Future Results - Our Business Has Been Adversely Impacted by the Worldwide Economic Slowdown and Related Uncertainties."

In 2001, sales decreased by 16.9% to $27.3 million from $32.8 million in 2000 primarily as a result of decreased unit sales of our ophthalmology products. Domestic sales which represented 58.7% of total sales, decreased by $5.1 million or 24.3% primarily as a result of weakened economic conditions in the United States of America and $0.2 million due to lower average selling prices for aesthetics products. International sales, which were 41.3% of total net sales, decreased by $0.4 million or 3.7% primarily as a result of the strength of the U.S. dollar. To compensate, we lowered our average selling prices for our ophthalmology products which resulted in $0.5 million less international sales.

Ophthalmology Sales

Ophthalmology sales increased in 2002 by $3.2 million or 15.5% to $24.2 million. Domestic ophthalmology sales increased by $3.4 million or 30.5% to $14.3 million. Domestic ophthalmology sales increased during this period mainly as a result of $2.6 million in increased unit sales of visible laser consoles, including the Millenium EndoLase module, $1.2 million in increased unit sales of delivery devices and $0.1 million in increased service revenue offset, in part, by a decrease in average selling prices of $0.5 million. International ophthalmology sales decreased by $0.1 million or 1.0% to $9.8 million. The decrease in international sales was due primarily to a $0.2 million decrease in unit sales of infrared laser consoles, which resulted from the stronger U.S. dollar in 2002, offset by a $0.1 million increase in combined unit sales of visible laser consoles and delivery devices.

In 2001, ophthalmology sales decreased $6.1 million or 22.7% to $20.9 million. Domestic ophthalmology sales decreased $5.6 million or 33.7% to $11.0 million. International ophthalmology sales decreased by $0.6 million or 5.3% to $9.9 million. The decrease in domestic sales was due primarily to weakened economic conditions in the U.S. In addition, sales of our OcuLight SLx, in particular, were impacted in the United States as a result of uncertainties surrounding reimbursement by the Center for Medicare and Medicaid (CMS) for certain procedures to treat age-related macular degeneration (AMD) using our products. The decrease in international sales included a $0.5 million decrease in average selling prices for our ophthalmology products.

Aesthetics Sales

Aesthetics sales increased in 2002 by $0.1 million or 1.8% to $6.5 million. Domestic aesthetics sales increased by $0.2 million or 4.2% to $5.2 million. The increase in domestic aesthetics sales was due mainly to a $0.4 million increase from 2001 to 2002 in unit sales of the Apex 800 laser system which was introduced

in July 2001, a $0.1 million increase in unit sales of delivery devices and $0.1 million in increased service revenue offset, in part, by a $0.3 million decrease in unit sales of the DioLite laser and a decrease in average selling prices of $0.1 million. International aesthetics sales decreased by $0.1 million or 7.4% to $1.2 million. Increases in international unit sales of the Apex 800 laser system of $0.2 million and in delivery devices of $0.2 million were offset by a $0.5 million decrease in unit sales of the DioLite 532. We expect that the current economic slowdown will continue to adversely affect sales of our aesthetic products, particularly the Apex 800 laser system, and to a greater extent than sales of our ophthalmology products since aesthetic procedures are typically elective and therefore can be deferred, while ophthalmology procedures are typically not deferred. In addition, the continued political uncertainties in the Middle East and any extended hostilities in Iraq, to the extent these factors affect worldwide economic conditions, may adversely impact our international sales. See "-Factors That May Affect Future Results - Our Business Has Been Adversely Impacted by the Worldwide Economic Slowdown and Related Uncertainties."

Aesthetics sales increased in 2001 by $0.6 million or 10.0% to $6.4 million. Domestic aesthetics sales increased by $0.5 million or 9.9% to $5.0 million. International aesthetics sales increased $0.1 million or 10.5% to $1.3 million. The overall increase in aesthetics sales in 2001 was due primarily to sales of our Apex 800 laser system, which we introduced in July 2001. Included in the increase in aesthetics sales from 2000 to 2001 was a $0.2 million decrease in domestic average selling prices.

Gross Profit. Gross profit was $13.6 million in 2002, $13.1 million in 2001 and $18.3 million in 2000. Gross profit represented 44.4% of sales in 2002, 47.9% in 2001 and 55.8% in 2000. Gross profit as a percentage of sales decreased in 2002 by 3.5% as compared to 2001. The decrease in gross profit as a percentage of sales was due primarily to 1.5% for inventory related charges, 1.2% for increased warranty costs related to a change in estimate, 1.6% for lower average selling prices offset, in part, by increased gross margin of 0.4% associated with a reduction in direct inventory costs and 0.3% for increased domestic sales which have a higher gross margin. We intend to continue our efforts to reduce the cost of components and thereby mitigate the impact of price reductions on our gross profit. We believe gross profit in dollars will increase as volumes increase and unit production costs will decrease as costs are engineered out of new products. However, gross margins as a percentage of sales will continue to fluctuate due to changes in the relative proportions of domestic and international sales, the mix of product sales, costs associated with future product introductions and a variety of other factors. See "Factors That May Affect Future Results - Our Operating Results May Fluctuate from Quarter to Quarter."

Gross profit as a percentage of sales decreased 7.9% in 2001 as compared to 2000. Of this decrease, 2.6% was due to decreased sales volume of the OcuLight SLx, which has a relatively higher gross margin. In addition, fixed manufacturing costs were spread over a lower sales volume and we experienced higher initial production costs of our Apex 800 hair removal laser, which decreased gross profit as a percentage of sales in 2001 as compared to 2000 by 4.1%. We also charged to expense $0.3 million of inventory related to the OcuLight 664 which decreased gross profit by an additional 1.0%.

Research and Development. Research and development expenses decreased by 10.3% in 2002 to $4.3 million and decreased by 8.7% in 2001 to $4.8 million from $5.3 million in 2000. These expenses were 14.1% of sales in 2002, 17.6% of sales in 2001 and 16.0% of sales in 2000. The decrease in 2002, in absolute dollars, consisted of $0.3 million in reduced personnel spending related to a reduction in force in June 2002, $0.3 million in reduced spending due to the completion of the Apex Hair Removal Laser system in 2001, offset, in part, by a $0.1 million increase in clinical spending. The decrease in research and development expenses in 2002, as a percentage of sales, was due to the decline in expenses in absolute dollars and an increase in the level of sales exceeding the increase in research and development expense. We expect to increase our research and development expenditures in 2003 as we conduct additional development projects with our existing research and development staff. The decrease in 2001, in absolute dollars was primarily due to a reduction of expenses of $0.8 million related to the completion of the Apex 800 and $0.2 million due to cost containment measures, offset in part by a $0.6

million increase in other new project spending. The increase in research and development expenses in 2001, as a percentage of sales, was driven by the decrease in sales which exceeded the decrease in research and development costs.

Sales, General and Administrative. Sales, general and administrative expenses decreased by 7.8% in 2002 to $9.5 million and decreased by 4.6% in 2001 to $10.3 million from $10.7 million in 2000. These expenses were 30.9% of sales in 2002, 37.6% of sales in 2001 and 32.7% of sales in 2000. The decrease in sales, general and administrative expenses, in absolute dollars, from 2001 to 2002 consisted of reduced marketing and administrative personnel spending of $0.2 million related, in part, to the reduction in force in June 2002, $0.3 million in reduced spending on marketing programs, $0.2 million in reduced insurance spending and $0.1 million of other cost containment actions targeted at non-personnel expenses and resulting in reduced costs. The decrease, as a percentage of net sales, from 2001 to 2002 was attributable to the decline in expenses in absolute dollars and an increase in the level of sales exceeding the increase in sales, general and administrative expense. From 2000 to 2001, sales, general and administrative expenses, in absolute dollars, decreased as a result of $0.2 million in lower commissions, $0.1 million from fewer marketing and administrative personnel and $0.2 million of other cost containment actions. The increase in sales, general and administrative expense, as a percentage of net sales, from 2000 to 2001 was due to the decrease in the level of sales exceeding the decrease in sales, general and administrative expense.

Other income, net. Other income, net consists primarily of interest income. Interest income was $151,000, $378,000 and $552,000 in 2002, 2001 and 2000, respectively. This income was primarily from interest earned on available-for-sale securities. Interest income decreased in both 2002 and 2001 compared with 2001 and 2000, respectively, because of lower interest rates in 2002 and 2001 and overall lower average cash balances in 2001.

Income Taxes. In 2002, our effective rate was a benefit of 360% primarily as a result of pretax income nearing zero and the level of tax credits for research and development activities relative to the loss for 2002. Our effective tax rate for 2001 was a benefit of 62% and in 2000 it was 28%. The tax rate for 2001 and 2000 was lower than the Federal and State combined statutory rate of 40% because of certain tax benefits associated with tax-exempt interest on tax preferred securities and with tax credits for research and development activities.

Discontinued Operations. In April 2001, we discontinued our Laser Research segment. In the first quarter of 2001, we recorded a loss of $893,000 (net of a $542,000 tax benefit). In the fourth quarter of 2001, we adjusted the loss on discontinued operations to $672,000 (net of a $439,000 income tax benefit). Revenues for this segment were $599,000 for 2000. Costs and operating expenses of the Laser Research segment were $132,000 for 2000. Sales, general and administrative costs and indirect costs of manufacturing historically were not allocated to the Laser Research segment.

The Laser Research segment conducted research and development under research grants from the U.S. Federal Government and others. We discontinued our Laser Research activities to better focus available resources on our medical applications and products. The assets of the segment, primarily inventory, were fully reserved and the liabilities were fully paid. The components of the recorded loss were inventory costs of $0.7 million, the loss on operations for the first quarter of 2001 of $0.3 million, estimated sales return costs of $0.2 million, estimated costs for the phase-out period of $0.1 million and purchase order commitments of $0.1 million offset by a tax benefit of $0.5 million. In the fourth quarter of 2001, the accrued loss for the discontinuation of the segment was adjusted to reflect fewer than anticipated product returns.

Reduction in Force. During the quarter ended June 28, 2002, we reduced our workforce by seventeen positions or approximately 12%. For the three months ended June 28, 2002, we recorded restructuring charges totaling approximately $150,000 that were related primarily to the severance costs associated with the headcount reduction instituted in the second quarter of 2002. The reduction in workforce is expected to reduce employee-related costs by $1.2 million annually going forward.

LIQUIDITY AND CAPITAL RESOURCES

At December 28, 2002, our primary sources of liquidity included cash and cash equivalents of $9.2 million and available-for-sale securities of $2.3 million, for a total of $11.5 million. In addition, we have available $4.0 million under our unsecured line of credit which bears interest at the bank's prime rate and expires in October 2003. As of December 28, 2002, no borrowings were outstanding under this credit facility. We expect to renew the line of credit in October 2003 assuming that terms continue to be acceptable. We believe that, based on current estimates, our current cash, available-for-sale securities and the credit facility will be sufficient to meet our working capital and capital expenditure requirements at least through the next twelve months. However, we believe that the level of financial resources is a significant competitive factor in our industry, and accordingly we may choose to raise additional capital through debt or equity financing prior to the end of 2003.

We generated $4,613,000 in cash and cash equivalents during 2002. In 2001, we used $5,385,000 in cash and cash equivalents. In 2000, we generated $353,000.

Net cash generated by operations in 2002 totaled $2,509,000 as compared with $3,635,000 used in operations in 2001 and $74,000 used in operations in 2000. In 2002, sources of cash included decreases in net inventories of $1,837,000, depreciation of $869,000, increases in accrued expenses of $638,000, decreases in prepaid expenses of $359,000 and net income of $150,000. Uses of cash in 2002 included decreases in accounts payable of $519,000, increases in net accounts receivable of $482,000 and an increase in the deferred tax asset of $343,000. The decrease in inventory and accounts payable was due mainly to implementation of an inventory reduction program. The increase in accrued expenses consisted mainly of $0.4 million for income tax payable, $0.1 million for an increase in accrued warranty and $0.1 million for an accrued liability. The decrease in prepaid expenses consisted primarily of $0.4 million for tax receivable. In 2001, uses of cash included increases in net inventories of $2,841,000, a net loss of $1,273,000, increases in deferred income taxes of $332,000, decreases in accrued expenses of $338,000, decreases in net accounts receivable of $56,000 offset by sources of cash from operations which included depreciation of $859,000, tax benefit of employee stock option plans of $372,000 and decreases in prepaids and other current assets of $206,000. The increase in inventory was due primarily to material purchases associated with the Apex 800 which commenced shipment in July 2001. The increase in deferred income taxes was due primarily to the tax loss generated in 2001. The decrease in accrued expenses resulted primarily from a decrease in accrued payroll. The decrease in accounts payable related to a decreased level of inventory receipts at the end of the year. Prepaid and other current assets decreased due to decreases in accounts payable of $232,000 and decreased prepaid spending on trade shows.

We generated $1,849,000 for investing activities in 2002. We used $1,991,000 and $133,000 of cash in 2001 and 2000 respectively. Net cash provided by or used in investing activities was primarily due to the sale or purchase and proceeds of available-for-sale securities and the acquisition of fixed assets.

Net cash provided by financing activities during 2002, 2001 and 2000 was $205,000, $241,000 and $560,000, respectively, which consisted primarily of issuance of stock in connection with our employee stock programs, offset in part by purchase of treasury stock of $115,000 in 2001.

In December 1998, we instituted a stock repurchase program whereby up to 150,000 shares of our common stock may be repurchased in the open market. We plan to utilize all of the reacquired shares for reissuance in connection with employee stock programs. No shares of our common stock from the open market were purchased during 2000 and 2002. In 2001, we purchased 27,000 shares of our common stock from the open market. As of December 28, 2002 we have repurchased 103,000 shares of common stock.

CRITICAL ACCOUNTING POLICIES

The preparation of our condensed consolidated financial statements in conformity with United States Generally Accepted Accounting Principles (GAAP) requires us to make estimates and judgments that affect the reported amounts of assets and liabilities, net sales and expenses, and the related disclosures. We base our estimates on historical experience, our knowledge of economic and market factors and various other assumptions we believe to be reasonable under the circumstances. Actual results may differ from these estimates under different assumptions or conditions. We believe the following critical accounting policies are affected by significant estimates, assumptions, and judgments used in the preparation of our condensed consolidated financial statements.

Revenue Recognition

Revenue from product sales is recognized upon receipt of a purchase order and product shipment provided no significant obligations remain and collection of the receivables is deemed probable. Shipments are generally made with Free-On-Board (FOB) shipping point terms, whereby title passes upon shipment from our dock. Any shipments with FOB receiving point terms are recorded as revenue when the shipment arrives at the receiving point. Up-front fees received in connection with product sales are deferred and recognized over the associated product shipments.

Warranty

The Company accrues for estimated warranty costs upon shipment of products in accordance with SFAS No. 5, "Accounting for Contingencies." Actual warranty costs incurred have not materially differed from those accrued. The Company's warranty policy is effective for shipped products which are considered defective or fail to meet the product specifications. We analyze historical returns, current economic trends and changes in customer demand and acceptance of our products when evaluating the adequacy of the sales returns allowance. Warranty costs are reflected in the income statement as a cost of revenues.

Sales Returns Allowance and Allowance for Doubtful Accounts

In the process of preparing financial statements we must make estimates and assumptions that affect the reported amount of assets and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reported period. Specifically, we must estimate future product returns related to current period product revenue. We analyze historical returns, current economic trends and changes in customer demand and acceptance of our products when evaluating the adequacy of the sales returns allowance and other allowances. Significant management judgments and estimates must be made and used in connection with establishing the sales returns and other allowances in any accounting period. Material differences may result in the amount and timing of our revenue for any period if management made different judgments or utilized different estimates. The provision for sales returns amounted to $0.2 million in 2002. Similarly our management must make estimates of the uncollectibility of our accounts receivable. Management specifically analyzes accounts receivable and analyzes historical bad debts, customer concentrations, customer credit-worthiness, current economic trends and changes in our customer payment terms when evaluating the adequacy of the allowance for doubtful

accounts. Our accounts receivable balance was $8.0 million, net of allowance for doubtful accounts of $0.3 million as of December 28, 2002.

Inventories

Inventories are stated at the lower of cost or market. Cost is determined on a standard cost basis which approximates actual cost on a first-in, first-out (FIFO) method. Lower of cost or market is evaluated by considering obsolescence, excessive levels of inventory, deterioration and other factors.

Income Taxes

Income taxes are accounted for under Statement of Financial Accounting Standards (SFAS) No. 109, "Accounting for Income Taxes." Under SFAS No. 109, deferred assets and liabilities are recognized for the future consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax basis. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. Valuation allowances are established when necessary to reduce deferred tax assets to the amounts expected to be realized. Changes in estimate of future levels of taxable income or tax planning strategies could result in the need to provide or increase the valuation allowance against the net deferred tax assets which could materially impact earnings in the period of change.

CONTRACTUAL OBLIGATIONS

The following table summarizes purchase commitments and minimum rentals due for our facility and other leased assets under long-term, non-cancelable operating leases as of December 28, 2002 (in thousands):

	Payments Due by Period		
Contractual Obligations	Total	Less than 1 Year	1 - 3 Years
Operating Leases ...	$ 824	$ 702	$122
Unconditional Purchase Obligations*	$ 389	$ 389	$ 0
Total Contractual Cash Obligations ...	$ 1,213	$ 1,091	$ 122

*Contractual purchase obligations have varying cancellation terms.

RECENT ACCOUNTING PRONOUNCEMENTS

In April 2002, the FASB issued SFAS No. 145 "Rescission of FASB Statement No. 4, 44, and 64, Amendment of FASB Statement No. 13, and Technical Corrections," which eliminates inconsistencies between the required accounting for sale-leaseback transactions and the required accounting for certain lease modifications that have economic effects that are similar to sale-leaseback transactions. SFAS No. 145 also amends other existing authoritative pronouncements to make various technical corrections, clarify meanings, or describe their applicability under changed conditions. The provisions of SFAS No. 145 are effective for fiscal years beginning after May 15, 2002 and for transactions occurring after May 15, 2002. We do not expect the adoption of SFAS No. 145 to have a material impact on our financial position or on our results of operations.

