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 31, 1997

[ ] 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 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. [X]

The aggregate market value of the voting stock held by non-affiliates of the Registrant as of March 19, 1998, was approximately $31,518,173 based on the closing price reported for such date on the Nasdaq National Market System. 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, 1998, the Registrant had 6,465,558 shares of Common Stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Parts of the Proxy Statement for the Registrant's 1998 Annual Meeting of Stockholders (the "Proxy Statement") are incorporated by reference into Part III of this Annual Report on Form 10-K.

PART 1

ITEM 1. BUSINESS

GENERAL

IRIDEX Corporation ("IRIDEX" or the "Company") is the leading worldwide provider of semiconductor-based laser systems used to treat eye diseases in ophthalmology and skin lesions in dermatology. IRIDEX products are sold in the United States predominantly through a direct sales force and internationally through 53 independent distributors into 72 countries. The Company markets its products using three brand names: IRIS Medical to the ophthalmic market, IRIDERM to the dermatological market, and Light Solutions to the research market.

The Company's ophthalmic products treat eye diseases, including the three leading causes of irreversible blindness. The current family of ophthalmic laser systems includes the IRIS Medical OcuLight SL, OcuLight SLx and OcuLight GL Laser Photocoagulation systems (each an "OcuLight System"). Since its first shipment in 1990, more than 1,800 OcuLight Systems have been sold worldwide, primarily for hospital and office-based use by ophthalmic specialists. The Company's dermatological products treat skin diseases, primarily vascular and pigmented lesions. In June 1997, the Company launched the IRIDERM DioLite 532 Laser System to address the dermatological market. The DioLite 532 Laser System is sold primarily for office-based use by dermatologists. Each ophthalmic and dermatological system consists of a small, portable laser console and interchangeable delivery devices. The Company believes that its semiconductor-based systems are more portable and economical and have a greater degree of reliability and flexibility than competing systems which use traditional vacuum tube-based technology.

IRIDEX Corporation was incorporated in California in February 1989 as IRIS Medical Instruments, Inc. In 1996, the Company changed its name to IRIDEX Corporation and reincorporated in Delaware. IRIDEX conducts most of its business through its wholly-owned operating subsidiary, IRIS Medical Instruments, Inc. The Company's executive offices are located at 1212 Terra Bella Avenue, Mountain View, California 94043-1824, and its telephone number is (650) 940-4700. As used in this Form 10-K, the terms "Company" and "IRIDEX" refer to IRIDEX Corporation, a Delaware corporation, and, when the context so requires, its wholly-owned subsidiaries, IRIS Medical Instruments, Inc. and Light Solutions Corporation, both California corporations and its dermatological division IRIDERM.

This Annual Report on Form 10-K contains trend analysis and other 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. Actual results could differ materially from those set forth in such forward looking statements as a result of a number of risks and uncertainties, including the factors set forth under "Management's Discussion and Analysis of Financial Condition and Results of Operation--Factors That May Affect Future Results" and other risks detailed from time to time in the Company's reports filed with the Securities and Exchange Commission. Statements made herein are as of the date of the filing of this Form 10-K with the Securities and Exchange Commission, and should not be relied upon as of any subsequent date. The Company expressly disclaims any obligation to update information presented herein, except as may otherwise be required by law.

THE IRIDEX STRATEGY

The Company's objective is to become a worldwide leader in developing, manufacturing, marketing and selling innovative and cost-effective medical laser systems. The key elements of the Company's strategy are:

Broaden Product Lines by Leveraging Existing Technology. In 1996, the Company introduced a new visible laser system, the OcuLight GL, for ophthalmology, which significantly expanded the market opportunity for the Company's products. In 1997, the Company introduced the DioLite 532, based on the same visible light technology as the OcuLight GL, for the dermatological market. The characteristics of both of these new products are similar to those which have made the Company's previous products successful, such as low cost ownership, reliability, and portability.