In June 2002, the FASB issued SFAS No. 146, "Accounting for Exit or Disposal Activities" which addresses the recognition, measurement, and reporting of costs that are associated with exit and disposal activities, including restructuring activities that are currently accounted for pursuant to the guidance that the EITF has set forth in EITF Issue No. 94-3, "Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring)". SFAS No. 146 will be effective for exit or disposal activities that are initiated after December 31, 2002. We do not expect the adoption of SFAS No. 146 to have a material impact on our financial position or on our results of operations.

In November 2002, the FASB issued FASB Interpretation No. 45, or FIN 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees, including Indirect Guarantees of Indebtedness of Others." FIN 45 requires that a liability be recorded in the guarantor's balance sheet upon issuance of a guarantee. In addition, FIN 45 requires disclosures about the guarantees that an entity has issued, including a reconciliation of changes in the entity's product warranty liabilities. The initial recognition and initial measurement provisions of FIN 45 are applicable on a prospective basis to guarantees issued or modified after December 31, 2002, irrespective of the guarantor's fiscal year-end. The disclosure requirements of FIN 45 are effective for financial statements of interim or annual periods ending after December 15, 2002. The adoption of FIN 45 did not have a material impact on our financial position or on our results of operations.

In November 2002, the Emerging Issues Task Force ("EITF") reached a consensus on EITF 00-21, "Accounting for Revenue Arrangements with Multiple Deliverables." EITF 00-21 establishes criteria for whether revenue on a deliverable can be recognized separately from other deliverables in a multiple deliverable arrangement. The criteria consider whether the delivered item has standalone value to the customer, whether the fair value of the delivered item can be reliably determined and the rights of returns for the delivered items. EITF 00-21 is effective for revenue arrangements entered into in fiscal years beginning June 15, 2003 with early adoption permitted. We do not expect that the adoption of EITF 00-21 to have a material impact on our financial position or on our results of operations.

In December 2002, the FASB issued SFAS No. 148, "Accounting for Stock-Based Compensation- Transition and Disclosure an amendment of FASB Statement No. 123." SFAS No. 148 provides alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. SFAS No. 148 also requires prominent disclosures of the pro forma effect of using the fair value method of accounting for stock-based employee compensation in both annual and interim financial statements. The transition and annual disclosure requirements of SFAS No. 148 are effective for fiscal years ending after December 15, 2002. The interim disclosure requirements are effective for interim

periods beginning after December 15, 2002. The adoption of SFAS No. 148 did not have a material impact on our financial position or on our results of operations.

In January 2003, the FASB issued FASB Interpretation No. (FIN) 46 "Consolidation of Variable Interest Entities." This interpretation of Accounting Research Bulletin No. 51, Consolidated Financial Statements, addresses consolidation by business enterprises of variable interest entities which possess certain characteristics. The Interpretation requires that if a business enterprise has a controlling financial interest in a variable interest entity, the assets, liabilities, and results of the activities of the variable interest entity must be included in the consolidated financial statements with those of the business enterprise. This Interpretation applies immediately to variable interest entities created after January 31, 2003 and to variable interest entities in which an enterprise obtains an interest after that date. We do not have any ownership in any variable interest entities as of December 28, 2002. We will apply the consolidation requirements of FIN 46 in future periods if we should own any interest in any variable interest entity.

FACTORS THAT MAY AFFECT FUTURE RESULTS

We Rely on Continued Market Acceptance of Our Existing Products and Any Decline in Sales of Our Existing Products Would Adversely Affect our Business and Results of Operations. We currently market visible and infrared light semiconductor-based photocoagulator medical laser systems to the ophthalmic market. We also market a visible and infrared light semiconductor-based photocoagulator medical laser system to the aesthetics market. We believe that continued and increased sales, if any, of these medical laser systems is dependent upon a number of factors including the following:

- Product performance, features, ease of use, scalability and durability:
- Recommendations and opinions by ophthalmologists, dermatologists, clinicians, and their associated opinion leaders;
- Price of our products and prices of competing products and technologies:
- Availability of competing products, technologies and alternative treatments;
- Willingness of ophthalmologists and dermatologists to convert to semiconductor-based or infrared laser systems from alternative technologies; and
- Level of reimbursement for treatments administered with our products.

Any significant decline in market acceptance of our products would have a material adverse effect on our business, results of operations and financial condition.

We Face Strong Competition in Our Markets and Expect the Level of Competition to Grow in the Foreseeable Future. Competition in the market for devices used for ophthalmic and aesthetic treatments is intense and is expected to increase. This market is also characterized by rapid technological innovation and change and our products could be rendered obsolete as a result of future innovations. Our competitive position depends on a number of factors including product performance, characteristics and functionality, ease of use, scalability, durability and cost. Our principal competitors in ophthalmology are Lumenis Ltd., Nidek, Inc., Carl Zeiss, Inc., Alcon Inc. and Quantel. All of these companies currently offer a competitive, semiconductor-based laser system in ophthalmology. Our principal competitors in aesthetics are

Lumenis Ltd., Laserscope, Candela Corporation, Altus Medical Inc. and Palomar Medical Technologies, Inc. Some competitors have substantially greater financial, engineering, product development, manufacturing, marketing and technical resources than we do. Some companies also have greater name recognition than us and long-standing customer relationships. In addition to other companies that manufacture photocoagulators, we compete with pharmaceuticals, other technologies and other surgical techniques. Some medical companies, academic and research institutions or others may develop new technologies or therapies that are more effective in treating conditions targeted by us or are less expensive than our current or future products. Any such developments could have a material adverse effect on our business, financial condition and results of operations.

Our Future Success Depends on Our Ability to Develop and Successfully Introduce New Products and Applications. Our current products provide applications in the fields of ophthalmology and aesthetics. We cannot assure you that the market for these applications will continue to generate significant or consistent demand for our products. Demand for our products could be significantly diminished by new technologies or products that replace them or render them obsolete. Our future success is dependent upon, among other factors, our ability to develop, obtain regulatory approval of, manufacture and market new products. In October 2002, we announced the introduction of a number of new products, specifically the OcuLight Symphony multi-wavelength laser delivery system, an expanded EndoProbe product line and a 5 mm Large Spot Slit Lamp Adapter. We also announced the Millenium EndoLase module, which we manufacture to be included in Bausch & Lomb's Millenium Microsurgical system. Successful commercialization of these new products and new applications will require that we effectively transfer production processes from research and development to manufacturing and effectively coordinate with our suppliers. In addition, we must successfully sell and achieve market acceptance of new products and applications and enhanced versions of existing products. The extent of, and rate at which, market acceptance and penetration are achieved by future products, is a function of many variables. These variables include price, safety, efficacy, reliability, marketing and sales efforts, the development of new applications for these products, the availability of third-party reimbursement of procedures using our new products, the existence of competing products and general economic conditions affecting purchasing patterns. Our ability to market and sell new products may also be subject to government regulation, including approval by the United States Food and Drug Administration, or FDA, and foreign government agencies. Any failure in our ability to successfully develop and introduce new products or enhanced versions of existing products and achieve market acceptance of new products and new applications could have a material adverse effect on our operating results and would cause our net revenues to decline.

Our Business Has Been Adversely Impacted By The Worldwide Economic Slowdown and Related Uncertainties. Weaker economic conditions worldwide, particularly in the U.S., have contributed to the continued slowdown in our business in general. This has resulted in reduced demand for some of our products, particularly in our aesthetics products, such as the Apex 800, excess manufacturing capacity under current market conditions and higher manufacturing overhead costs as a percentage of revenue. Recent political and social turmoil in many parts of the world, including terrorist and military actions, may continue to adversely impact global economic conditions. These political, social and economic conditions and related economic uncertainties are making it very difficult for us, our customers and our distributors to forecast orders and sales of our products and, accordingly, plan future business activities. In addition, the continued political uncertainties in the Middle East and any extended hostilities in Iraq, to the extent these factors affect worldwide economic conditions, may adversely impact out international sales. This level of uncertainty strongly challenges our ability to operate profitably or grow our business. If the economic or market conditions continue or further deteriorate, this may have a material adverse impact on our financial position, results of operation and cash flows.

If We Cannot Increase Our Sales Volumes, Reduce Our Costs or Introduce Higher Margin Products to Offset Anticipated Reductions in the Average Unit Price of our Products, Our Operating Results May Suffer. We have experienced declines in the average unit price of our products and expect to continue to

suffer from declines in the future. The average unit price of our products may decrease in the future in response to changes in product mix, competitive pricing pressures, new product introductions by us or our competitors or other factors. If we are unable to offset the anticipated decrease in our average selling prices by increasing our sales volumes, our net revenues will decline. In addition, to maintain our gross margins, we must continue to reduce the manufacturing cost of our products. Further, should average unit prices of our current products decline, we must develop and introduce new products and product enhancements with higher margins. If we cannot maintain our gross margins, our business could be seriously harmed, particularly if the average selling price of our products decreases significantly without a corresponding increase in sales.

We Face Risks of Manufacturing. The manufacture of our infrared and visible light photocoagulators and the related delivery devices is a highly complex and precise process. We assemble critical subassemblies and the final product at our facility in Mountain View, California. Although our OcuLight Systems, DioLite 532 and our Apex 800 have been introduced, we continue to face risks associated with manufacturing these products. Various difficulties may occur despite testing. Furthermore, we may experience delays, disruptions, capacity constraints or quality control problems in our manufacturing operations and, as a result, product shipments to our customers could be delayed, which would negatively impact our net revenues.

We Depend on Sole Source or Limited Source Suppliers. We rely on third parties to manufacture substantially all of the components used in our products, including optics, laser diodes and crystals. We have some long term or volume purchase agreements with our suppliers and currently purchase components on a purchase order basis. Some of our suppliers and manufacturers are sole or limited source. In addition, some of these suppliers are relatively small private companies that may discontinue their operations at any time. There are risks associated with the use of independent manufacturers, including the following:

- unavailability of, shortages or limitations on the ability to obtain supplies of components in the quantities that we require;

- delays in delivery or failure of suppliers to deliver critical components on the dates we require;

- failure of suppliers to manufacture components to our specifications, and potentially reduced quality; and

- inability to obtain components at acceptable prices.

Our business and operating results may suffer from the lack of alternative sources of supply for critical sole and limited source components. The process of qualifying suppliers is complex, requiring extensive testing and interoperability with our products, and may be lengthy, particularly as new products are introduced. New suppliers would have to be educated in our production processes. In addition, the use of alternate components may require design alterations to our products and additional product testing under FDA and relevant foreign regulator agency guidelines, which may delay sales and increase product costs. Any failures by our vendors to adequately supply limited and sole source components may impair our ability to offer our existing products, delay the submission of new products for regulatory approval and market introduction, materially harm our business and financial condition and cause our stock price to decline. Establishing our own capabilities to manufacture these components would be expensive and could significantly decrease our profit margins. We do not currently intend to manufacture any of these components. Our business and results of operations would be adversely affected if we are unable to continue to obtain components in the quantity and quality desired and at the prices we have budgeted.

We Depend on International Sales for a Significant Portion of Our Operating Results. We derive and expect to continue to derive a large portion of our revenue from international sales. In 2002, 2001 and 2000, our international sales were $11.1 million, $11.3 million and $11.7 million, or 36.1%, 41.3%, and 35.6%, respectively, of total sales. We anticipate that international sales will continue to account for a significant portion of our revenues in the foreseeable future. None of our international revenues and costs has been denominated in foreign currencies. As a result, an increase in the value of the U.S. dollar relative to foreign currencies makes our products more expensive and thus less competitive in foreign markets. The factors stated above could have a material adverse effect on our business, financial condition or results of operations. Our international operations and sales are subject to a number of risks, including:

- longer accounts receivable collection periods;

- impact of recessions in economies outside of the United States;

- foreign certification requirements, including continued ability to use the "CE" mark in Europe;

- reduced or limited protections of intellectual property rights in jurisdictions outside the United States;

- potentially adverse tax consequences; and

- multiple protectionist, adverse and changing foreign governmental laws and regulations.

Any one or more of these factors stated above could have a material adverse effect on our business, financial condition or results of operations. For additional discussion about our foreign currency risks, see Item 7A, "Quantitative and Qualitative Disclosures About Market Risk."

Our Operating Results May be Adversely Affected by Changes in Third Party Coverage and Reimbursement Policies and any Uncertainty Regarding Healthcare Reform Measures. Our ophthalmology products are typically purchased by doctors, clinics, hospitals and other users, which bill various third-party payers, such as governmental programs and private insurance plans, for the health care services provided to their patients. Third-party payers are increasingly scrutinizing and challenging the coverage of new products and the level of reimbursement for covered products. Doctors, clinics, hospitals and other users of our products may not obtain adequate reimbursement for use of our products from third-party payers. While we believe that the laser procedures using our products have generally been reimbursed, payers may deny coverage and reimbursement for our products if they determine that the device was not reasonable and necessary for the purpose used, was investigational or was not cost-effective. In addition, third-party payers may not initiate coverage of new procedures using our products for a significant period. For example, in September 2000, the Center for Medicare and Medicaid Services, or CMS, advised that claims for reimbursement for certain AMD procedures, which use our OcuLight SLx laser system, could be submitted for reimbursement, with coverage and payment to be determined by the local medical carriers at their discretion. To date, only two carriers, Noridian Mutual Insurance, which is the CMS Part B Carrier for Alaska, Arizona, Colorado, Hawaii, Iowa, Nevada, North Dakota, Oregon, South Dakota, Washington and Wyoming, as well as Cigna, which is the carrier for North Carolina, Tennessee and Idaho, have made coverage decisions approving the use of the Transpupillary Thermotherapy, or TTT protocol for the treatment of wet AMD. No other carriers have approved reimbursement of such AMD procedures using the OcuLight SLx and domestic sales of the OcuLight SLx laser system continue to be limited until more local medical carriers reimburse for performing such AMD procedures or until CMS advises that claims foe these procedures may be submitted directly to CMS at the national level.

Changes in government legislation or regulation or in private third-party payers' policies toward reimbursement for procedures employing our products may prohibit adequate reimbursement. There have been a number of legislative and regulatory proposals to change the healthcare system, reduce the costs of healthcare and change medical reimbursement policies. Doctors, clinics, hospitals and other users of our products may decline to purchase our products to the extent there is uncertainty regarding reimbursement of medical procedures using our products and any healthcare reform measures. Further proposed legislation, regulation and policy changes affecting third-party reimbursement are likely. We are unable to predict what legislation or regulation, if any, relating to the health care industry or third-party coverage and reimbursement may be enacted in the future, or what effect such legislation or regulation may have on us. However, denial of coverage and reimbursement for our products would have a material adverse effect on our business, results of operations and financial condition.

We are Dependent on the Successful Outcome of Clinical Trials of Our Products and New Applications using our Products. Our success will depend in part on the successful outcome of clinical trials of our products and new applications using our products. Clinical trials are long, expensive and uncertain processes. We are currently supporting several ongoing clinical trials including, for example, the TTT4CNV clinical trial. The TTT4CNV clinical trial is a multi-center, prospective, placebo-controlled, randomized trial conducted at 22 centers in the United States. This clinical trial is a post marketing study performed within the FDA cleared indications of the OcuLight SLx and is being conducted to determine whether TTT laser treatment using our OcuLight SLx infrared laser system and Large Spot Slit Lamp Adapter can reduce the risk of vision loss for patients with wet age-related macular degeneration (AMD) compared to sham treated eyes. In order to successfully commercialize the use of our OcuLight SLx for TTT procedures, we must be able to, among other things, demonstrate with substantial evidence from well-controlled clinical trials where TTT procedures using the OcuLight SLx product fits within the treatment regimen of wet AMD. This process may take a number of years. In March 2003, we announced that the Executive Committee for the TTT4CNV clinical trial accepted the recommendations of the independent Data and Safety Monitoring Committee that an adequate number of patients were enrolled to detect a clinically relevant difference between outcomes in TTT-treated eyes and patients not being treated. We cannot assure you that results from the TTT4CNV clinical trial will prove to be successful. If the future results of the TTT4CNV clinical trial or any other clinical trial regarding our products fails to validate the safety and effectiveness of treatments using our products, our ability to generate revenues from new products or new applications using our products would be adversely affected and our business would be harmed.

Our Operating Results May Fluctuate from Quarter to Quarter and Year to Year. Our sales and operating results may vary significantly from quarter to quarter and from year to year in the future. Our operating results are affected by a number of factors, many of which are beyond our control. Factors contributing to these fluctuations include the following:

- General economic uncertainties and political concerns;

- The timing of the introduction and market acceptance of new products, product enhancements and new applications;

- Changes in demand for our existing line of aesthetic and ophthalmic products;

- The cost and availability of components and subassemblies, including the ability of our sole or limited source suppliers to deliver components at the times and prices that we have planned;

- Fluctuations in our product mix between aesthetic and ophthalmic products and foreign and domestic sales;

- The effect of regulatory approvals and changes in domestic and foreign regulatory requirements;

- Introduction of new products, product enhancements and new applications by our competitors, entry of new competitors into our markets, pricing pressures and other competitive factors;

- Our long and highly variable sales cycle;

- Decreases in the prices at which we can sell our products;

- Changes in customers' or potential customers' budgets as a result of, among other things, reimbursement policies of government programs and private insurers for treatments that use our products; and

- Increased product development costs.

In addition to these factors, our quarterly results have been and are expected to continue to be affected by seasonal factors.

Our expense levels are based, in part, on expected future sales. If sales levels in a particular quarter do not meet expectations, we may be unable to adjust operating expenses quickly enough to compensate for the shortfall of sales, and our results of operations may be adversely affected. In addition, we have historically made a significant portion of each quarter's product shipments near the end of the quarter. If that pattern continues, any delays in shipment of products could have a material adverse effect on results of operations for such quarter. Due to these and other factors, we believe that quarter to quarter and year to year comparisons of our past operating results may not be meaningful. You should not rely on our results for any quarter or year as an indication of our future performance. Our operating results in future quarters and years may be below public market analysts' expectations, which would likely cause the price of our common stock to fall.

We Rely on Our Direct Sales Force and Network of International Distributors to Sell Our Products and any Failure to Maintain our Direct Sales Force and Distributor Relationships Could Harm Our Business. Our ability to sell our products and generate revenue depends upon our direct sales force within the United States and relationships with independent distributors outside the United States. As of December 28, 2002, our direct sales force consisted of 15 employees and we maintained relationships with 66 independent distributors internationally selling our products into 107 countries. We generally grant our distributors exclusive territories for the sale of our products in specified countries. The amount and timing of resources dedicated by our distributors to the sales of our products is not within our control. Our international sales are entirely dependent on the efforts of these third parties. If any distributor breaches or fails to generate sales of our products, we may be forced to replace the distributor and our ability to sell our products in that exclusive sales territory would be adversely affected.

We do not have any long-term employment contracts with the members of our direct sales force. We may be unable to replace our direct sales force personnel with individuals of equivalent technical expertise and qualifications, which may limit our revenues and our ability to maintain market share. The loss of the services of these key personnel would harm our business. Similarly, our distributorship agreements are

generally terminable at will by either party and distributors may terminate their relationships with us, which would affect our international sales and results of operations.

We Depend on Collaborative Relationships to Develop, Introduce and Market New Products, Product Enhancements and New Applications. We have entered into collaborative relationships with academic medical centers and physicians in connection with the research and development and clinical testing of new products. We plan to collaborate with third parties to develop and commercialize existing and new products. In October 2002, we announced our collaboration with Bausch & Lomb to design and manufacture a solid-state green wavelength (532 nm) laser photocoagulator module, called the Millenium EndoLase module. The Millenium EndoLase module is designed to be a component of Bausch & Lomb's ophthalmic surgical suite product offering and is not expected to be sold as a stand-alone product. Sales of the Millenium EndoLase module are dependent upon the actual order rate from and shipment rate to Bausch & Lomb, which depends on the efforts of our partner and is beyond our control. We cannot assure you that our relationship with Bausch & Lomb will result in sales of our Millenium EndoLase module, if at all. Our collaborators may not pursue further development and commercialization of products resulting from collaborations with us or may not devote sufficient resources to the marketing and sale of such products. Additionally, our reliance on others for clinical development, manufacturing and distribution of our products may result in unforeseen problems. Further, our collaborative partners may develop or pursue alternative technologies either on their own or in collaboration with others. If a collaborator elects to terminate its agreement with us, our ability to develop, introduce, market and sell the product may be significantly impaired and we may be forced to discontinue the product resulting from the collaboration altogether. We may not be able to negotiate alternative collaborative agreements on acceptable terms, if at all. The failure of any current or future collaboration efforts could have a material adverse effect on our ability to introduce new products or applications and therefore could have a material adverse effect on our business, results of operations and financial condition.

We Rely on Patents and Other Proprietary Rights to Protect our Intellectual Property and Business. Our success and ability to compete is dependent in part upon our proprietary information. We rely on a combination of patents, trade secrets, copyright and trademark laws, nondisclosure and other contractual agreements and technical measures to protect our intellectual property rights. We file patent applications to protect technology, inventions and improvements that are significant to the development of our business. We have been issued thirteen United States patents and one foreign patent on the technologies related to our products and processes. We have approximately seven pending patent applications in the United States and six foreign pending patent applications that have been filed. Our patent applications may not be approved. Any patents granted now or in the future may offer only limited protection against potential infringement and development by our competitors of competing products. Moreover, our competitors, many of which have substantial resources and have made substantial investments in competing technologies, may seek to apply for and obtain patents that will prevent, limit or interfere with our ability to make, use or sell our products either in the United States or in international markets.

In addition to patents, we rely on trade secrets and proprietary know-how which we seek to protect, in part, through proprietary information agreements with employees, consultants and other parties. Our proprietary information agreements with our employees and consultants contain industry standard provisions requiring such individuals to assign to us, without additional consideration, any inventions conceived or reduced to practice by them while employed or retained by us, subject to customary exceptions. Proprietary information agreements with employees, consultants and others may be breached, and we may not have adequate remedies for any breach. Also, our trade secrets may become known to or independently developed by competitors.

The laser and medical device industry is characterized by frequent litigation regarding patent and other intellectual property rights. Companies in the medical device industry have employed intellectual property litigation to gain a competitive advantage. Numerous patents are held by others, including academic institutions and our competitors. Until recently, patent applications were maintained in secrecy in the United States until the patents issued. Patent applications filed in the United States after November 2000 generally will be published eighteen months after the filing date. However, since patent applications continue to be maintained in secrecy for at least some period of time, both within the United States and with regards to international patent applications, we cannot assure you that our technology does not infringe any patents or patent applications held by third parties. We have, from time to time, been notified of, or have otherwise been made aware of claims that we may be infringing upon patents or other proprietary intellectual property owned by others. If it appears necessary or desirable, we may seek licenses under such patents or proprietary intellectual property. Although patent holders commonly offer such licenses, licenses under such patents or intellectual property may not be offered or the terms of any offered licenses may not be reasonable.

Any claims, with or without merit and regardless of whether we are successful on the merits, would be time-consuming, result in costly litigation and diversion of technical and management personnel, cause shipment delays or require us to develop noninfringing technology or to enter into royalty or licensing agreements. An adverse determination in a judicial or administrative proceeding and failure to obtain necessary licenses or develop alternate technologies could prevent us from manufacturing and selling our products, which would have a material adverse effect on our business, results of operations and financial condition.

We Are Subject To Government Regulation Which May Cause Us to Delay or Withdraw the Introduction of New Products or New Applications for Our Products. The medical devices that we market and manufacture are subject to extensive regulation by the FDA and foreign governments. Under the Federal Food, Drug and Cosmetic Act and the related regulations, the FDA regulates the design, development, clinical testing, manufacture, labeling, sale, distribution and promotion of medical devices. Before a new device can be introduced into the market, the product must undergo rigorous testing and an extensive regulatory approval process implemented by the FDA under federal law. A device manufacturer must obtain market clearance through either the 510(k) premarket notification process or the lengthier premarket approval, or PMA, application process. Depending upon the type, complexity and novelty of the device and the nature of the disease or disorder to be treated, the FDA approval process can take several years, require extensive clinical testing and result in significant expenditures. Even if regulatory approval is obtained, later discovery of previously unknown safety issues may result in restrictions on the product, including withdrawal of the product from the market. Other countries also have extensive regulations regarding clinical trials and testing prior to new product introductions. Our failure to obtain government approvals or any delays in receipt of such approvals would have a material adverse effect on our business, results of operations and financial condition.

The FDA imposes additional regulations on manufacturers of approved medical devices. We are required to comply with the applicable FDA good manufacturing practice regulations, which include quality control and quality assurance requirements, as well as maintenance of records and documentation. Our manufacturing facilities are subject to ongoing periodic inspections by the FDA and corresponding state agencies, including unannounced inspections, and must be licensed as part of the product approval process before being utilized for commercial manufacturing. Noncompliance with the applicable requirements, can result in, among other things, fines, injunctions, civil penalties, recall or seizure of products, total or partial suspension of production, withdrawal of marketing approvals, and criminal prosecution. The FDA also has the authority to request repair, replacement or refund of the cost of any device we manufacture or distribute. Any of these actions by the FDA would materially and adversely affect our ability to continue operating our business and the results of our operations.

In addition, we are also subject to varying product standards, packaging requirements, labeling requirements, tariff regulations, duties and tax requirements. As a result of our sales in Europe, we are required to have all products "CE" registered, an international symbol affixed to all products demonstrating compliance to the European Medical Device Directive and all applicable standards. While currently all of our released IRIS Medical and IRIDERM products are CE registered, continued registration is based on successful review of the process by our European Registrar during their annual audit. Any loss of registration would have a material adverse effect on our business, results of operations and financial condition.

If Product Liability Claims are Successfully Asserted Against Us, We may Incur Substantial Liabilities That May Adversely Affect Our Business or Results of Operations. We may be subject to product liability claims in the future. Our products are highly complex and are used to treat extremely delicate eye tissue and skin conditions on and near a patient's face. Although we maintain product liability insurance with coverage limits of $11.0 million per occurrence and an annual aggregate maximum of $12.0 million, our coverage from our insurance policies may not be adequate. Product liability insurance is expensive. We might not be able to obtain product liability insurance in the future on acceptable terms or in sufficient amounts to protect us, if at all. A successful claim brought against us in excess of our insurance coverage could have a material adverse effect on our business, results of operations and financial condition.

If We Fail to Accurately Forecast Demand For Our Product and Component Requirements For The Manufacture Of Our Product, We Could Incur Additional Costs or Experience Manufacturing Delays And May Experience Lost Sales or Significant Inventory Carrying Costs. We use quarterly and annual forecasts based primarily on our anticipated product orders to plan our manufacturing efforts and determine our requirements for components and materials. It is very important that we accurately predict both the demand for our product and the lead times required to obtain the necessary components and materials. Lead times for components vary significantly and depend on numerous factors, including the specific supplier, the size of the order, contract terms and current market demand for such components. If we overestimate the demand for our product, we may have excess inventory, which would increase our costs. If we underestimate demand for our product and, consequently, our component and material requirements, we may have inadequate inventory, which could interrupt our manufacturing, delay delivery of our product to our customers and result in the loss of customer sales. Any of these occurrences would negatively impact our business and operating results.

If We Fail to Manage Growth Effectively, Our Business Could Be Disrupted Which Could Harm Our Operating Results. We have experienced, and may continue to experience, growth in our business. We have made and, although we are currently in a global economic downturn, expect to continue to make significant investments to enable our future growth through, among other things, new product development and clinical trial results for new applications and products. We must also be prepared to expand our workforce and to train, motivate and manage additional employees as the need for additional personnel arises. Our personnel, systems, procedures and controls may not be adequate to support our future operations. Any failure to effectively manage future growth could have a material adverse effect on our business, results of operations and financial condition.

If Our Facilities Were To Experience Catastrophic Loss, Our Operations Would Be Seriously Harmed. Our facilities could be subject to a catastrophic loss such as fire, flood or earthquake. All of our research and development activities, manufacturing, our corporate headquarters and other critical business operations are located near major earthquake faults in Mountain View, California. Any such loss at any of our facilities could disrupt our operations, delay production, shipments and revenue and result in large expense to repair and replace our facilities.

We May Need Additional Capital, Which May Not Be Available and Our Ability to Grow May be Limited as a Result. We believe that our existing cash balances, available-for-sale securities, credit facilities and cash flow expected to be generated from future operations, will be sufficient to meet our capital requirements at least through the next 12 months. However, we may be required, or could elect, to seek additional funding prior to that time. The development and marketing of new products and associated support personnel requires a significant commitment of resources. If cash from available sources is insufficient, we may need additional capital, which may not be available on favorable terms, if at all. If we cannot raise funds on acceptable terms we may not be able to develop or enhance our products, take advantage of future opportunities or respond to competitive pressures or unanticipated requirements. Any inability to raise additional capital when we require it would seriously harm our business.

Our Stock Price Has Been and May Continue to be Volatile and an Investment in Our Common Stock Could Suffer a Decline in Value. The trading price of our common stock has been subject to wide fluctuations in response to a variety of factors, some of which are beyond our control, including quarterly variations in our operating results, announcements by us or our competitors of new products or of significant clinical achievements, changes in market valuations of other similar companies in our industry and general market conditions. We receive only limited attention by securities analyst and may experience an imbalance between supply and demand for our common stock resulting from low trading volumes. In addition, the stock market has experienced extreme volatility in the last few years that has often been unrelated to the performance of particular companies. These broad market fluctuations could have a significant impact on the market price of our common stock regardless of our performance.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

QUANTITATIVE DISCLOSURES

We are exposed to market risks inherent in our operations, primarily related to interest rate risk and currency risk. These risks arise from transactions and operations entered into in the normal course of business. We do not use derivatives to alter the interest characteristics of our marketable securities or our debt instruments. We have no holdings of derivative or commodity instruments.

Interest Rate Risk. We are subject to interest rate risks on cash and cash equivalents, available-for-sale marketable securities and any future financing requirements. Interest rate risks related to marketable securities are managed by managing maturities in our marketable securities portfolio. We have no long-term debt as of December 28, 2002.

The fair value of our investment portfolio or related income would not be significantly impacted by changes in interest rates since the marketable securities maturities do not exceed fiscal year 2003 and the interest rates are primarily fixed.

QUALITATIVE DISCLOSURES

Interest Rate Risk. Our primary interest rate risk exposures relate to:

- The available-for-sale securities will fall in value if market interest rates increase.

- The impact of interest rate movements on our ability to obtain adequate financing to fund future operations.

We have the ability to hold at least a portion of the fixed income investments until maturity and therefore would not expect the operating results or cash flows to be affected to any significant degree by a sudden change in market interest rates on its short and long-term marketable securities portfolio.

Management evaluates its financial position on an ongoing basis.

Currency Rate Risk.

We do not hedge any balance sheet exposures against future movements in foreign exchange rates. The exposure related to currency rate movements would not have a material impact on future net income or cash flows.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

Our consolidated balance sheets as of December 28, 2002 and December 29, 2001 and the consolidated statements of operations, comprehensive income (loss), stockholders' equity and cash flows for each of the three years in the period ended December 28, 2002, together with the related notes and the report of PricewaterhouseCoopers LLP, independent accountants, are on the following pages. Additional required financial information is described in Item 14.

REPORT OF INDEPENDENT ACCOUNTANTS

To the Board of Directors and Stockholders of IRIDEX Corporation:

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of operations, of stockholders' equity, of cash flows and of comprehensive income (loss) present fairly, in all material respects, the financial position of IRIDEX Corporation and its Subsidiaries (the "Company") at December 28, 2002 and December 29, 2001 and the results of their operations, their cash flows and comprehensive income (loss) for each of the three years in the period ended December 28, 2002 in conformity with accounting principles generally accepted in the United States of America. In addition, in our opinion, the financial statement schedule listed in the accompanying index under 15(a)(2) on page 65 presents fairly, in all material respects, the information set forth therein when read in conjunction with the related consolidated financial statements. These financial statements and financial statement schedule are the responsibility of the Company's management; our responsibility is to express an opinion on these financial statements and financial statement schedule based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States of America, which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit 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, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

/s/ PricewaterhouseCoopers LLP

San Jose, California
January 27, 2003

IRIDEX CORPORATION

CONSOLIDATED BALANCE SHEETS
(IN THOUSANDS, EXCEPT SHARE AND PER SHARE DATA)

ASSETS	DECEMBER 28, 2002	DECEMBER 29, 2001
Current assets:		
Cash and cash equivalents	$ 9,186	$ 4,613
Available-for-sale securities	2,356	4,489
Accounts receivable, net of allowance for doubtful accounts of $262 in 2002 and $318 in 2001	8,037	7,555
Inventories, net	10,725	12,562
Prepaids and other current assets	751	1,110
Total current assets	31,055	30,329
Property and equipment, net	950	1,535
Deferred income taxes	2,267	1,924
Total assets	$ 34,272	$ 33,788
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 657	$ 1,176
Accrued expenses	3,417	2,779
Total liabilities	4,074	3,955
Commitments and contingencies (Note 5)		
Stockholders' Equity		
Convertible Preferred Stock, $.01 par value: Authorized: 2,000,000 shares; Issued and outstanding: none	--	--
Common Stock, $.01 par value: Authorized: 30,000,000 shares; Issued and outstanding: 6,905,998 shares in 2002 and 6,815,672 shares in 2001	70	69
Additional paid-in capital	23,631	23,417
Accumulated other comprehensive income	3	3
Treasury Stock, at cost Outstanding: 103,000 shares in 2002 and 2001	(430)	(430)
Retained earnings	6,924	6,774
Total stockholders' equity	30,198	29,833
Total liabilities and stockholders'equity	$ 34,272	$ 33,788

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

IRIDEX CORPORATION

CONSOLIDATED STATEMENTS OF OPERATIONS
(IN THOUSANDS, EXCEPT PER SHARE DATA)

	YEAR ENDED DECEMBER 28, 2002	YEAR ENDED DECEMBER 29, 2001	YEAR ENDED DECEMBER 30, 2000
Sales	$ 30,634	$ 27,275	$ 32,838
Cost of sales	17,046	14,205	14,506
Gross profit	13,588	13,070	18,332
Operating expenses:			
Research and development	4,315	4,808	5,265
Sales, general and administrative	9,454	10,251	10,747
Total operating expenses	13,769	15,059	16,012
Income (loss) from operations	(181)	(1,989)	2,320
Interest income	151	378	552
Other income (expense), net	(29)	48	17
Income (loss) before income taxes	(59)	(1,563)	2,889
Benefit from (provision for) income taxes	209	962	(809)
Income (loss) from continuing operations	150	(601)	2,080
Income (loss) from operations of discontinued Laser Research segment (net of applicable income tax benefit (provision) of $0, $124 and $(131), respectively in 2002, 2001 and 2000)	0	(204)	336
Income (loss) on disposal of Laser Research segment, (net of applicable income tax benefit of $0, $315 and $0, respectively in 2002, 2001 and 2000)	0	(468)	0
Net income (loss)	$ 150	$ (1,273)	$ 2,416
Basic net income (loss) per share:			
Continuing operations	$ 0.02	$ (0.09)	$ 0.31
Discontinued operations	0.00	(0.10)	0.05
Basic net income (loss) per common share	$ 0.02	$ (0.19)	$ 0.36
Diluted net income (loss) per share:			
Continuing operations	$ 0.02	$ (0.09)	$ 0.29
Discontinued operations	0.00	(0.10)	0.04
Diluted net income (loss) per common share	$ 0.02	$ (0.19)	$ 0.33
Shares used in net income (loss) per common share basic calculations	6,870	6,757	6,637
Shares used in net income (loss) per common share diluted calculations	6,928	6,757	7,285