Develop and Validate New Applications. The Company is seeking to develop and validate treatments that are less costly, reduce complications and achieve better clinical results than existing treatments. The Company's products are currently being used in multiple studies in the United States and internationally to demonstrate the clinical benefits of its technology in treatment. Examples of these studies include a multi-site study to prophylactically treat age-related macular degeneration and international studies which are evaluating the use of the Company's G-Probe as a primary treatment for glaucoma.

Continue to Enhance Products. A core strength of the Company has been its regular introduction of new delivery devices and product upgrades which have enhanced the benefits of the Company's laser systems. The Company intends to continue its investment in research and development to improve the performance of its systems as well as to develop additional technologies which can more cost effectively address the needs of the ophthalmic and dermatological markets. To enhance the Company's research and development efforts, the Company collaborates with an extensive network of academic leaders who provide input and advice, as well as assist in validating the efficacy of new products and applications.

Provide Total Disease Management. The Company intends to pursue both therapeutic and adjunctive diagnostic systems. An adjunctive diagnostic system is used either to screen and identify more patients who require therapy or objectively assess the adequacy of therapy. The Company believes that a significant opportunity exists to provide diagnostic equipment to the ophthalmic and optometric communities. The Company intends to pursue its entrance into this diagnostic market through both internal development and selected acquisitions. By pursuing therapeutic and diagnostic systems, the Company intends to provide total disease management.

Develop New Markets through Strategic Alliances. The Company intends to establish strategic alliances in order to expedite and lower the cost of developing and bringing to market new products, both to the ophthalmic and dermatological markets and to markets not currently addressed by the Company's products. Through these alliances, the Company will seek access to technologies that it does not currently possess. In May 1996, the Company signed a Development and Distribution Agreement with Miravant Medical Technologies, formerly known as PDT, Inc. ("Miravant"), a company engaged in the development of photodynamic drugs and applications, to provide lasers to activate certain photodynamic drugs which are currently being developed by Miravant.

PRODUCTS

The Company utilizes 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 customers to purchase a basic system and add additional delivery devices as their needs expand or as the Company develops new applications. This systems approach also brings economies-of-scale to the Company's product development and manufacturing efforts since each application does not require the design and manufacture of complete stand-alone products.

Consoles. The Company's laser consoles incorporate the economic and technical benefits of semiconductor technology, which is the basis of the Company's semiconductor-based laser systems.

Infrared Photocoagulator Console. These OcuLight photocoagulator consoles are available in two infrared 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. Consoles have United States list prices ranging from $19,900 to $26,500.

Visible Photocoagulator Console: In September 1996, the Company introduced a new semiconductor-based photocoagulator, the OcuLight GL, which delivers visible laser light. In June 1997, the Company launched a dermatological product, the DioLite 532, also based on visible semiconductor-based technology. Both of these 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. The OcuLight GL has a United States list price of $27,500. The DioLite 532 has a United States list price of $44,500.

Peripheral Delivery Devices. The Company's versatile family of consoles and delivery devices has been designed to allow the addition of new capabilities with a minimal incremental investment. A user adds capabilities by simply purchasing a new interchangeable delivery device. The Company has developed both disposable and nondisposable delivery devices and expects 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 and has a United States list price of $8,800.

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 any of 50 variations of a standard diagnostic slit lamp into a therapeutic photocoagulator delivery system. Slit lamp adapters are used for treatment of both retinal and glaucomal diseases and have United States list prices ranging from $6,000 to $6,500.

Operating Microscope Adapter. These adapters allow the physician to utilize a standard operating microscope for both diagnosis and 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. The United States list price of the adapter is $7,500.

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, active aspiration and illuminating styles and have United States list prices ranging from $150 to $185.

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 and has a United States list price of $200.

DioPexy Probe. The DioPexy Probe is a hand-held instrument which is used to treat retinal tears and breaks transsclerally, noninvasively through the sclera as an alternative method of attaching the retina. Advantages include increased precision, less pain and less inflammation than traditional cryotherapy. The DioPexy Probe has a United States list price of $2,500.

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Dermatological Delivery Devices:

DioLite Handpiece. The DioLite Handpiece is a hand held instrument that is used to treat vascular and pigmented lesions. These devices are available in 200, 500, 700, 1000 and 1400 micron sizes and have a United States list price of $450 each.

The Company has developed a new laser system with Miravant. This system emits a laser beam to activate a photodynamic drug being developed by Miravant in order to achieve a therapeutic result in the treatment of age-related macular degeneration. Clinical studies are currently underway to test the efficacy of this procedure. Miravant has entered into a codevelopment agreement with Pharmacia & Upjohn to more rapidly develop the photodynamic drug and validate its use in clinical studies. The Company expects that, if clinical studies are successful, receipt of the appropriate regulatory approval thereof will take 3 to 5 years. See "Management's Discussion and Analysis of Financial Condition and Results of Operations--Factors That May Affect Future Results--Dependence on Development of New Products and New Applications," "--Dependence on Collaborative Relationships and "--Government Regulation."

The following chart lists the eye diseases that can be treated using the Company's photocoagulator systems, including the preferred delivery devices. The selection of delivery device is often determined by the severity and location of the disease. The chart also lists the skin diseases that can be treated with the DioLite 532.

Condition	Procedure	Console	Delivery Devices
Ophthalmic Treatments:			
Age-related Macular Degeneration	Retinal Photocoagulation	Infrared & Visible	Slit Lamp Adapter
Diabetic Retinopathy			
Macular Edema	Grid Retinal Photocoagulation	Infrared & Visible	Slit Lamp Adapter and Operating Microscope Adapter
	Focal Retinal Photocoagulation	Visible	Slit Lamp Adapter
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(1)	Infrared & Visible	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
Dermatological Treatments:			
Vascular Lesions	Selective photothermolysis	Visible	DioLite Handpiece

Condition	Procedure	Console	Delivery Devices
Pigmented Lesions	Selective photothermolysis	Visible	DioLite Handpiece

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(1) This indication is under an Investigational Device Exemption in the United States.

RESEARCH AND DEVELOPMENT

The Company's research and development activities are performed internally by its research and development staff comprised of 13 individuals and is supplemented 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. The Company's expenditures for research and development totaled approximately $1,716,000, $1,286,000 and $742,000 in 1997, 1996 and 1995, respectively. In addition, the Company receives funds under grant from the United States government for research. The Company has close working relationships with ophthalmic researchers, clinicians and dermatologists around the world who provide new ideas, test the feasibility of these new ideas, and assist the Company in validating new products and new applications before they are introduced.

The Company is supporting pre-clinical and clinical studies to develop new photocoagulation treatments and applications. 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 include:

Ophthalmic Applications

Age-Related Macular Degeneration. The Company is supporting a multi-center clinical trial which is testing a prophylactic treatment of age-related macular degeneration. This treatment involves the use of infrared light that passes through the sensory retina without damaging it.

Glaucoma. Preliminary studies are underway to evaluate the use of the G-Probe as a first-line treatment modality for various glaucomas.

Diabetic Retinopathy. Studies are underway to investigate the treatment of diabetic retinopathy using minimal impact infrared photocoagulation 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.

CUSTOMERS AND CUSTOMER SUPPORT

The Company's products are currently sold to ophthalmologists, including glaucoma specialists, retinal specialists, and pediatric ophthalmologists, and to dermatologists. 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 1997, 1996 or 1995.

The Company is continuing its efforts to broaden its customer base through the development of new products and new applications. The Company currently estimates that there are approximately 15,000 ophthalmologists in the United States and 45,000 internationally who are each potential customers. The Company believes there are approximately 10,000 dermatologists in the U.S. Additionally, the Company estimates that there

are approximately 4,800 and 18,000 hospitals in the United States and internationally, respectively, as well as approximately 2,200 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 and hospital and medical center is a potential customer for the Company's products. The Company is seeking to broaden its customer base by developing new diagnostic products directed at addressing the needs of optometrists and dermatologists.