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

IRIDEX CORPORATION

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
(IN THOUSANDS, EXCEPT SHARE DATA)

	Common Stock		Additional Paid-in	Treasury	Accumulated Other Comprehensive Income	Retained	
	Shares	Amount	Capital	Stock	(Loss)	Earnings	Total
Balances, January 1, 2000	6,540,358	$ 66	$ 22,124	$ (315)	$ (2)	$ 5,631	$ 27,504
Issuance of Common Stock under Stock Option Plan	120,173	1	317				318
Issuance of Common Stock under Employee Stock Purchase Plan	40,331		242				242
Stock compensation expense			8				8
Change in unrealized gains on available-for-sale securities					12		12
Net income						2,416	2,416
Balances, December 30, 2000	6,700,862	67	22,691	(315)	10	8,047	30,500
Issuance of Common Stock under Stock Option Plan	74,942	1	99				100
Issuance of Common Stock under Employee Stock Purchase Plan	66,868	1	255				256
Purchase of Treasury Stock	(27,000)			(115)			(115)
Tax Benefit of Employee Stock Option Plan			372				372
Change in unrealized gains on available-for-sale securities					(7)		(7)
Net loss						(1,273)	(1,273)
Balances, December 29,2001	6,815,672	69	23,417	(430)	3	6,774	29,833
Issuance of Common Stock under Stock Option Plan	36,930		78				78
Issuance of Common Stock under Employee Stock Purchase Plan	53,396	1	126				127
Tax Benefit of Employee Stock Option Plan			10				10
Change in unrealized gains on available-for-sale securities					--		
Net income						150	150
Balances, December 28, 2002	6,905,998	$ 70	$ 23,631	$ (430)	$ 3	$ 6,924	$ 30,198

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

IRIDEX CORPORATION

CONSOLIDATED STATEMENTS OF CASH FLOWS

(IN THOUSANDS)

	YEAR ENDED DECEMBER 28, 2002	YEAR ENDED DECEMBER 29, 2001	YEAR ENDED DECEMBER 30, 2000
Cash flows from operating activities:			
Net income (loss)	$ 150	$(1,273)	$ 2,416
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:			
Depreciation and amortization	869	859	893
Tax benefit of employee stock option plan	10	372	--
Stock compensation expense	--	--	8
Provision for doubtful accounts	(56)	(163)	131
Provision for inventories	125	322	285
Deferred income taxes	(343)	(332)	(74)
Changes in assets and liabilities:			
Accounts receivable	(426)	107	74
Inventories	1,712	(3,163)	(2,750)
Prepaids and other current assets	359	206	(323)
Accounts payable	(519)	(232)	280
Accrued expenses	638	(338)	(1,014)
Net cash provided by (used in) operating activities	2,519	(3,635)	(74)
Cash flows from investing activities:			
Purchases of available-for-sale securities	(2,356)	(4,489)	(3,856)
Proceeds from maturity of available-for-sale securities	4,489	2,989	4,375
Acquisition of property and equipment	(284)	(491)	(652)
Net cash provided by (used in) investing activities	1,849	(1,991)	(133)
Cash flows from financing activities:			
Purchase of treasury stock	--	(115)	--
Issuance of common stock under stock purchase and option plans	205	356	560
Net cash provided by financing activities	205	241	560
Net increase (decrease) in cash and cash equivalents	4,573	(5,385)	353
Cash and cash equivalents, beginning of year	4,613	9,998	9,645
Cash and cash equivalents, end of year	$ 9,186	$ 4,613	$ 9,998
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:			
Cash paid during the period for:			
Income taxes	$ 8	$ 12	$ 2,244
SUPPLEMENTAL DISCLOSURE OF NONCASH INVESTING AND FINANCING ACTIVITIES:			
Change in unrealized gains (losses) on available-for-sale securities	$ --	$ (7)	$ 12

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

IRIDEX CORPORATION
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)
(IN THOUSANDS)

	YEAR ENDED DECEMBER 28, 2002	YEAR ENDED DECEMBER 29, 2001	YEAR ENDED DECEMBER 30, 2000
Net income (loss)	$ 150	$(1,273)	$ 2,416
Other comprehensive income (loss):			
Changes in unrealized gains (losses) on available-for-sale securities	--	(7)	12
Comprehensive income (loss)	$ 150	$(1,280)	$ 2,428

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

1. BUSINESS OF THE COMPANY

Description of Business

IRIDEX Corporation is a leading worldwide provider of semiconductor-based laser systems used to treat eye diseases in ophthalmology and skin lesions in aesthetics.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Financial Statement Presentation

The consolidated financial statements include our accounts and our wholly-owned subsidiaries. All significant intercompany accounts and transactions have been eliminated.

Cash and Cash Equivalents

The Company considers all highly liquid debt instruments purchased with an original maturity of three months or less to be cash equivalents. The Company invests primarily in money market funds and government paper; accordingly, these investments are subject to minimal risks.

Available-for-Sale Securities

All marketable securities as of December 28, 2002 and December 29, 2001 are considered to be available-for-sale and therefore are carried at fair value. Available-for-sale securities are classified as current assets when they have scheduled maturities of less than one year. Available-for-sale securities are classified as non current assets when they have scheduled maturities of more than one year. Unrealized holding gains and losses on such securities are reported net of related taxes as a separate component of stockholders' equity until realized. Realized gains and losses on sales of all such securities are reported in interest and other income and are computed using the specific identification cost method.

Inventories

Inventories are stated at the lower of cost or market. Cost is determined on a standard cost basis which approximates actual cost on a first-in, first-out (FIFO) method. Lower of cost or market is evaluated by considering obsolescence, excessive levels of inventory, deterioration and other factors.

Property and Equipment

Property and equipment are stated at cost less accumulated depreciation and amortization. Depreciation is provided on a straight-line basis over the estimated useful lives of the assets, which is generally three years. Amortization of leasehold improvements and property and equipment is computed using the straight-line method over the estimated useful life of the related assets, typically three years.

Revenue Recognition

Revenue from product sales is recognized upon receipt of a purchase order and product shipment provided no significant obligations remain and collection of the receivables is deemed probable. Shipments are generally made with Free-On-Board (FOB) shipping point terms, whereby title passes upon shipment from our dock. Any shipments with FOB receiving point terms are recorded as revenue when the shipment arrives at the receiving point. Up-front fees received in connection with product sales are deferred and recognized over the associated product shipments.

Warranty

The Company accrues for estimated warranty costs upon shipment of products in accordance with SFAS No. 5, "Accounting for Contingencies." Actual warranty costs incurred have not materially differed from those accrued. The Company's warranty policy is effective for shipped products which are considered defective or fail to meet the product specifications. We analyze historical returns, current economic trends and changes in customer demand and acceptance of our products when evaluating the adequacy of the sales returns allowance. Warranty costs are reflected in the income statement as a cost of revenues. A reconciliation of the changes in the Company's warranty liability for the year ending December 28, 2002 follows (in thousands):

Balance at the beginning of the year	$ 582
Accruals for warranties issued during the year	463
Settlements made in kind during the year	(249)
Balance at the end of the year	$ 796

Research and Development

Research and development expenditures are charged to operations as incurred.

Advertising

We expense advertising costs as they are incurred. Advertising expenses for 2002, 2001 and 2000 were $242,000, $408,000 and $478,000, respectively.

Fair Value of Financial Instruments

Carrying amounts of our financial instruments including cash and cash equivalents, accounts receivable, accounts payable and accrued liabilities approximate fair values due to their short maturities. Estimated fair values for available-for-sale securities, which are separately disclosed elsewhere, are based on quoted market prices for the same or similar instruments.

Income Taxes

Income taxes are accounted for under Statement of Financial Accounting Standards (SFAS) No. 109, "Accounting for Income Taxes." Under SFAS No. 109, deferred assets and liabilities are recognized for the future consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax basis. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. Valuation allowances are established when necessary to reduce deferred tax assets to the amounts expected to be realized.

Accounting for Stock-Based Compensation

The Company accounts for stock-based compensation arrangements in accordance with provisions of Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees"("APB 25") and complies with the disclosure provisions of Statement of Financial Accounting Standards No. 123, "Accounting for Stock-Based Compensation"("SFAS 123").

Under APB 25, compensation expense for grants to employees is based on the difference, if any, on the date of the grant, between the fair value of the Company's stock and the option's exercise price. SFAS 123 defines a "fair value" based method of accounting for an employee stock option or similar equity investment. The pro forma disclosure of the difference between compensation expense included in net loss and the related cost measured by the fair value method is presented in Note 6.

The Company accounts for equity instruments issued to non-employees in accordance with the provisions of SFAS 123 and Emerging Issues Task Force Issue No. 96-18, "Accounting for Equity Instruments that are Issued to Other Than Employees, or in Conjunction with Selling Goods and Services." Stock-based compensation expense related to stock options granted to non-employees is recognized on a straight line basis as the stock options are earned. The stock-based compensation expense will fluctuate as the deemed fair market value of the common stock fluctuates. There were no equity instruments issued to non-employees in 2002, 2001 and 2000.

The following table provides a reconciliation of net income to pro forma net loss as if the fair value method had been applied to all awards (in thousands, except per share data):

Year Ended December 28, 2002	Year Ended December 29, 2001	Year Ended December 30, 2000
Net income (loss), as reported	$ 150	$ (1,273)	$ 2,416
Add: Total stock based compensation expense determined under fair value based method for all awards	(438)	(727)	(776)
Pro forma net loss	$ (288)	$ (2,000)	$ 1,640

Basic net income (loss) per share: As reported	$ 0.02	$ (0.19)
Pro forma	$ (0.04)	$ (0.30)
Diluted net income (loss) per share: As reported	$ 0.02	$ (0.19)
Pro forma	$ (0.04)	$ (0.30)

Concentration of Credit Risk and Other Risks and Uncertainties

Our cash and cash equivalents are deposited in demand and money market accounts of three financial institutions. Deposits held with banks may exceed the amount of insurance provided on such deposits. Generally these deposits may be redeemed upon demand and therefore, bear minimal risk.

We market our products to distributors and end-users throughout the world. Sales to international distributors are generally made on open credit terms and letter of credit. Management performs ongoing credit evaluations of our customers and maintains an allowance for potential credit losses. Historically, we have not experienced any significant losses related to individual customers or group of customers in any particular geographic area. For the years ended December 28, 2002, December 29, 2001 and December 30, 2000 no customer accounted for greater than 10% of revenue. As of December 28, 2002, one customer accounted for 11% of accounts receivable. As of December 29, 2001 and December 30, 2000 no customer accounted for more than 10% of accounts receivable.

Our products require approvals from the Food and Drug Administration and international regulatory agencies prior to commercialized sales. Our future products may not receive required approvals. If we were denied such approvals, or if such approvals were delayed, it would have a materially adverse impact on our business, results of operations and financial condition.

Reliance on Certain Suppliers

Certain components and services used by the Company to manufacture and develop its products are presently available from only one or a limited number of suppliers or vendors. The loss of any of these suppliers or vendors would potentially require a significant level of hardware and/or software development to incorporate the products or services into the Company's products.

Use of Estimates

Management makes estimates and assumptions to prepare the consolidated financial statements in conformity with generally accepted accounting principles. These estimates and assumptions 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.

Reclassification

Certain prior year amounts have been reclassified to conform to the current year's presentation. These reclassifications had no impact on prior year stockholders' equity or results of operations. In addition, as a result of IRIDEX's disposal of it's Laser Research segment in 2001, the Company's previously reported consolidated financial statements for 2001 and 2000 have been reclassified to present the discontinued Laser Research segment operations separate from continuing operations. (See Note 12.)

Fiscal Year

Our fiscal year covers a 52 or 53 week period and ends on the Saturday nearest December 31. Fiscal year 2000, 2001 and 2002 all included 52 weeks.

Net Income (loss) per Share

Basic and diluted net income per share are computed by dividing net income (loss) for the period by the weighted average number of shares of common stock outstanding during the period. The calculation of diluted net income (loss) per share excludes potential common stock if their effect is anti-dilutive. Potential common stock consists of incremental common shares issuable upon the exercise of stock options.

Recent Accounting Pronouncements

In April 2002, the FASB issued SFAS No. 145 "Rescission of FASB Statement No. 4, 44, and 64, Amendment of FASB Statement No. 13, and Technical Corrections," which eliminates inconsistencies between the required accounting for sale-leaseback transactions and the required accounting for certain lease modifications that have economic effects that are similar to sale-leaseback transactions. SFAS No. 145 also amends other existing authoritative pronouncements to make various technical corrections, clarify meanings, or describe their applicability under changed conditions. The provisions of SFAS No. 145 are effective for fiscal years beginning after May 15, 2002 and for transactions occurring after May 15, 2002. We do not expect the adoption of SFAS No. 145 to have a material impact on our financial position or on our results of operations.

In June 2002, the FASB issued SFAS No. 146, "Accounting for Exit or Disposal Activities" which addresses the recognition, measurement, and reporting of costs that are associated with exit and disposal activities, including restructuring activities that are currently accounted for pursuant to the guidance that the EITF has set forth in EITF Issue No. 94-3, "Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring)". SFAS No. 146 will be effective for exit or disposal activities that are initiated after December 31, 2002. We do not expect the adoption of SFAS No. 146 to have a material impact on our financial position or on our results of operations.

In November 2002, the FASB issued FASB Interpretation No. 45, or FIN 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees, including Indirect Guarantees of Indebtedness of Others." FIN 45 requires that a liability be recorded in the guarantor's balance sheet upon issuance of a guarantee. In addition, FIN 45 requires disclosures about the guarantees that an entity has issued, including a reconciliation of changes in the entity's product warranty liabilities. The initial recognition and initial measurement provisions of FIN 45 are applicable on a prospective basis to guarantees issued or modified after December 31, 2002, irrespective of the guarantor's fiscal year-end. The disclosure requirements of FIN 45 are effective for financial statements of interim or annual periods ending after December 15, 2002. The adoption of FIN 45 did not have a material impact on our financial position or on our results of operations.

In November 2002, the Emerging Issues Task Force ("EITF") reached a consensus on EITF 00-21, "Accounting for Revenue Arrangements with Multiple Deliverables." EITF 00-21 establishes criteria for whether revenue on a deliverable can be recognized separately from other deliverables in a multiple deliverable arrangement. The criteria consider whether the delivered item has standalone value to the customer, whether the fair value of the delivered item can be reliably determined and the rights of returns for the delivered items. EITF 00-21 is effective for revenue arrangements entered into in fiscal years beginning June 15, 2003 with early adoption permitted. We do not expect that the adoption of EITF 00-21 to have a material impact on our financial position or on our results of operations.

In December 2002, the FASB issued SFAS No. 148, "Accounting for Stock-Based Compensation- Transition and Disclosure an amendment of FASB Statement No. 123." SFAS No. 148 provides alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based

employee compensation. SFAS No. 148 also requires prominent disclosures of the pro forma effect of using the fair value method of accounting for stock-based employee compensation in both annual and interim financial statements. The transition and annual disclosure requirements of SFAS No. 148 are effective for fiscal years ending after December 15, 2002. The interim disclosure requirements are effective for interim periods beginning after December 15, 2002. The adoption of SFAS No. 148 did not have a material impact on our financial position or on our results of operations.

In January 2003, the FASB issued FASB Interpretation No. (FIN) 46 "Consolidation of Variable Interest Entities." This interpretation of Accounting Research Bulletin No. 51, Consolidated Financial Statements, addresses consolidation by business enterprises of variable interest entities which possess certain characteristics. The Interpretation requires that if a business enterprise has a controlling financial interest in a variable interest entity, the assets, liabilities, and results of the activities of the variable interest entity must be included in the consolidated financial statements with those of the business enterprise. This Interpretation applies immediately to variable interest entities created after January 31, 2003 and to variable interest entities in which an enterprise obtains an interest after that date. We do not have any ownership in any variable interest entities as of December 28, 2002. We will apply the consolidation requirements of FIN 46 in future periods if we should own any interest in any variable interest entity.

3. BALANCE SHEET DETAIL

Available-for-sale securities (in thousands):

	COST	UNREALIZED GAINS	ESTIMATED FAIR VALUE	MATURITY DATES
As of December 28, 2002, available-for-sale securities consisted of the following:				
Corporate notes	$1,430	$ 2	1,432	4/03 - 12/03
Foreign debt securities	523	1	524	3/03
Government agencies	400		400	1/03
Total	$2,353	$ 3	$2,356	
As of December 29, 2001, available-for-sale securities consisted of the following:				
Government agencies	$4,486	$ 3	4,489	1/02 - 7/02

There were no realized capital gains or losses recognized in 2002, 2001 and 2000.

	DECEMBER 28, 2002	DECEMBER 29, 2001
	(IN THOUSANDS)	
Inventories:		
Raw materials and work in process	$ 6,511	$ 8,078
Finished goods	4,214	4,484
Total inventories	$10,725	$12,562
Property and Equipment:		
Equipment	$ 3,306	$ 3,202
Leasehold improvements	1,872	1,872
Less: accumulated depreciation and amortization	(4,228)	(3,539)
Property and equipment, net	$ 950	$ 1,535
Accrued Expenses:		
Accrued payroll, vacation and related expenses	$ 824	$ 870
Accrued warranty	796	582
Income taxes payable	425	-
Sales and use tax payable	325	266
Deferred revenue	393	329
Other accrued expenses	654	732
Total accrued expenses	$ 3,417	$ 2,779

4. BANK BORROWINGS

We have a revolving line of credit agreement with a bank expiring on October 5, 2003, which provides for borrowings of up to $4.0 million at the bank's prime rate (4.25% at December 28, 2002). The agreement contains restrictive covenants including prohibiting payment of dividends without the bank's prior consent. There were no borrowings against the credit line at December 28, 2002.