The Company seeks to provide superior customer support and service. A 24-hour, seven day a week, telephone service line is maintained to service customers with products under warranty or paid service contacts. If a problem with a product cannot be diagnosed and resolved by telephone, a replacement unit is shipped overnight to any domestic customer, and the problem unit is returned to the Company. The small size and rugged design of the Company's products allows for economical shipment and quick response to customers almost anywhere in the world.

SALES AND MARKETING

To support its sales process, the Company conducts marketing programs which include direct mail, trade shows, public relations, advertising in trade and academic journals and newsletters. The Company annually participates in approximately 50 trade shows or meetings in the United States and 65 trade shows or meetings internationally. These meetings allow the Company to present its products to existing as well as to prospective buyers. While the sales cycle varies from customer to customer, it averages 12 months and typically ranges from two to 24 months. The Company's sales and marketing organization is based at the Company's corporate headquarters in Mountain View, with area sales managers located in California, Georgia, Maryland, Massachusetts, Ohio and Texas.

International product sales represented 51.8%, 49.6% and 48.7% of the Company's sales in 1997, 1996 and 1995, respectively. The Company's products are sold in the United States predominantly through a direct sales force and internationally through 53 independent distributors into 72 countries. International sales are administered through the Company's corporate headquarters in Mountain View, California, along with two area sales managers. The Company's distribution agreements with its international distributors are generally exclusive and typically can be terminated by either party without cause on 90 days notice. See "Management's Discussion and Analysis of Financial Condition and Results of Operations--Factors That May Affect Future Results - --Dependence on International Sales."

The Company believes that educating patients and physicians about the long-term health benefits and cost-effectiveness of diagnosis and treatment of diseases that cause blindness at an early stage is critical to market acceptance of the Company's ophthalmic products. The Company believes 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 its ophthalmic laser products as well as its prospective diagnostic products.

The Company works with its customers to enhance its ability to identify new applications for its products, validate new procedures using its products, respond more effectively to new procedures 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. These luminaries in the field of ophthalmology and dermatology are key to the successful introduction of new technologies and their subsequent acceptance by the general market. Acceptance of the Company's products by these early adopters is key to the Company's strategy in the validation of its technology. In addition, the Company believes that widespread adoption of its laser platforms will require education about the Company's products as compared to competing systems.

OPERATIONS

The manufacture of ophthalmic and dermatological laser systems is a complex process involving precision components, intricate procedures, and environmental controls. Completed systems must pass quality control and reliability tests before shipment. The Company purchases substantially all of its components that are either standard or built to proprietary specifications and subassemblies from various independent suppliers and sub-contractors. The Company assembles critical subassemblies as well as the final product at its Mountain View, California facility. Most of the sub-contractors are located within 10 miles of the Company's Mountain View, California facility. There are risks associated with the use of independent suppliers and sub-contractors, including unavailability of or delays in obtaining adequate supplies of components and potentially reduced control of quality, production costs and the timing of delivery. Any failures by such third parties to adequately perform may delay the submission of products for regulatory approval, impair the Company's ability to deliver products on a timely basis, or otherwise impair the Company's competitive position. Establishing its own capabilities to manufacture these components would require significant scale-up expenses and additions to facilities and personnel and could adversely affect the Company's earnings.

The Company has qualified two or more sources for most of the components used in its products. However, certain of the Company's products remain significantly dependent on sole source suppliers. Certain diodes purchased from SDL, Inc. ("SDL") were not readily available from other suppliers until the second quarter of 1997. During the last half of 1996 and the first quarter of 1997, the Company experienced delays in its manufacturing of the OcuLight GL due to the inability of SDL to deliver components in volume and on a timely basis. The Company continues to work with SDL to ensure that such difficulties do not reoccur. Additionally, during the first quarter of 1997, the Company qualified Opto Power Corporation ("Opto Power"), a division of Spectra Physics Lasers, Inc., as a second source of this diode component. Although the Company believes that deliveries from SDL and Opto Power should meet the Company's future requirements for such diode components, there can be no assurance that the Company will not experience a shortfall in these diodes in the future. The process of qualifying suppliers is ongoing and may be lengthy, particularly as new products are introduced. The Company does not have long-term or volume purchase agreements with any of its suppliers and currently purchases components on a purchase order basis. The Company's business, financial condition and results of operations would be adversely affected if it is unable to obtain components in the quantities required at a reasonable cost and on a timely basis or if it could not expand manufacturing capacity to meet demand or if operations at its single facility were disrupted. See "Management's Discussion and Analysis of Financial Condition and Results of Operations--Factors That May Affect Future Results--Risks of Manufacturing and Dependence on Key Manufacturers and Suppliers."

The Company implemented policies and procedures and quality systems that are intended to allow the Company to receive ISO 9001 certification. ISO 9001 is an international series of quality standards designed to demonstrate a company's capability and commitment to quality. An audit of the Company's policies and procedures is in process, and the Company expects to be ISO 9001 certified by June 1998.

International regulatory bodies often establish varying regulations governing product standards, packaging requirements, labeling requirements, tariff regulations, duties and tax requirements. As a result of the Company's sales in Europe, the Company was required to receive a "CE" mark certification, an international symbol of quality and compliance with applicable European medical device directives. Although the Company has received a CE mark certification for the OcuLight SL platform, and has self-certified CE compliance for the OcuLight GL and the DioLite 532, there can be no assurance that the Company will be successful in meeting new certification requirements in the future or in obtaining such certifications for its new products. Any failure to obtain required certifications would have a material adverse effect on the Company's business, results of operations and financial condition.

COMPETITION

Competition in the market for devices used for ophthalmic and dermatological treatments is intense and may increase. This market is also characterized by rapid technological innovation and change, and the Company's products could be rendered obsolete as a result of future innovations. The Company's 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, the Company's products compete with pharmaceutical treatments, other technologies and other surgical techniques. The Company's principal competitors in ophthalmology are Coherent, Inc., Nidek, Inc. ("Nidek"), Carl Zeiss, Inc. ("Zeiss"), Alcon International ("Alcon"), Keeler Instruments, Inc. ("Keeler") and HGM Medical Laser Systems, Inc. ("HGM"). Of these companies, Nidek, Zeiss, Alcon and Keeler currently offer a semiconductor-based laser system in ophthalmology, and other companies may introduce a semiconductor-based laser system. The Company's principal competitors in dermatology are Laserscope and HGM, neither of which currently offers a semiconductor-based laser system in dermatology. Other competitors have substantially greater financial, engineering, product development, manufacturing, marketing and technical resources than the Company. Such companies may also have greater name recognition than the Company and long-standing customer relationships. In addition, there can be no assurance that other medical companies, academic and research institutions or others will not 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 ophthalmic and dermatological conditions targeted by the Company or are less expensive than the Company's current or future products. Moreover, there can be no assurance that the Company's technologies and products would not be rendered obsolete by such developments. Any such developments could have a material adverse effect on the business, financial condition and results of operations of the Company. See "Management's Discussion and Analysis of Financial Condition and Results of Operations--Factors That May Affect Future Results--Competition."

PATENTS AND PROPRIETARY RIGHTS

The Company's success and ability to compete is dependent in part upon its proprietary information. The Company relies on a combination of patents, trade secrets, copyright and trademark laws, nondisclosure and other contractual agreements and technical measures to protect its intellectual property rights. The Company files patent applications to protect technology, inventions and improvements that are significant to the development of its business. The Company has been issued six United States patents on the technologies related to its products and processes. The Company has applied for two additional patents related to its solid state laser products. There can be no assurance that any of the Company's patent applications will issue as patents, that any patents now or hereafter held by the Company will offer any degree of protection or that the Company's patents or patent applications will not be challenged, invalidated or circumvented in the future. Moreover, there can be no assurance that the Company's competitors, many of which have substantial resources and have made substantial investments in competing technologies, will not seek to apply for and obtain patents that will prevent, limit or interfere with the Company's ability to make, use or sell its products either in the United States or in international markets.