5. COMMITMENTS AND CONTINGENCIES

Lease Agreements

We lease our operating facilities under a noncancelable operating lease. The lease, which expired in 2002, was renewed for two years. Rent expense, net of sublease income, totaled $642,000, $498,000 and $289,000 for the years ended December 28, 2002, December 29, 2001 and December 30, 2000 respectively. Rental income related to a facility sublease was $0, $11,000 and $262,000 for the years ended December 28, 2002, December 29, 2001 and December 30, 2000, respectively.

Future minimum lease payments under current operating leases at December 28, 2002 are summarized as follows (in thousands):

Fiscal Year	Operating Lease Payments
2003	702
2004	122
	$824

License Agreements

The Company is obligated to pay royalties equivalent to 5% and 7.5% of sales on certain products under certain license agreements. Royalty expense was $105,000, $85,000 and $21,000 for the years ended December 28, 2002, December 29, 2001 and December 30, 2000, respectively.

Contingencies

From time to time, the Company may be engaged in certain administrative proceedings, incidental to its normal business activities. Management believes that liabilities resulting from such proceedings, or claims which are pending or known to be threatened, are adequately covered by liability insurance and will not have a material adverse effect on the Company's financial position or results of operations.

6. STOCKHOLDERS' EQUITY

CONVERTIBLE PREFERRED STOCK

Our Articles of Incorporation authorize 2,000,000 shares of undesignated preferred stock. Preferred Stock may be issued from time to time in one or more series. As of December 28, 2002, we had no preferred stock issued and outstanding.

TREASURY STOCK

In December 1998, we instituted a stock repurchase program whereby up to 150,000 shares of our Common Stock may be repurchased in the open market. We plan to utilize all of the reacquired shares for reissuance in connection with our employee stock programs. In 2000 and 2002, no shares of Common Stock were repurchased. In 2001, we repurchased 27,000 shares of Common Stock for $115,000. As of December 28, 2002 we have repurchased 103,000 shares of common stock.

STOCK OPTION PLANS

Amended and Restated 1989 Incentive Stock Plan

The Amended and Restated 1989 Plan (the "1989 Plan") provided for the grant of options and stock purchase rights to purchase shares of our Common Stock to employees and consultants. The terms of the 1989 Plan, which expired in August 1999, are substantially the same as the 1998 Plan described below.

1998 Stock Plan

The 1998 Stock Plan (the "1998 Plan") provides for the granting to employees (including officers and employee directors) of incentive stock options and for the granting to employees (including officers and employee directors) and consultants of nonstatutory stock options and stock purchase rights ("SPRs"). The exercise price of incentive stock options and SPRs granted under the 1998 Plan must be at least equal to the fair market value of the shares at the time of grant. With respect to any recipient who owns stock possessing more than 10% of the voting power of our outstanding capital stock, the exercise price of any option or SPR granted must be at least equal to 110% of the fair market value at the time of grant. Options granted under the 1998 Plan are exercisable at such times and under such conditions as determined by the Administrator; generally over a four year period. The maximum term of incentive stock options granted to any recipient must not exceed ten years; provided, however, that the maximum term of an incentive stock option granted to any recipient possessing more than 10% of the voting power of our outstanding capital stock must not exceed

five years. In the case of SPRs, unless the Administrator determines otherwise, we have a repurchase option exercisable upon the voluntary or involuntary termination of the purchaser's employment with us for any reason (including death or disability). Such repurchase option lapses at a rate determined by the Administrator. The purchase price for shares repurchased by us is the original price paid by the purchaser. The form of consideration for exercising an option or stock purchase right, including the method of payment, is determined by the Administrator. The 1998 Plan expires in June 2008.

1995 Director Option Plan

In October 1995, we adopted the 1995 Director Option Plan (the "Director Plan"), under which members of the Board of Directors are granted options to purchase 11,250 shares upon the first to occur of their appointment or the adoption of the Director Plan ("First Option") and an option to purchase 3,750 shares ("Subsequent Option") on July 1 of each year thereafter provided that he or she has served on the Board for at least the preceding six months. The options granted are at fair market value on the date of grant. The First Option becomes exercisable as to one-twelfth (1/12) of the shares subject to the First Option for each quarter over a three-year period. Each Subsequent Option becomes exercisable as to one-fourth (1/4) of the shares subject to the Subsequent Option for each quarter, commencing one quarter after the First Option and any previously granted Subsequent Options have become fully exercisable. Options granted under the Director Plan have a term of 10 years.

In the event of our merger with or into another corporation, resulting in a change of control, or the sale of substantially all of our assets, each Director Plan option becomes exercisable in full and shall be exercisable for 30 days after written notice to the holder of the event causing the change in control.

Unless terminated sooner, the Director Plan will terminate in 2005. The Board has authority to amend or terminate the Director Plan, provided no such amendment may impair the rights of any optionee without the optionee's consent.

1995 Employee Stock Purchase Plan

Our 1995 Employee Stock Purchase Plan (the "Purchase Plan") was adopted by the Board of Directors in October 1995. The total number of shares of common stock reserved for issuance under the Purchase Plan at December 28, 2002 were 370,000. The Purchase Plan permits eligible employees (including officers and employee directors) to purchase Common Stock through payroll deductions, which may not exceed 10% of an employee's compensation. No employee may purchase more than $25,000 worth of stock in any calendar year or more than 1,000 shares of Common Stock in any twelve-month period. The price of shares purchased under the Purchase Plan is 85% of the lower of the fair market value of the Common Stock at the beginning of the offering period or the end of the offering period. The Purchase Plan will terminate in 2005, unless terminated sooner by the Board of Directors.

Information with respect to activity under these option plans are set forth below (in thousands except share and per share data):

		OUTSTANDING OPTIONS		
	SHARES AVAILABLE FOR GRANT	NUMBER OF SHARES	AGGREGATE PRICE	WEIGHTED AVERAGE EXERCISE PRICE
Balances, January 1, 2000	189,665	1,407,193	$ 6,076	$ 4.31
Additional shares reserved	260,000	--	--	--
Options granted	(384,700)	384,700	3,570	9.28
Options exercised		(120,173)	(318)	2.64
Options cancelled	(82,560)			
Options terminated	181,407	(181,407)	(1,036)	5.71
Balances, December 30, 2000	163,812	1,490,313	$ 8,292	$ 5.56
Additional shares reserved	290,000	--	--	--
Options granted	(368,050)	368,050	1,512	4.11
Options exercised		(74,942)	(100)	1.61
Options cancelled	(29,068)			
Options terminated	126,604	(126,604)	(873)	7.07
Balances, December 29, 2001	183,298	1,656,817	$ 8,831	$ 5.34
Additional shares reserved	300,000	--	--	--
Options granted	(229,400)	229,400	858	3.74
Options exercised		(36,930)	(78)	2.08
Options cancelled	(2,575)			
Options terminated	148,424	(148,424)	(924)	6.23
Balances, December 28, 2002	399,747	1,700,863	$ 8,687	$ 5.11

The following table summarizes information with respect to stock options outstanding at December 28, 2002:

	OPTIONS OUTSTANDING			OPTIONS EXERCISEABLE	
RANGE OF EXERCISE PRICES	NUMBER OUTSTANDING AT 12/28/02	WEIGHTED AVERAGE REMAINING CONTRACTUAL LIFE (YEARS)	WEIGHTED AVERAGE EXERCISE PRICE	NUMBER EXERCISABLE AT 12/28/02	WEIGHTED AVERAGE EXERCISE PRICE
$1.00 - $3.50	286,808	6.70	$ 2.58	114,996	$ 1.25
$3.71 - $3.71	177,800	8.56	3.71	62,977	3.71
$3.90 - $3.94	15,500	8.43	3.90	1,944	3.91
$4.00 - $4.00	430,535	4.76	4.00	426,999	4.00
$4.01 - $4.88	186,370	7.09	4.36	127,039	4.38
$5.00 - $5.75	210,925	6.48	5.40	138,256	5.51
$6.25 - $8.88	189,500	5.33	8.25	172,989	8.24
$9.00 - $10.50	172,425	7.29	9.23	124,176	9.20
$12.19 - $12.75	23,500	7.50	12.55	7,929	12.38
$14.88 - $14.88	7,500	3.50	14.88	7,500	14.88
$1.00 - $14.88	1,700,863	6.34	5.11	1,184,805	5.22

The following table summarizes information with respect to stock options outstanding at December 29, 2001:

	OPTIONS OUTSTANDING			OPTIONS EXERCISEABLE	
RANGE OF EXERCISE PRICES	NUMBER OUTSTANDING AT 12/29/01	WEIGHTED AVERAGE REMAINING CONTRACTUAL LIFE (YEARS)	WEIGHTED AVERAGE EXERCISE PRICE	NUMBER EXERCISABLE AT 12/29/01	WEIGHTED AVERAGE EXERCISE PRICE
$0.16 - $2.00	136,549	2.90	$ 1.17	136,549	$ 1.17
$3.71 - $3.71	203,800	9.55	3.71	0	0.00
$3.90 - $3.94	23,000	8.63	3.91	6,132	4.00
$4.00 - $4.00	457,086	5.77	4.00	387,425	4.00
$4.03 - $4.88	199,357	8.08	4.35	78,321	4.42
$5.00 - $5.75	178,925	6.99	5.46	110,825	5.55
$6.25 - $8.88	203,500	6.47	8.27	150,603	8.23
$9.00 - $9.25	189,600	8.29	9.09	80,246	9.10
$9.50 - $12.75	57,500	8.66	11.18	14,828	10.92
$14.88 - $14.88	7,500	4.50	14.88	7,500	14.88
$0.16 - $14.88	1,656,817	6.92	5.34	972,249	5.08

At December 29, 2001 and December 30, 2000 options to purchase 972,249 and 762,123 shares of Common Stock were exercisable at weighted average exercise prices of $5.08 and $4.29, respectively.

The following information concerning our stock option and employee stock purchase plans is provided in accordance with SFAS No. 123, "Accounting for Stock-Based Compensation." We account for such plans in accordance with Accounting Principles Board No. 25 and related Interpretations.

The fair value of each option grant has been estimated on the date of grant using the Black-Scholes multiple option pricing model with the following weighted average assumptions:

	2002		2001		2000	
	GROUP A	GROUP B	GROUP A	GROUP B	GROUP A	GROUP B
Risk-free Interest Rates	4.38%	4.38%	4.45%	4.40%	6.00%	6.19%
Expected Life from Date of Vesting	4 yrs.	2 yrs.	3 yrs.	2 yrs.	3 yrs.	2 yrs.
Volatility	0.84	0.84	0.90	0.90	0.78	0.78
Dividend Yield	--	--	--	--	--	--

The weighted average expected life was calculated based on the exercise behavior of each group. Group A represents officers and directors who are a smaller group holding a greater average number of options than other option holders and who tend to exercise later in the vesting period. Group B are all other option holders, virtually all of whom are employees. This group tends to exercise earlier in the vesting period.

The weighted average grant-date fair value per share of those options granted in 2002, 2001 and 2000 was $2.48, $2.82 and $5.96, respectively.

We have also estimated the fair value for the purchase rights issued under our 1995 Employee Stock Purchase Plan, under the Black-Scholes valuation model using the following assumptions for 2001, 2000 and 1999:

	2002	2001	2000
Risk-free Interest Rates ...	2.01%	4.63%	5.67%
Expected Life	0.5 year	0.5 year	0.5 year
Volatility	0.85	0.90	0.78
Dividend Yield	--	--	--

The weighted average grant-date fair value per share of those purchase rights granted in 2002, 2001 and 2000 was $1.31, $2.11 and $2.94, respectively.

7. EMPLOYEE BENEFIT PLAN

We have a plan known as the IRIS Medical Instruments 401(k) trust to provide retirement benefits through the deferred salary deductions for substantially all employees. Employees may contribute up to 15% of their annual compensation to the plan, limited to a maximum amount set by the Internal Revenue Service. The plan also provides for Company contributions at the discretion of the Board of Directors. On April 1, 2000 the Company commenced a Company match for the 401(k) in the amount of 50% of employee contributions up to an annual maximum of $1,000 per year. The Company contributions totaled $98,000 in 2002 and $99,000 in 2001. No contributions were made in fiscal 2000.

8. INCOME TAXES

The provision for income taxes includes:

	YEAR ENDED DECEMBER 28, 2002	YEAR ENDED DECEMBER 29, 2001	YEAR ENDED DECEMBER 30, 2000
		(IN THOUSANDS)	
Current:			
Federal	$ 121	$(750)	$ 855
State	5	--	28
	126	(750)	883
Deferred:			
Federal	(231)	(184)	(96)
State	(104)	(28)	22
	(335)	(212)	(74)
Income tax (benefit) provision	$(209)	$(962)	$ 809

The Company's effective tax rate differs from the statutory federal income tax rate as shown in the following schedule:

	YEAR ENDED DECEMBER 28, 2002	YEAR ENDED DECEMBER 29, 2001	YEAR ENDED DECEMBER 30, 2000
Income tax provision (benefit) at statutory rate	(34%)	(34%)	34%
State income taxes, net of federal benefit	(6%)	(5%)	6%
Tax exempt interest	0%	(3%)	(3%)
Nondeductible permanent differences	56%	4%	0%
Research and development credits	(377%)	(28%)	(10%)
Other	1%	4%	1%
Effective tax rate	(360%)	(62%)	28%

The tax effect of temporary differences and carry-forwards that give rise to significant portions of the net deferred tax assets are presented below (in thousands):

	DECEMBER 28, 2002	DECEMBER 29, 2001
Fixed assets	$ 547	$ 304
Accrued liabilities	414	419
Allowance for excess and obsolete inventories	366	287
Research credit	603	437
State tax	1	1
Allowance for doubtful accounts	104	127
Other	232	349
Net deferred tax asset	$2,267	$1,924

9. MAJOR CUSTOMERS AND BUSINESS SEGMENTS

We operate in two reportable segments: the ophthalmology medical device segment and the aesthetics medical device segment. In both segments, we develop, manufacture and market medical devices. Our revenues arise from the sale of consoles, delivery devices, disposables and service and support activities.

In the years ended December 28, 2002, December 29, 2001 and December 30, 2000, no customer individually accounted for more than 10% of our revenue.

Revenue information shown in thousands by geographic region is as follows:

	DECEMBER 28, 2002	DECEMBER 29, 2001	DECEMBER 30, 2000
United States	$19,564	$16,004	$21,133
Europe	5,429	5,530	5,475
Rest of Americas	833	809	1,283
Asia/Pacific Rim	4,808	4,932	4,947
	$30,634	$27,275	$32,838

Revenues are attributed to countries based on location of customers.

In the years ended December 28, 2002, December 29, 2001 and December 30, 2000, no country individually accounted for more than 10% of our sales, except for the United States, which accounted for 63.9% of sales in 2002, 58.7% in 2001 and 64.4% in 2000.

Information on reportable segments for the three years ended December 28, 2002, December 29, 2001 and December 30, 2000 is as follows:

	YEAR ENDED DECEMBER 28, 2002			YEAR ENDED DECEMBER 29, 2001			YEAR ENDED DECEMBER 30, 2000		
	Ophthalmology Medical Devices	Aesthetics Medical Devices	Total	Ophthalmology Medical Devices	Aesthetics Medical Devices	Total	Ophthalmology Medical Devices	Aesthetics Medical Devices	Total
Sales	$ 24,169	$ 6,465	$ 30,634	$ 20,922	$ 6,353	$ 27,275	$ 27,065	$ 5,773	$ 32,838
Direct Cost of Goods Sold	7,917	2,844	10,761	6,772	2,595	9,367	7,796	2,051	9,847
Direct Gross Margin	16,252	3,621	19,873	14,150	3,758	17,908	19,269	3,722	22,991
Total Unallocated Costs	--	--	20,054	--	--	19,897	--	--	20,671
Income(loss) from operations ..			$ (181)			$ (1,989)			$ 2,320

Indirect costs of manufacturing, research and development and selling, general and administrative costs are not allocated to the segments.

The Company's assets and liabilities are not evaluated on a segment basis. Accordingly, no disclosure on segment assets and liabilities is provided.

10. COMPUTATION OF NET INCOME PER COMMON SHARE AND PER DILUTED COMMON SHARE

A reconciliation of the numerator and denominator of net income (loss) per common share and diluted net income (loss) per common share is provided as follows (in thousands, except per share amounts):

	YEAR ENDED DECEMBER 28, 2002	YEAR ENDED DECEMBER 29, 2001	YEAR ENDED DECEMBER 30, 2000
Income (loss) from continuing operations	$ 150	$ (601)	$2,080
Income (loss) from discontinued operations	0	(672)	336
Net income (loss)	$ 150	$(1,273)	$2,416
Denominator--Net income (loss) per common share			
Weighted average common stock outstanding	6,870	6,757	6,637
Basic income (loss) per common share continuing operations	$ 0.02	$ (0.09)	$ 0.31
Basic income (loss) per common share discontinued operations	0	(0.10)	0.05
Net income (loss) per common share	$ 0.02	$ (0.19)	$ 0.36
Diluted income (loss) per common share continuing operations	$ 0.02	$ (0.09)	$ 0.29
Diluted income (loss) per common share discontinuing operations	0	(0.10)	0.04
Diluted net income (loss) per common share	$ 0.02	$ (0.19)	$ 0.33
Weighted average common stock outstanding	6,870	6,757	6,637
Effect of dilutive securities			
Weighted average common stock options	58	--	648
Total weighted average stock and options outstanding	6,928	6,757	7,285

In 2002 and 2000, there were 1,296,391 and 62,930 outstanding options to purchase shares, respectively, at a weighted average exercise price of $5.97 and $9.82 per share, respectively, that were not included in the computation of diluted net income (loss) per common share since, in each case, the exercise price of the options exceeded the market price of the common stock. In 2001, there were 1,656,817 options outstanding at a weighted average exercise price of $5.34 per share that were not included in the computation of dilutive net loss per common share because their effect was anti-dilutive. These options could dilute earnings per share in future periods.