In addition to patents, the Company relies on trade secrets and proprietary know-how which it seeks to protect, in part, through proprietary information agreements with employees, consultants and other parties. The Company's proprietary information agreements with its employees and consultants contain provisions requiring such individuals to assign to the Company without additional consideration any inventions conceived or reduced to practice by them while employed or retained by the Company, subject to customary exceptions. There can be no assurance that proprietary information agreements with employees, consultants and

others will not be breached, that the Company would have adequate remedies for any breach or that the Company's trade secrets will not otherwise 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 and 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 competitors of the Company. Because patent applications are maintained in secrecy in the United States until patents are issued and are maintained in secrecy for a period of time outside the United States, the Company has not conducted any searches to determine whether the Company's technology infringes any patents or patent applications. The Company has from time to time been notified of, or has otherwise been made aware of claims that it may be infringing upon patents or other proprietary intellectual property owned by others. If it appears necessary or desirable, the Company may seek licenses under such patents or proprietary intellectual property. Although patent holders commonly offer such licenses, no assurance can be given that licenses under such patents or intellectual property will be offered or that the terms of any offered licenses will be reasonable or will not adversely impact the Company's operating results. Recently, a company has challenged one of the patents held by Light Solutions Corporation, a wholly owned subsidiary of IRIDEX. The Company believes that this dispute will be settled without a material adverse effect to the Company's business and financial condition.

Any claims, with or without merit, could be time-consuming, result in costly litigation and diversion of technical and management personnel, cause shipment delays, require the Company to develop noninfringing technology or require the Company to enter into royalty or licensing agreements. Although patent and intellectual property disputes in the medical device area have often been settled through licensing or similar arrangements, costs associated with such arrangements may be substantial and could include ongoing royalties. An adverse determination in a judicial or administrative proceeding or failure to obtain necessary licenses could prevent the Company from manufacturing and selling its products, which would have a material adverse effect on the Company's business, results of operations and financial condition. Conversely, litigation may be necessary to enforce patents issued to the Company, to protect trade secrets or know-how owned by the Company 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.

GOVERNMENT REGULATION

The medical devices to be marketed and manufactured by the Company 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 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 the Company.

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), and 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 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 predicate 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 the Company's business, financial condition and results of operations. For any of the Company's products that are cleared through the 510(k) process, 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 test, 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 includes 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.

The Company has obtained 510(k) clearance for its OcuLight SL, OcuLight SLx and OcuLight GL consoles and a number of peripheral delivery devices including the EndoProbe, the Laser Indirect Ophthalmoscope, the Slit Lamp Adapter, the G-Probe and the DioPexy Probe, for photocoagulation of tissues and structures in the eye in the treatment of various retinal and glaucoma diseases. The Company has also made certain modifications to the Slit Lamp Adapter that the Company has determined do not require the submission of a new 510(k) notification. However, there can be no assurance that the FDA will agree with the Company's determination that a 510(k) notification is not required for the Slit Lamp Adapter modifications nor that FDA will not require the Company to submit a new 510(k) notification for the modification. If the FDA requires the Company to submit a new 510(k) notification for the modified Slit Lamp Adapter, the Company may be prohibited from marketing the modified device until the 510(k) notification is cleared by the FDA.

In July 1991, the Company submitted a 510(k) notification to obtain clearance for use of its Slit Lamp Adapter for use in iridectomy and other indications. After conducting an initial review of the submission, the FDA indicated that clinical data would be required in order for the agency to make a substantial equivalence determination regarding use of the device for iridectomy. As a result, the Company obtained FDA approval of an investigational device exemption ("IDE") to conduct clinical studies of the Slit Lamp Adapter for iridectomy. Although the Company obtained IDE approval in September 1992, to date, no patients have been recruited for the study. There can be no assurance that once clinical data are collected and submitted to the FDA, that they will be adequate to establish substantial equivalence, that the FDA will not require additional clinical data, or that the FDA will grant 510(k) clearance in a timely manner, if at all.

The Company has also established a strategic alliance with Miravant to manufacture a device designed to photoactivate an ophthalmic drug currently under development by Miravant. Miravant is responsible for obtaining the required regulatory approvals. Under the FDA's combination products policy, the ophthalmic drug and photoactivating device may be considered a drug-device combination product and, therefore, be required to undergo the new drug approval process. The steps required before a new drug can be commercially distributed in the United States include (1) conducting appropriate pre-clinical laboratory and animal tests, (2) submitting to the FDA an application for an investigational new drug ("IND"), which must become effective before clinical trials may commence, (3) conducting well-controlled human clinical trials that establish the safety and effectiveness of the drug, (4) filing with the FDA a new drug application ("NDA"), and (5) obtaining FDA approval of the NDA prior to any commercial distribution of the drug. The new drug approval process is expensive, lengthy and uncertain, and many new drug products have never been approved for marketing. There can be no assurance that an approved NDA would not be required for the ophthalmic drug and photoactivating device as a combination product or, if required, that such approval could be obtained. In addition, there can be no assurance that the FDA would not require separate premarket clearance for the photoactivating device through either a 510(k) notification or a PMA or, if required, that such premarket clearance or approval could be obtained.

The Company has received 510(k) clearance for the DioLite 532 console, a new product for the dermatological market to treat vascular and pigmented skin lesions, and the DioLite handpieces. The Company introduced the DioLite 532 in June 1997.

Any products manufactured or distributed by the Company 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 the Company 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. The Company and its products are also subject to a variety of state laws and regulations in those states or localities where its products are or will be marketed. Any applicable state or local regulations may hinder the Company's ability to market its 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. There can be no assurance that the Company will not be required to incur significant costs to comply with such laws and regulations now or in the future or that such laws or regulations will not have a material adverse effect upon the Company's ability to do business.

Exports of the Company's 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 the Company's products in foreign markets will also subject the Company 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, and no assurance can be given that the necessary approvals or clearances will 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 the business, financial condition and results of operations of the Company.

Changes in existing requirements or adoption of new requirements or policies by the FDA or other foreign and domestic regulatory authorities could adversely affect the ability of the Company to comply with regulatory requirements. Failure to comply with regulatory requirements could have a material adverse effect on the Company's business, financial condition and results of operations. There can be no assurance that the Company will not be required to incur significant costs to comply with laws and regulations in the future or that laws or regulations will not have a material adverse effect upon the Company's business, financial condition or results of operations.

REIMBURSEMENT

The Company's 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 carefully review and are increasingly challenging the prices charged for medical products and services. Reimbursement rates from private companies vary depending on the procedure performed, the third-party payor, the insurance plan and other factors. Medicare reimburses hospitals on a prospectively-determined fixed amount for the costs associated with an in-patient hospitalization based on the patient's discharge diagnosis, and 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 unrelated to the specific devices used in that procedure. Third- party payers are increasingly scrutinizing whether to cover new products and the level of reimbursement for covered products.

While the Company believes that the laser procedures using its products have generally been reimbursed, payers may deny coverage and reimbursement for the Company's products if they determine that the device was not reasonable and necessary for the purpose for which used, was investigational or was not cost-effective. Additionally, there can be no assurance that Miravant will be able to obtain coverage for its use of drugs with the Company's OcuLight Systems, or that the reimbursement will be adequate to cover the treatment procedure. The inability of doctors, clinics, hospitals and other users of the Company's products to obtain adequate reimbursement for use of the Company's products from third-party payers, and/or changes in government legislation or regulation or in private third-party payers' policies toward reimbursement for procedures employing the Company's products could have a material adverse effect on the Company's business, results of operations and financial condition. Moreover, the Company is 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 the Company. Most of the treatment procedures for the Company's DioLite 532 dermatological systems are billed to private-pay customers.