11. SELECTED QUARTERLY FINANCIAL DATA, (UNAUDITED)

	QUARTER			
	FIRST	SECOND	THIRD	FOURTH
	(IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)			
Year Ended December 28, 2002				
Sales	$ 6,963	$ 7,433	$ 6,717	$9,521
Gross profit	$ 3,085	$ 3,121	$ 3,012	$4,370
Net income (loss)	$ (207)	$ (447)	$ 206	$ 598
Net income (loss) per common share	$ (0.03)	$ (0.07)	$ 0.03	$ 0.09
Diluted net income (loss) per common share	$ (0.03)	$ (0.07)	$ 0.03	$ 0.09
Year Ended December 29, 2001				
Sales	$ 5,735	$ 7,088	$ 6,750	$7,702
Gross profit	$ 2,363	$ 3,697	$ 3,498	$3,512
Income (loss) from continuing operations	$ (924)	$ 11	$ 171	$ 141
Income (loss) from discontinued operations	$ (893)	$ 0.00	$ 0.00	$ 221
Net income (loss)	$(1,817)	$ 11	$ 171	$ 362
Net income (loss) per common share	$ (0.27)	$ 0.00	$ 0.03	$ 0.05
Diluted income (loss) from continuing operations per common share	$ (0.14)	$ 0.00	$ 0.02	$ 0.02
Diluted income (loss) from discontinued operations per common share	$ (0.13)	$ 0.00	$ 0.00	$ 0.03
Diluted net income (loss) per common share	$ (0.27)	$ 0.00	$ 0.02	$ 0.05

12. DISCONTINUED OPERATIONS

In April 2001, we discontinued our Laser Research segment. In the first quarter of 2001, we recorded a loss of $893,000 (net of a $542,000 tax benefit). In the fourth quarter of 2001, we adjusted the loss on discontinued operations to $672,000 (net of a $439,000 income tax benefit). There were no revenues, costs or operating expenses for the Laser Research segment in 2002 or 2001. Sales, general and administrative costs and indirect costs of manufacturing historically were not allocated to the Laser Research segment.

The Laser Research segment conducted research and development under research grants from the U.S. Federal Government and others. We discontinued our Laser Research activities to better focus available resources on our medical applications and products. The assets of the segment, primarily inventory, were fully reserved and the liabilities were fully paid. The components of the recorded loss were inventory costs of $0.7 million, the loss on operations for the first quarter of 2001 of $0.3 million, estimated sales return costs of $0.2 million, estimated costs for the phase-out period of $0.1 million and purchase order commitments of $0.1 million offset by a tax benefit of $0.5 million. In the fourth quarter of 2001, the accrued loss for the discontinuation of the segment was adjusted to reflect fewer than anticipated product returns.

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

PART III

Certain information required by Part III has been omitted from this Form 10-K. This information is instead incorporated by reference to our definitive Proxy Statement for our 2003 Annual Meeting of Stockholders , which we will file within 120 days after the end of our fiscal year pursuant to Regulation 14A in time for our Annual Meeting of Stockholders to be held June 4, 2003.

ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT

Information regarding our directors is incorporated by reference to "Election of Directors--Nominees" in our Proxy Statement for our 2003 Annual Meeting of Stockholders. The information concerning our current executive officers is incorporated by reference to "Executive Officers" in our Proxy Statement for our 2003 Annual Meeting of Stockholders.

ITEM 11. EXECUTIVE COMPENSATION

The information required by this Item is incorporated by reference to "Executive Compensation" in our Proxy Statement.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

The information required by this Item is incorporated by reference to "Security Ownership of Certain Beneficial Owners and Management" in our Proxy Statement.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

The information required by this Item is incorporated by reference to "Certain Relationships and Related Transactions" in our Proxy Statement.

ITEM 14. CONTROLS AND PROCEDURES.

EVALUATION OF DISCLOSURE CONTROLS AND PROCEDURES

Within 90 days prior to the filing date of this Annual Report on Form 10-K (the "Evaluation Date"), our President and Chief Executive Officer, who is our principal executive officer, and our Chief Financial Officer and Vice president, Administration, who is our principal financial officer, performed an evaluation of the effectiveness of our "disclosure controls and procedures" (as defined in Rules 13a-14(c) and 15(d)-14(c) of the Securities Exchange Act of 1934, as amended). Based on that evaluation, our President and Chief Executive Officer and our Chief Financial Officer and Vice President, Administration concluded that, as of the Evaluation Date, our disclosure controls and procedures were effective to ensure that material information about IRIDEX Corporation and our consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this annual report was being prepared.

CHANGES IN INTERNAL CONTROLS

There have been no significant changes in our internal controls or in other factors that could significantly affect our disclosure controls and procedures subsequent to the Evaluation Date.

PART IV

ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES AND REPORTS ON FORM 8-K

Other schedules have been omitted because they are either not required, not applicable, or the required information is included in the consolidated financial statements or notes thereto.

3. EXHIBITS

Exhibits	Exhibit Title
3.1(1)	Amended and Restated Certificate of Incorporation of Registrant
3.2(2)	Amended and Restated Bylaws of Registrant.
10.1(1)	Form of Indemnification Agreement with directors and officers.
10.2(1)	1995 Employee Stock Purchase Plan, as amended and form of agreement thereunder.
10.3(1)	1995 Director Option Plan and form of agreement thereunder.
10.4(1)	1995 Profit Sharing Plan
10.5(1)	Third Restated Registration Rights Agreement dated as of October 27, 1995 by and among Registrant and certain individuals and entities named therein.
10.6	Lease Agreement dated December 6, 1996 by and between Zappettini Investment Co. and the Registrant, as amended.

Exhibits	Exhibit Title
10.7(3)	1998 Stock Option Plan, as amended
21.1(1)	Subsidiaries of Registrant.
23.1	Consent of PricewaterhouseCoopers LLP, Independent Accountants.
24.1	Power of Attorney (See page 68).
99.1	Certification of Chief Executive Officer and Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

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(1) Incorporated by reference to the Exhibits filed with the Registration Statement on Form SB-2 (No. 333-00320-LA) which was declared effective on February 15, 1996.

(2) Incorporated by reference to the Exhibits in Registrant's Report on Form 10-Q for the quarter ended October 3, 1998.

(3) Incorporated by reference to the Exhibits in Registrant's Proxy Statement for the Company's 1998 Annual Meeting of Stockholders which was filed April 30, 1998.

(B) REPORTS ON FORM 8-K

No reports on Form 8-K were filed during the fourth quarter of 2002.

TRADEMARK ACKNOWLEDGMENTS

SCHEDULE II

IRIDEX CORPORATION AND SUBSIDIARIES

VALUATION AND QUALIFYING ACCOUNTS
(IN THOUSANDS)

DESCRIPTION	BALANCE AT BEGINNING OF THE PERIOD	CHARGED TO COSTS AND EXPENSES	DEDUCTIONS	BALANCE AT END OF THE PERIOD
Balance for the year ended December 30, 2000:				
Allowance for doubtful accounts receivable	$396	$ 131	$(46)	$ 481
Provision for inventory	$374	$ 285	$ --	$ 659
Balance for the year ended December 29, 2001:				
Allowance for doubtful accounts receivable	$481	$(163)	$ --	$ 318
Provision for inventory	$659	$ 322	$ --	$ 981
Balance for the year ended December 28, 2002:				
Allowance for doubtful accounts receivable	$318	$ (56)	$ --	$ 262
Provision for inventory	$981	$ 125	$ --	$1,106

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized, in the City of Mountain View, State of California, on 28th day of March, 2003.

IRIDEX CORPORATION

By: /s/ Theodore A. Boutacoff

Theodore A. Boutacoff
President, Chief Executive Officer, and Director

KNOW ALL PERSONS BY THESE PRESENTS, that each person whose signature appears below constitutes and appoints Theodore A. Boutacoff and Robert Kamenski, jointly and severally, their attorney-in-fact, each with full power of substitution, for him in any and all capacities, to sign on behalf of the undersigned any amendments to this Annual Report on Form 10-K, and to file the same, with exhibits thereto and other documents in connection therewith, with the Securities and Exchange Commission, and each of the undersigned does hereby ratifying and confirming all that each of said attorneys-in-fact, or his substitutes, may do or cause to be done by virtue hereof.

Pursuant to the requirements of the Securities Act of 1934, this report has been signed by the following persons in the capacities and on the dates indicated.

/s/ Theodore A. Boutacoff (Theodore A. Boutacoff)	President, Chief Executive Officer, and Director (Principal Executive Officer)	March 28, 2003
/s/ Robert Kamenski (Robert Kamenski)	Chief Financial Officer and Vice President, Administration (Principal Financial and Accounting Officer)	March 28, 2003
/s/ James L. Donovan (James L. Donovan)	Vice President, Corporate Business Development and Director	March 28, 2003
/s/ Robert K. Anderson (Robert K. Anderson)	Director	March 28, 2003
/s/ Donald L. Hammond (Donald L. Hammond)	Director	March 28, 2003
/s/ Joshua Makower (Joshua Makower)	Director	March 28, 2003
/s/ John M. Nehra (John M. Nehra)	Chairman of the Board	March 28, 2003

CERTIFICATION OF CHIEF EXECUTIVE OFFICER AND CHIEF FINANCIAL OFFICER
PURSUANT TO
SECTION 13(a) OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 AS ADOPTED
PURSUANT TO
SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

I, Theodore A. Boutacoff, certify that:

1. I have reviewed this annual report on Form 10-K of IRIDEX Corporation;

2. Based on my knowledge, this annual report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statement made, in light of the circumstances under which such statement were made, not misleading with respect to the period covered by this annual report;

3. Based on my knowledge, the financial statements, and other financial information included in this annual report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this annual report;

4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and have:

   a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this annual report is being prepared;

   b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this annual report (the "Evaluation Date"); and

   c) presented in this annual report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;

5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):

   a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and

b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and

6. The registrant's other certifying officers and I have indicated in this annual report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regards to significant deficiencies and material weaknesses.

Date: March 28, 2003

By: /s/ THEODORE A. BOUTACOFF

Name: Theodore A. Boutacoff
Title: President and Chief Executive Officer
(Principal Executive Officer)

I, Robert Kamenski, certify that:

1. I have reviewed this annual report on Form 10-K of IRIDEX Corporation;

2. Based on my knowledge, this annual report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statement made, in light of the circumstances under which such statement were made, not misleading with respect to the period covered by this annual report;

3. Based on my knowledge, the financial statements, and other financial information included in this annual report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this annual report;

4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and have:

   a. designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this annual report is being prepared;

   b. evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this annual report (the "Evaluation Date"); and

   c. presented in this annual report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;

5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):

   a. all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and

   b. any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and

6. The registrant's other certifying officers and I have indicated in this annual report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regards to significant deficiencies and material weaknesses.

Date: March 28, 2003

By: /s/ ROBERT KAMENSKI

Name: Robert Kamenski
Title: Chief Financial Officer and Vice President, Administration
(Principal Financial and Accounting Officer)

Index to Exhibits

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(3) Incorporated by reference to the Exhibits in Registrant's Proxy Statement for the Company's 1998 Annual Meeting of Stockholders which was filed April 30, 1998.

Exhibit 10.6

LEASE AGREEMENT

This Lease, executed in duplicate at Palo Alto, California, this 6th day of December 1996, by and between:

PARTIES

Zappettini Investment Co.

and

Iridex Corporation

hereinafter called respectively Lessor and Lessee, without regard to number or gender,

PREMISES

1. WITNESSETH: That Lessor hereby leases to Lessee, and Lessee hires from Lessor, those certain premises, hereinafter in this lease designated as "the Premises", with the appurtenances, situated in the City of Mountain View, County of Santa Clara, State of California, and more particularly described as follows, to-wit:

An appropriate 37,166 square foot industrial building located on 2.69 acre lot and commonly referred to as 1212 Terra Bella, Mountain View, California.

USE

2. The Premises shall be used and occupied by Lessee for design, testing, manufacturing, assembly, sales, office, administration, research and development and other legal uses ancillary thereto and for no other purpose without the prior written consent of Lessor.

TERM

3. The term shall be for 5 (five) years, commencing on the 1st day of March, 1997, (the "Commencement Date") and ending on the 28th day of February, 2002.

RENTAL

4. Rent shall be payable to the Lessor without deduction or offset at such place or places as may be designated from time to time by the Lessor as follows:

Thirty Three Thousand One Hundred Eighty Two and 60/100ths Dollars ($33,182.60) upon execution of this Lease representing rental due March 1, 1997. $33,182.60 shall be due on April 1, 1997 and on the 1st day of each and every succeeding month through August 1st 1997. Forty Thousand Eight Hundred Eighty Two and 60/100ths ($40,882.60) shall be due on September l, 1997 and on the 1st day of each and every succeeding month through February 1, 1999. Forty

Two Thousand Seven Hundred Forty and 90/100ths Dollars ($42,740.90) shall be due on March 1, 1999 and on the 1st day of each and every succeeding month through February 1, 2000. Forty Four Thousand Five Hundred Ninety Nine and 20/100ths dollars ($44,599.20) shall be due on March 1, 2000 and on the 1st day of each and every succeeding month through February 1, 2001. Forty Six Thousand Four Hundred Fifty Seven and 50/100ths Dollars ($46,457.50) shall be due on March 1, 2001 and on the 1st day of each and every succeeding month through February 1, 2002.

SECURITY DEPOSIT

5. Lessee has deposited with Lessor $46,457.50 as security for the full and faithful performance of each and every term, provision, covenant and condition of this Lease. In the event Lessee defaults in respect of any of the terms, provisions, covenants or conditions of this Lease, including, but not limited to the payment of rent, Lessor may use, apply or retain the whole or any part of such security for the payment of any rent in default or for any other sum which Lessor may spend or be required to spend by reason of Lessee's default. Should Lessee faithfully and fully comply with all of the terms, provisions, covenants and conditions of this Lease, the security of any balance thereof shall be returned to Lessee or, at the option of Lessor, to the last assignee of Lessee's interest in this Lease at the expiration of the term hereof. Lessee shall not be entitled to any interest on said security deposit.

POSSESSION

6. If Lessor, for any reason whatsoever, cannot deliver possession of the Premises to Lessee at the commencement of the said term, as hereinbefore specified, this Lease shall not be void or voidable, nor shall Lessor, or Lessor's agents, be liable to Lessee for any loss or damage resulting therefrom; but in that event the commencement and termination dates of the Lease and all other dates affected thereby shall be revised to conform to the date of Lessor's delivery possession.(*) (*) See Addendum attached

ACCEPTANCE OF PREMISES AND CONSENT TO SURRENDER

7. By entry hereunder, the Lessee accepts the Premises as being in good and satisfactory condition, unless within forty-five (45) days after such entry Lessee shall give Lessor written notice specifying in reasonable detail the respects in which the Premises were not in satisfactory condition.(*) The Lessee agrees on the last day of the term hereof, or on sooner termination of this Lease, to surrender the premises, together with all alterations, additions, and improvements which may have been made in, to, or on the Premises by Lessor or Lessee, unto Lessor in the same good condition as at Lessee's entry into the Premises excepting for such wear and tear as would be normal for the period of the Lessee's occupancy and

casualty. The Lessee, on or before the end of the term or sooner termination of this Lease, shall remove all Lessee's personal property and trade fixtures from the premises and all property not so removed shall be deemed to be abandoned by the Lessee. If the Premises be not surrendered at the end of the term or sooner termination of this Lease, the Lessee shall indemnify the Lessor against loss or liability resulting from delay by the Lessee in so surrendering the Premises including, without limitation, any claims made by any succeeding tenant founded on such delay. (*)
(*) See Addendum attached

USES PROHIBITED

8. Lessee shall not commit, or suffer to be committed, any waste upon the Premises, or any nuisance, or other act or thing which may disturb the quiet enjoyment of any other tenant in or around the buildings in which the Premises may be located, or allow any sale by auction upon the Premises, or allow the Premises to be used for any improper, immoral, unlawful or objectionable purpose, or place any loads upon the floor, walls, or roof which endanger the structure, or place any harmful liquids in the drainage system of the building. No waste materials or refuse shall be dumped upon or permitted to remain upon any part of the Premises outside of the building proper. No materials, supplies, equipment, finished products or semi-finished products, raw materials or articles of any nature shall be stored upon or permitted to remain on any portion of the Premises outside of the buildings proper.

ALTERATIONS AND ADDITIONS

9. The lessee shall make no alternations, additions or improvements to the Premises or any part thereof without first obtaining the prior written consent of the Lessor, which consent shall not be unreasonably withheld or delayed. The Lessor may impose as a condition to the aforesaid consent such requirements as Lessor may deem necessary in Lessor's sole discretion including without limitation thereto, a right of approval of the contractor by whom the work is to be performed which approval shall not be unreasonably withheld or delayed, the times during which it is to be accomplished, and the requirement that upon written request of Lessor prior to the expiration or earlier termination of the Lease, Lessee will remove any or all improvements or additions to the Premises installed at Lessee's expense.(*) All such alterations, additions or improvements not specified to be removed shall at the expiration of earlier termination of the lease become the property of the Lessor and remain upon and be surrendered with the Premises. All movable furniture, business and trade fixtures, and machinery and equipment shall remain the property of the Lessee and may be removed by the Lessee at any time during the Lease term when Lessee is not in default hereunder. Items which are not to be deemed as movable

furniture, business and trade fixtures, or machinery and equipment shall include heating, lighting, electrical systems, air conditioning, permanent partitioning, carpeting, or any other installation which has become an integral part of the Premises.(**) The Lessee will at all times permit notices of non-responsibility to be posted and to remain posted until the completion of alterations or additions which have been approved by the Lessor. (*) & (**) SEE ADDENDUM ATTACHED

MAINTENANCE OF PREMISES

10. Lessee shall, at Lessee's sole cost, keep and maintain the Premises and appurtenances and every part thereof, including but not limited to, glazing, sidewalks, parking areas, including resealing the parking lot approximately every three (3) years, plumbing, electrical systems, heating and air conditioning installations, any store front, roof covering - unless it is not feasible to repair the existing roof covering and a new roof covering is required, and the interior of the Premises in good order, condition, and repair. Lessor at Lessor's sole cost and expense shall maintain the exterior of the walls, and structural portions of the roof, foundations, walls, and floors except for any repairs caused by the wrongful act of the Lessee and Lessee's agents. The Lessor will replace the roof covering if repairs to said covering are no longer economically feasible in the judgment of roofing experts, and provided that said replacement is not made necessary by acts of the Lessee and Lessee's agents. The Lessee shall water, maintain and replace, when necessary, any shrubbery and landscaping provided by the Lessor on the Premises. The Lessee expressly waives the benefits of any statute now or hereafter in effect which would otherwise afford the Lessee the right to make repairs at Lessor's expense or to terminate this lease because of Lessor's failure to keep the Premises in good order, conditions or repair. (***) (***) SEE ADDENDUM ATTACHED

INSURANCE

11. Lessee shall not use, or permit the Premises, or any part thereof, to be used, for any purposes other than that for which the Premises are hereby leased; and no use shall be made or permitted to be made on the Premises, nor acts done, which will cause a cancellation of any insurance policy covering said building, or any part thereof, nor shall Lessee sell or permit to be kept, used or sold, in or about the Premises, any article which may be prohibited by the standard form of fire insurance policies. Lessee shall, at his sole cost and expense, comply with any and all requirements, pertaining to the Premises, of any insurance organization or company, necessary for the maintenance of reasonable fire and public liability insurance, covering said building and appurtenances.

11.1 Lessee shall, at its expense, obtain and keep in force

during the term of this Lease a policy of comprehensive public liability insurance insuring Lessee, Lessor, and any third parties named by Lessor which may include Lessor's lender, against liability for personal injury, bodily injury, death and damage to property arising out of the condition, use, occupancy or maintenance of the Premises. Such insurance policy shall have a combined single limit for both bodily injury and property damage in an amount not less than One Million Dollars ($1,000,000.00). The limits of said insurance shall not limit the liability of Lessee hereunder.

11.2 Lessee shall, at its expense, keep in force during the term of this Lease, a policy of fire and property damage insurance in an "all risk" form with a sprinkler leakage endorsement, insuring Lessee's inventory, fixtures, equipment and personal property within the Premises for the full replacement value thereof.

11.3 Lessor shall maintain a policy or policies of fire and property damage insurance in an "all risk" form, with sprinkler and, at the option of the Lessor, earthquake endorsements, covering loss or damage to the building, including Lessee's leasehold improvements installed with the written consent of the Lessor for the full replacement cost thereof.

11.4 Lessee shall pay to Lessor as additional rent, during the term hereof, upon receipt of an invoice therefore, 100 percent of the premiums for any insurance obtained by Lessor pursuant to 11.3 above. Lessor may obtain such insurance for the Building separately, or together with other buildings and improvements which Lessor elects to insure together under blanket policies of insurance. In such case Lessee shall be liable for only such portion of the premiums for such blanket policies as are allocable to the Premises. It is understood and agreed that Lessee's obligation under this paragraph shall be prorated to reflect the Commencement Date and Expiration Date of the Lease. If Lessor carries earthquake insurance, Lessee's obligation to reimburse Lessor for premiums shall not exceed $20,000.00 annually.

11.5 Notwithstanding anything to the contrary in this Lease, Lessee and Lessor each hereby waives any and all rights of recovery against the other, or against the officers, directors, employees, partners, agents and representatives of the other, for loss of or damage to the property of the waiving party or the property of others under its control, to the extent such loss or damage is insured against under any insurance policy carried by Lessor or Lessee hereunder. Each party shall notify their respective insurance carriers of this waiver.

ABANDONMENT

12. Lessee shall not abandon the Premises at any time during the term; and if Lessee shall abandon, or surrender the premises, or be dispossessed by process of law, or otherwise, any personal property belonging to Lessee and left on the Premises shall be deemed to be abandoned, at the option of Lessor.

FREE FROM LIENS

13. Lessee shall keep the Premises and the property in which the premises are situated, free from any liens arising out of any work performed, materials furnished, or obligations incurred by Lessee.

COMPLIANCE WITH GOVERNMENTAL REGULATIONS

14. Lessee shall, at his sole cost and expense, comply with all of the requirements of all Municipal, State and Federal authorities now in force, or which may hereafter be in force, pertaining to the Premises, and shall faithfully observe in the use of the Premises all Municipal ordinances and State and Federal statutes now in force or which may hereafter be in force. The judgment of any court of competent jurisdiction, or the admission of Lessee in any action or proceeding against Lessee, whether Lessor be a party thereto or not, that Lessee has violated any such ordinance or statute in the use of the Premises, shall be conclusive of that fact as between Lessor and Lessee.(*) SEE ADDENDUM ATTACHED.

INDEMNIFICATION OF LESSOR AND LESSEE'S LIABILITY INSURANCE

15. The Lessee, as a material part of the consideration to be rendered to the Lessor, hereby waives all claims against the Lessor for damages to goods, wares and merchandise, and all other personal property in, upon, or about the Premises and for injuries to persons in or about the Premises, from any cause arising at any time, excepting claims arising from the Lessor's negligence and willful misconduct or breach of this Lease and the Lessee will hold the Lessor exempt and harmless from any damage or injury to any person, or to the goods, wares and merchandise and all other personal property of any person, arising from the use of the Premises by the Lessee, or from the failure of the Lessee to keep the Premises in good condition and repair, as herein provided.

ADVERTISEMENTS AND SIGNS

16. Lessee will not place or permit to be placed, in, upon or about the Premises any unusual or extraordinary signs, or any signs not approved by the city or other governing authority. The Lessee will not place, or permit to be placed, upon the Premises, any signs, advertisements or notices without the written consent of the Lessor first had and obtained.(*) Any sign so placed on the Premises shall be so placed upon the understanding and agreement that Lessee will remove same at the termination of the tenancy herein created and repair any damage or injury to the Premises caused thereby, and if not so removed by Lessee then Lessor may have same so removed at

Lessee's expense. (*) SEE ADDENDUM ATTACHED

UTILITIES

17. Lessee shall pay for all water, gas, heat, light, power, telephone service and all other service supplied to the Premises.

ATTORNEY'S FEES

18. In case suit should be brought for the possession of the Premises, for the recovery or any sum due hereunder, or because of the breach of any other covenant herein, the losing party shall pay to the prevailing party a reasonable attorney's fee, which shall be deemed to have accrued on the commencement of such action and shall be enforceable, whether or not such action is prosecuted to judgment.

DEFAULT

19. In the event of any breach of this Lease by the Lessee, or an abandonment of the Premises by the Lessee, the Lessor has the option of 1) removing all persons and property from the Premises and repossessing the Premises in which case any of the Lessee's property which the Lessor removes from the Premises may be stored in a public warehouse or, elsewhere at the cost of, and for the account of Lessee, or 2) allowing the Lessee to remain in full possession and control of the Premises. If the Lessor chooses to repossess the Premises, the Lease will automatically terminate in accordance with provisions of the California Civil Code, Section 1951.2. In the event of such termination of the Lease, the Lessor may recover from the Lessee: 1) the worth at the time of award of the unpaid rent which had been earned at the time of termination including interest at 7% per annum; 2) the worth at the time of award of the amount by which the unpaid rent which would have been earned after termination until the time of award exceeds the amount of such rental loss that the Lessee proves could have been reasonably avoided including interest at 7% per annum; 3) the worth at the time of award of the amount by which the unpaid rent for the balance of the term after the time of award exceeds the amount of such rental loss that the Lessee proves could be reasonably avoided; and 4) any other amount necessary to compensate the Lessor for all the detriment proximately caused by the Lessee's failure to perform his obligations under the Lease or which in the ordinary course of things would be likely to result therefrom. If the Lessor chooses not to repossess the Premises, but allows the Lessee to remain in full possession and control of the Premises, then in accordance with provisions of the California Civil Code, Section 1951.4, the Lessor may treat the Lease as being in full force and effect, and may collect from the Lessee all rents as they become due through the termination date of the lease as specified in the lease. For the purposes of this paragraph, the following do not constitute a termination of Lessee's

right to possession:

a) Acts of maintenance or preservation or efforts to relet the property.

b) The appointment of a receiver on the initiative of the Lessor to protect his interest under this Lease. (*)

(*) SEE ADDENDUM ATTACHED

LATE CHARGES

20. Lessee hereby acknowledges that late payment by Lessee to Lessor of rent and other sums due hereunder will cause Lessor to incur costs not contemplated by this lease, the exact amount of which will be extremely difficult to ascertain. Such costs include, but are not limited to, processing and accounting charges, and late charges which may be imposed on Lessor by the terms of any mortgage or trust deed covering the Premises. Accordingly, if any installment of rent or any other sum due from Lessee shall not be received by Lessor or Lessor's designee within ten (10) days after such amount shall be due, Lessee shall pay to Lessor a late charge equal to seven and one half percent (7.5%) of such overdue amount. The parties hereby agree that such late charge represents a fair and reasonable estimate of the costs Lessor will incur by reason of late payment by Lessee. Acceptance of such late charge by Lessor shall in no event constitute a waiver of Lessee's default with respect to such overdue amount, nor prevent Lessor from exercising any of the other rights and remedies granted hereunder.

SURRENDER OF LEASE

21. The voluntary or other surrender of this Lease by Lessee, or a mutual cancellation thereof, shall not work a merger, and shall, at the option of Lessor, terminate all or any existing subleases or subtenancies, or may, at the option of Lessor, operate as an assignment to him of any or all such subleases or subtenancies.

TAXES

22. The Lessee shall be liable for all taxes levied against personal property and trade or business fixtures. The Lessee also agrees to pay, as additional rental, during the term of this Lease and any extensions thereof, all real estate taxes plus the yearly installments of any special assessments which are of record or which may become of record during the term of this lease. If said taxes and assessments are assessed against the entire building and building site, and this Lease does not cover the entire building or building site, the taxes and assessment installments allocated to the Premises shall be prorated on a square footage or other equitable basis, as calculated by the Lessor. It is understood and agreed that the Lessee's obligation under his paragraph will be pro-rated to reflect the commencement and termination dates of this Lease. Real estate taxes shall not include taxes assessed on the net income of Lessor or any gift, franchise or inheritance taxes.

NOTICES

23. All notices to be given to Lessee may be given in writing personally or by depositing the same in the United States mail, postage prepaid, and addressed to Lessee at the said Premises, whether or not Lessee has departed from, abandoned or vacated the Premises.

ENTRY BY LESSOR

24. Lessee shall permit Lessor and his agents to enter into and upon the Premises at all reasonable times for the purpose of inspecting the same or for the purpose of maintaining the building in which the Premises are situated, or for the purpose of making repairs, alterations or additions to any other portion of said building, including the erection and maintenance of such scaffolding, canopies, fences and props as may be required without any rebate of rent and without any liability to Lessee for any loss of occupation or quiet enjoyment of the Premises thereby occasioned; and shall permit Lessor and his agents, at any time within ninety days prior to the expiration of this Lease, to place upon the Premises any usual or ordinary "For Sale" or "To Lease" signs and exhibit the Premises to prospective tenants at reasonable hours.

DESTRUCTION OF PREMISES

25. In the event of a partial destruction of the Premises during the said term from any cause, Lessor shall forthwith repair the same, provided such repairs can be made within one hundred twenty (120) days under the laws and regulations of State, Federal, County or Municipal authorities, but such partial destruction shall in no way annul or void this Lease, except that Lessee shall be entitled to a proportionate reduction of rent while such repairs are being made, such proportionate reduction to be based upon the extent to which the making of such repairs shall interfere with the business carried on by Lessee in the Premises. If such repairs cannot be made in one hundred twenty (120) days, Lessor may, at his option, make same within a reasonable time, this Lease continuing in full force and effect and the rent to be proportionately reduced as aforesaid in this paragraph provided. In the event that Lessor does not so elect to make such repairs which cannot be made in one hundred twenty (120) days, or such repairs cannot be made under such laws and regulations, this Lease may be terminated at the option of either party. In respect to any partial destruction which Lessor is obligated to repair or may elect to repair under the terms of this paragraph, the provision of Section 1932, Subdivision 2, and of section 1933, Subdivision 4, of the Civil Code of the State of California are waived by Lessee. In the event that the building in which the Premises may be situated be destroyed to the extent of not less than fifty percent (50%) of the replacement cost thereof, Lessor may elect to terminate this Lease, whether the Premises be injured or not. A total destruction of the building in which the Premises may be situated shall terminate this Lease. In the event of any dispute between Lessor and Lessee relative to the provisions of this paragraph, they shall each select an arbitrator, the two arbitrators so selected shall select a third arbitrator and the three arbitrators so selected shall hear and determine the controversy and their decision thereon shall be final and binding upon both Lessor and Lessee, who shall bear the cost of such arbitration equally between them.

ASSIGNMENT AND SUBLETTING

26. The Lessee shall not assign, transfer, or hypothecate the leasehold estate under this Lease, or any interest therein, and shall not sublet the Premises, or any part thereof, or any right or privilege appurtenant thereto, or suffer any other person or entity to occupy or use the Premises, or any portion thereof, without, in each case, the prior written consent of the Lessor. Lessor agrees not to unreasonably withhold consent to sublet or assign. As a condition for granting its consent to any subletting the Lessor may require the Lessee to agree to pay to the Lessor, as additional rental, 50% of all rents received by the Lessee from its Sublessee after deductions for brokerage commissions which are in excess of the amount payable

by the Lessee to the Lessor hereunder. The Lessee shall, by thirty (30) days written notice, advise the Lessor of its intent to sublet the Premises or any portion thereof for any part of the term hereof. Within thirty (30) days after receipt of Lessee's notice, Lessor shall either given approval or disapproval to Lessee to sublease the portion of the Premises described in Lessee's notice. If the Lessor approves a subletting, the Lessee may sublet immediately after receipt of the Lessor's written approval. In the event Lessee is allowed to assign, transfer or sublet the whole or any part of the Premises, with the prior written consent of Lessor, no assignee, transferee or sublessee shall assign or transfer this Lease, either in whole or in part, or sublet the whole or any part of the Premises, without also having obtained the prior written consent of the Lessor. A consent of Lessor to one assignment, transfer, hypothecation, subletting, occupation or use by any other person shall not release Lessee from any of Lessee's obligations hereunder or be deemed to be a consent to any subsequent similar or dissimilar assignment, transfer, hypothecation, subletting, occupation or use by any other person. Any such assignment, transfer, hypothecation, subletting, occupation or use without such consent shall be void and shall constitute a breach of this Lease by Lessee and shall, at the option of Lessor exercised by written notice to Lessee, terminate this Lease. The leasehold estate under this Lease shall not, nor shall any interest therein, be assignable for any purpose by operation of law without the written consent of Lessor. As a condition to its consent, Lessor may require Lessee to pay all expense in connection with the assignment, and Lessor may require Lessee's assignee or transferee (or other assignees or transferees) to assume in writing all of the obligations under this Lease. (*)
(*) SEE ADDENDUM ATTACHED

CONDEMNATION

27. If any part of the premises shall be taken for any public or quasi-public use, under any statute or by right of eminent domain or private purchase in lieu thereof, and a part thereof remains which is susceptible of occupation hereunder, this Lease shall, as to the part so taken, terminate as of the date title shall vest in the condemnor or purchaser, and the rent payable hereunder shall be adjusted so that the Lessee shall be required to pay for the remainder of the term only such portion of such rent as the value of the part remaining after such taking bears to the value of the entire Premises prior to such taking; but in such event Lessor shall have the option to terminate this Lease as of the date when title to the part so taken vests in the condemnor or purchaser. If all of the premises, or such part thereof be taken so that there does not remain a portion susceptible for occupation hereunder, this Lease shall thereupon terminate. If a part or all of the Premises be taken, all compensation awarded upon such taking shall

go to the Lessor and the Lessee shall have no claim thereto, except that Lessee shall have the right to receive that portion of the condemnation proceeds based upon the value of all personal property that Lessee shall have the right to remove from the Premises.

EFFECT OF CONVEYANCE

28. The term "Lessor" as used in this Lease, means only the owner for the time being of the land and building containing the Premises, so that, in the event of any sale of said land or building, or in the event of a lease of said building, the Lessor shall be and hereby is entirely freed and relieved of all covenants and obligations of the Lessor hereunder, provided that Lessor transfers the security deposit to the transferee and the transferee assumes in writing Lessor's obligations hereunder, and it shall be deemed and construed, without further agreement between the parties and the purchaser at any such sale, or the Lessee of the building, that the purchaser or lessee of the building has assumed and agreed to carry out any and all covenants and obligations of the Lessor hereunder. If any security be given by the Lessee to secure the faithful performance of all or any of the covenants of this Lease on the part of the Lessee, the Lessor may transfer and deliver the security, as such, to the purchaser at any such sale or the lessee of the building, and thereupon the Lessor shall be discharged from any further liability In reference thereto.

SUBORDINATION

29. Lessee agrees that this Lease may, at the option of Lessor, be subject and subordinate to any mortgage, deed of trust or other instrument of security which has been or shall be placed on the land and building or land or building of which the Premises form a part, and thus subordination is hereby made effective without any further act of Lessee. The Lessee shall, at any time hereinafter, on demand, execute any instruments, releases, or other documents that may be required by any mortgagee, mortgagor, or trustor or beneficiary under any deed of trust for the purpose of subjecting and subordinating this Lease to the lien of any such mortgage, deed of trust or other instrument of security, and the failure of the Lessee to execute any such instruments, releases or documents, shall constitute a default hereunder. Lessee shall not be required to execute any documents subordinating this Lease unless the holder of any such Lien executes a Non-Disturbance Agreement in favor of Lessee.

WAIVER

30. The waiver by Lessor of any breach of any term, covenant or condition, herein contained shall not be deemed to be a waiver of such term, covenant or condition or any subsequent breach of the same or any other term, covenant or condition therein contained. The subsequent acceptance of rent hereunder by Lessor shall not be deemed to be a waiver of any preceding breach by Lessee of any term, covenant or condition of this Lease, other than the failure of Lessee to pay the particular rental so accepted, regardless of Lessor's knowledge of such preceding breach at the time or acceptance of such rent.

HOLDING OVER

31. Any holding over after the expiration of the said term, with the consent of Lessor, shall be construed to be a tenancy from month to month, at a rental to be negotiated by Lessor and Lessee prior to the expiration of said term, and shall otherwise be on the terms and conditions herein specified, so far as applicable.

SUCCESSORS AND ASSIGNS

32. The covenants and conditions herein contained shall, subject to the provisions as to assignment, apply to and bind the heirs, successors, executors, administrators and assigns of all of the parties hereto; and all of the parties hereto shall be jointly and severally liable hereunder.

TIME

33. Time is of the essence of this lease.

MARGINAL CAPTIONS

34. The marginal headings or titles to the paragraphs of this Lease are not a part of this Lease and shall have no effect upon the construction or interpretation of any part thereof. This instrument contains all of the agreements and conditions made between the parties hereto and may not be modified orally or in any other manner than by an agreement in writing signed by all of the parties hereto or their respective successors in interest.

PARAGRAPHS #35 AND #36 AND ADDENDUM ATTACHED HERETO ARE HEREBY MADE A PART OF THIS LEASE.

THIS LEASE HAS BEEN PREPARED FOR SUBMISSION TO YOUR ATTORNEY WHO WILL REVIEW THE DOCUMENT AND ASSIST YOU TO DETERMINE WHETHER YOUR LEGAL RIGHTS ARE ADEQUATELY PROTECTED. RENAULT & HANDLEY IS NOT AUTHORIZED TO GIVE LEGAL AND TAX ADVICE. NO REPRESENTATION OR RECOMMENDATION IS MADE BY RENAULT & HANDLEY OR ITS AGENTS OR EMPLOYEES AS TO THE LEGAL SUFFICIENCY, LEGAL EFFECT OR TAX CONSEQUENCES OF THIS DOCUMENT OR ANY TRANSACTION RELATING THERETO. THESE ARE QUESTIONS FOR YOUR ATTORNEY WITH WHOM YOU SHOULD CONSULT BEFORE SIGNING THIS DOCUMENT.

IN WITNESS WHEREOF, Lessor and Lessee have executed these presents, the day and year first above written.

LESSOR	LESSEE
ZAPPETTINI INVESTMENT CO.	IRIDEX CORPORATION
/s/ George O. McKee	/s/ Theodore A. Boutacoff
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- ----------	----------
- ----------	----------

ADDITIONAL PARAGRAPHS

These additional paragraphs are hereby made apart of that certain Lease dated December 6, 1996 by and between Zappettini Investment Co., Lessor, and Iridex Corporation, Lessee, covering premises at 1212 Terra Bella, Mountain View, California.

35. Options to Renew. Lessor grants to Lessee two successive two year options to renew this Lease. The first two year option shall commence, if at all, on the termination date of this Lease and will terminate on February 29, 2004. The second option period shall commence, if at all, on March 1, 2004 providing that the first option has been exercised and shall terminate on February 28, 2006. In no event can the 2nd option to renew be exercised unless the 1st option to renew has been exercised. The option terms shall be governed by all the terms and conditions as are contained in the Lease excepting that there shall be no additional options and also excepting the basic monthly rental. The basic monthly rent for each of the option terms shall be negotiated by Lessor and Lessee at the time each option is exercised and shall be based on 98 percent of the then market rent for the Premises based on similar space within a 1 mile radius of the subject property. In no event however, shall the monthly rental for the first option term be less than $46,457.50 nor shall the rental amount for the 2nd option term be less than that amount being paid for the 1st option term. In order to exercise each option, the Lessee must give the Lessor written notice a minimum of 90 days and a maximum of 120 days prior to the termination of the immediately preceding term. At the option of the Lessor, any of the above options to renew may be declared null and void if the Lessee is in default under any of the terms or conditions of the Lease when said option is exercised.

36. Lessor will indemnify, defend and hold Lessee harmless from and against all costs of response, corrective action, remedial action, claims, demands, losses and liabilities arising from any pre-existing environmental contamination which may have occurred prior to the Lessee taking possession of the Premises.

Lessee will only be responsible for contamination of the Premises or the soils or ground water thereon or thereunder in violation of Hazardous Materials Laws, that Is caused by Lessee or Lessee's agents, contractors or invitees during the term as may be extended. All hazardous materials and toxic wastes that Lessee brings on the Premises shall be stored according to Hazardous Materials Law.

All hazardous materials and toxic wastes that Lessee brings on the site shall be stored according to all local, state and national government regulations. Hazardous Materials shall be defined as those substances that are recognized as posing a risk of injury to health or safety by the Santa Clara Fire Department, the Santa Clara County Health Department, the Regional Water Quality Control Board, the State of California or the Federal Government.

For purposes of this Lease, "Hazardous Materials Law" shall mean all local, state and federal laws, statutes, ordinances, rules, regulations, judgements, injunctions, stipulations, decrees, orders, permits, approvals, treaties or protocols now or hereafter enacted, issued or promulgated by any governmental authority which relate to any Hazardous Material or the use, handling, transportation,

production, disposal, discharge, release, emission, sale or storage of, or the exposure of any person to, a Hazardous Material.

Lessor hereby releases Lessee from and waives all claims, costs, losses, damages and liabilities ("Claims") against Lessee, arising out of or in connection with any Hazardous Material present at any time on, in, under or about the Premises except to the extent that any such Claims results from the release, disposal, emission or discharge of Hazardous Materials on or about the Premises by Lessee by its agent, contractors or employees. In this regard, Lessor hereby waives the benefits of California Civil Code Section 1542 which provides as follows: "A general release does not extend to claims which the creditor does not know or suspect to exist in his favor at the time of executing the release which if known by him must have materially have affected his settlement with debtor."

ADDENDUM

ADDED TO THE END OF PARAGRAPH 6: *Notwithstanding anything to the contrary in this Lease, (i) if possession of the Premises has not been delivered to Lessee for any reason whatsoever on or before March 1, 1997, Lessee shall not be obligated to pay rent for that period of time after the Rent Commencement Date equal to the number of days that possession of the Premises is delayed beyond March 1, 1997, and (ii) if possession of the Premises is not delivered to Lessee for any reason whatsoever on or before April 30, 1997 then Lessee may terminate this Lease by written notice to Lessor, whereupon any monies previously paid to Lessor by Lessee shall be reimbursed to Lessee and neither party shall have any further obligation to each other.

ADDITION TO PARAGRAPH 7:

*If Lessee notifies Lessor within such 45 day period that there are structural defects in the Premises, Lessor shall, at its cost, repair such structural defects.

ADDITIONS TO PARAGRAPH 9:

*Upon request, Lessor shall advise Lessee in writing whether it reserves the right to require Lessee to remove any such alterations, additions or improvements from the Premises upon expiration or sooner termination of this Lease. If Lessor elects not to reserve such right, then Lessee shall not be required to remove the initial tenant improvements which Lessee intends to construct in the Premises.

** ;provided however, that Lessee shall have the right to remove at any time any special purpose improvements installed in the Premises by Lessee at Lessee's cost including, without limitation, supplementary heating, ventilation and air conditioning systems and chillers for laboratory bench heat exchange. Lessee shall, upon removal of such special purpose improvements, return the Promises to its condition prior to their installation including all patching, cleaning and repainting if necessary.

ADDITION TO PARAGRAPH 10:

***In the event of fire or other casualty, paragraph 25, rather than this paragraph 10, shall govern the obligations of the parties with respect to the repair, maintenance and replacement of the Premises. Notwithstanding anything to the contrary in this Lease, Lessor, at its cost and expense, shall make any repair, maintenance or improvement (i) required as a result of a construction defect in the Premises as of the Commencement Date, and (ii) for which Lessor has a right of reimbursement from others (including, without limitation, insurers). Lessee shall have the benefit of any construction and/or equipment warranties existing in favor of Lessor that would assist Lessee in discharging Its obligations under this Lease.

1. If Lessee is required to replace an HVAC unit, plumbing line, main electrical panel or generator, it may instead elect to require Lessor to perform such Capital Repair.

2. The cost of any of the above replacements performed by Landlord, which is reimbursable by Lessee, shall be amortized over the useful life of the Capital Repair determined in accordance with generally accepted accounting principles with interest on the unamortized balance at the then prevailing market rate Lessor would pay if it borrowed funds to replace these units from an institutional lender. Lessor shall inform Lessee of the monthly amortization payment required to so amortize such costs, and shall also provide Lessee with the information upon which such determination is made. Tenant shall pay such amortized payment for each month during the term of the Lease after such improvement is completed until the first to occur of (i) the resetting of rent or the end of the term over which such costs were amortized. Such amortized amount shall be due at the same time that rent is due.

3. The cost of any Capital Repair performed by Lessor shall be shared by Lessee and Lessor as follows. Upon completion of the Capital Repair, Lessor shall notify Lessee of the total cost incurred by Lessor to complete the work and shall deliver to Lessee documentary support for such costs and lien waivers (or lien release bonds) for such work. Lessee shall be responsible for that portion of the cost incurred by Lessor for the Capital Repair times a fraction, the numerator of which shall be equal to the lesser of the months in the Lease term (a) until the resetting of monthly rent for the Premises based upon the fair market value of the Premises as so repaired or improved, or (b) the useful life of the capital repairs and the denominator shall be the months on the useful life of the capital repair.

4. For the purposes of this paragraph, a Capital Repair shall not include the resealing of the parking lot.

ADDITION TO PARAGRAPH 16:

*which consent shall not be unreasonably withheld or delayed. Lessee shall have the right to place signs displaying the name and logo of Lessee in the present sign locations and on the entry doorways.

ADDITION TO PARAGRAPH 19:

*Notwithstanding anything to the contrary in this Lease, (i) Lessee shall not be deemed to be in default or breach of this Lease on account of Lessee's failure to pay money to Lessor unless Lessee's failure to pay continues for ten (10) days after the first day of each month, and (ii) Lessee shall not be in default or breach of this Lease for failing to perform any covenant of this Lease (other than a covenant to pay money to Lessor) unless Lessee's failure to perform such covenant continues for a period of thirty (30) days after Lessee's receipt of written notice of such failure, or such longer time as may be reasonably required to cure the default so long as Lessee commences to cure such failure within thirty (30) day period and diligently prosecutes such cure to completion.

ADDITION TO PARAGRAPH 24:

Lessor shall provide to Lessee twenty-four (24) hours' notice prior to its entry onto the Premises (except in the event of an emergency) and such entry shall be subject to Lessee's right to accompany Lessor at all times and Lessee's reasonable security precautions. Lessor shall ensure that reasonable

access to the Premises is available to Lessee at all times and shall use reasonable efforts to mitigate any interference with Lessee's business caused by Lessor's entry and work.

ADDITION TO PARAGRAPH 25:

Landlord shall have the additional right to terminate the Lease in the event of a casualty which is not required hereunder to be covered by insurance or where insurance proceeds are not available to pay at least eighty percent (80%) of the replacement cost of the Building. Tenant shall have the additional right to terminate the Lease if restoration or repair of the Building would take longer than one hundred twenty (120) days.

ADDITION TO PARAGRAPH 26:

*arising after the effective date of the transfer in question. Notwithstanding anything to the contrary in this Lease, Lessee may, without Lessor's prior written consent and without being subject to the terms of this paragraph 26 including, without limitation, Lessor's right to recapture the Premises and participate in assignment and subletting proceeds, sublease the Premises or assign the Lease to: (i) a corporation controlling, controlled by or under common control with Lessee; (ii) a successor corporation related to Tenant by merger, consolidation or nonbankruptcy reorganization; or (iii) a purchaser of substantially all of the assets of Lessee.

ADDITION TO PARAGRAPH 14:

If Lessee is required to make any capital repairs to this paragraph 14 then the provisions of paragraph 10 with regard to capital repairs shall apply. The paragraph 14 shall not apply to any requirement regarding any Hazardous Material.

[LETTERHEAD OF RENAULT & HANDLEY]

January 15, 1997

Iridex Corporation
340 Pioneer Way
Mountain View, CA 94041

ATTN: Theodore A. Boutacoff

RE: That certain Lease dated December 6, 1996 by and between Zappettini Investment Co and Iridex Corporation for 1212 Terra Bella Avenue, Mountain View, California

Dear Mr. Boutacoff:

With reference to the above Lease, Lessor agrees that he will

(A) Repaint the exterior of the building

(B) Resurface and restripe the parking lot

(C) Replace the existing roof

(D) Trim trees on Shoreline side of property

(E) Lessor will advance to Lessee the sum of $16,000.00 for the purpose of replacing T-Bar and tile in the clean room area.

(F) Lessor shall not be responsible for any fixer expenditures other than those listed above, including those that may be triggered by the City of Mountain View or any governing body as a result of Lessors fulfilling the obligations listed above. Should the Lessee be required by the City of Mountain View to spend in excess of $25,000.00 in retrofitting the drop ceiling for earthquake protection, Lessee may, at its option, cancel the above Lease without further obligation to Lessor. Lessee shall have until 5:00 p.m. January 31, 1997 to exercise this option to cancel if these costs exceed $25,000.00. If the Lessee does not inform Lessor by that time and date, then the Lease shall continue in full force and effect.

Notwithstanding anything to the contrary contained in the above Lease the commencement date will be 30 days after the building is vacated by Abbott and made available to Index Corporation.

In order for the enclosed Lease to be valid, it must be executed by both parties before 12 noon, January 20, 1997.

Yours sincerely,

/s/ George O. McKee
- ----------
George O. McKee
Gen. Mgr. Partner
Zappettini Investment Co.

Read and Agreed:

IRIDEX CORPORATION

By: /s/ Theodore A. Boutacoff

Theodore A. Boutacoff

Date: 1/20/97

GOM:bg

Enclosures

[LETTERHEAD OF IRIDEX CORPORATION]

May 7, 1997

Mr. George McKee
Zappettini Investment Co.
2500 El Camino Real
Palo Alto, CA 94306

Re: 1212 Terra Bella, Mountain View; waiver of part of paragraph 26 of the Lease

Dear George:

Per our phone conversation on Wednesday, April 30, you agreed to waive the second sentence of paragraph 26 of the Lease (between Zappettini Investment Co. and Iridex Corporation, dated the 6th day of December, 1996) and not require Iridex Corporation to make any payments to Zappettini Investment Co. on account of rents collected from a subtenant. The second sentence of Paragraph 26 states:

"As a condition for granting its consent to any subletting, the Lessor may require the Lessee to agree to pay to Lessor, as additional rental, 50% of all rents received by the Lessee from its Sublessee after deductions for brokerage commissions which are in excess of the amount payable by the Lessee to the Lessor hereunder."

Please document your waiver of this sentence from the aforementioned Lease by signing below* and returning a signed original of this letter to our offices at 340 Pioneer Way, Mountain View CA 94041.

Thank you for your attention to this matter.

Yours sincerely,

/s/ Robert Kamenski
- ----------
Robert Kamenski
Vice President of Finance and Administration

*Agreement to Waiver:

/s/ George O. McKee
- ----------
George McKee
General Partner
Zappettini Investment Co.

November 26, 2001

EXERCISE OF OPTION

Re: Paragraph 35 (Additional Paragraphs) of that certain Lease dated December 6th 1996 by and between Zappettini Investment Co., Lessor, Iridex Corporation, Lessee, for an approximately 37,166 square foot industrial building commonly referred to as 1212 Terra Bella Avenue, Mountain View, California.

Lessee hereby exercises its option to renew the above described Lease for an additional two (2) year term commencing March 1st 2002 and terminating on February 29th 2004. All the terms and conditions of the original Lease shall be in full force and effect excepting the rental amount which shall be as follows:

March 1, 2002 through February 28, 2003.....	Fifty Five Thousand Seven Hundred Forty Nine and No/100ths Dollars ($55,749.00).
March 1, 2003 through February 29th 2004.....	Fifty Seven Thousand Six Hundred Seven and 30/100ths Dollars ($57,607.30).

LESSOR:

ZAPPETTINI INVESTMENT CO.

/s/ George O. McKee

/s/ Allen M. Karing

Date: November 26, 2001

LESSEE:

IRIDEX CORPORATION

/s/ Robert Kamenski

Date: November 26, 2001

Exhibit 23.1

CONSENT OF INDEPENDENT ACCOUNTANTS

We hereby consent to the incorporation by reference in the Registration Statement on Form S-8 (No. 333-97541) of IRIDEX Corporation of our report dated January 27, 2003 relating to the consolidated financial statements and financial statement schedule, which appears in this Form 10-K.

/s/ PricewaterhouseCoopers LLP

San Jose, California
March 28, 2003

Exhibit 99.1

CERTIFICATION OF CHIEF EXECUTIVE OFFICER AND CHIEF FINANCIAL OFFICER
PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

I, Theodore A. Boutacoff, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that the Annual Report of IRIDEX Corporation on Form 10-K for the fiscal year ended December 28, 2002 fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 and that information contained in such Annual Report on Form 10-K fairly presents in all material respects the financial condition and results of operations of IRIDEX Corporation.

By: /s/ Theodore A. Boutacoff

Name: Theodore A. Boutacoff
Title: Chief Executive Officer

I, Robert Kamenski, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that the Annual Report of IRIDEX Corporation on Form 10-K for the year ended December 28, 2002 fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 and that information contained in such Annual Report on Form 10-K fairly presents in all material respects the financial condition and results of operations of IRIDEX Corporation.

By: /s/ Robert Kamenski

Name: Robert Kamenski
Title: Chief Financial Officer