PRODUCT LIABILITY AND INSURANCE

The Company may be subject to product liability claims in the future. The Company's products are highly complex and are used to treat extremely delicate eye tissue as well as to treat skin conditions primarily on the face. The Company's products are often used in situations where there is a high risk of serious injury or adverse side effects. In addition, although the Company recommends that its disposable products only be used once and so prominently labels these products, the Company believes that certain customers may nevertheless reuse these disposable products. Were such a disposable product not adequately sterilized by the customer between such uses, a patient could suffer serious consequences, possibly resulting in a suit against the Company for damages. Accordingly, the manufacture and sale of medical products entails significant risk of product liability claims. Although the Company maintains product liability insurance with coverage limits of $6.0 million per occurrence and an annual aggregate maximum of $7.0 million, there can be no assurance that the coverage of the Company's insurance policies will 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 the Company in excess of its insurance coverage could have a material adverse effect on the Company's business, results of operations and financial condition. To date, the Company has not experienced any product liability claims.

BACKLOG

The Company generally ships its products within a few days after acceptance of a customer's purchase order. Accordingly, the Company does not believe that its backlog at any particular time is indicative of future sales levels. See "Management's Discussion and Analysis of Financial Condition and Results of Operations--Factors That May Affect Future Results--Quarterly Fluctuations in Operating Results."

EMPLOYEES

At December 31, 1997, the Company had a total of 73 full-time employees, including 31 in operations, 21 in sales and marketing, 13 in research and development and 8 in finance and administration. The Company also employs, from time to time, a number of temporary and part-time employees as well as consultants on a contract basis. At December 31, 1997, the Company employed 7 such persons. The Company intends to hire additional personnel during the next twelve months in each of these areas. The Company's future success will depend in part on its ability to attract, train, retain and motivate highly qualified employees, who are in great demand. There can be no assurance that the Company will be successful in attracting and retaining such personnel. The Company's employees are not represented by a collective bargaining organization, and the Company has never experienced a work stoppage or strike. The Company considers its employee relations to be good.

EXECUTIVE OFFICERS OF THE COMPANY

The executive officers of the Company and their ages as of December 31, 1997 were as follows:

Name	Age	Position
Theodore A. Boutacoff	50	President, Chief Executive Officer and Director
Robert Kamenski	43	Chief Financial Officer and Vice President, Administration
Eduardo Arias	53	Senior Vice President, Worldwide Sales
David M. Buzawa	45	Vice President, Product Development
James L. Donovan	60	Vice President, Corporate Business Development
Timothy Powers	37	Vice President, Operations

Mr. Boutacoff co-founded the Company and since February 1989 has served as its President, Chief Executive Officer and a member of its Board of Directors. Prior to co-founding the Company, Mr. Boutacoff held various positions, including Director of New Business and Clinical Development, Director of Marketing and Director of Regulatory Affairs, with the Medical Division of Coherent, Inc., a manufacturer of laser systems for science, medicine and industry. Mr. Boutacoff holds a B.S. degree in civil engineering from Stanford University.

Robert Kamenski joined the Company in March 1997 as Vice President, Finance and Administration and was appointed Chief Financial Officer in October 1997. Prior to joining the Company, from July 1992 to March 1997, Mr. Kamenski held various positions, including Chief Financial Officer and Vice President of Finance and Administration, with TeleSensory Corporation. Mr. Kamenski holds a B.B.A. degree in accounting from the University of Wisconsin-Milwaukee and is a member of the American Institute of CPAs.

Mr. Arias co-founded the Company and served as Vice President, Sales & Marketing from April 1989 until September 1991 when he was promoted to the position of Senior Vice President, Worldwide Sales. Prior to co-founding the Company, Mr. Arias held various positions, including Director of Marketing and Sales, Medical Group and Director of International Operations, at Coherent, Inc.

Mr. Buzawa co-founded the Company and since February 1989 has managed the Company's Product Development group, serving since February 1993 as the Vice President, Product Development. Prior to co-founding the Company, Mr. Buzawa held various positions, including Project Engineer, with Coherent, Inc. Mr. Buzawa holds a B.A. degree in general science from the University of Rochester. Mr. Buzawa served as executive officer of IRIDEX Corporation through February 23, 1998. He presently serves as Vice President, Product Development for IRIS Medical Instruments, Inc., a wholly-owned subsidiary of IRIDEX Corporation, focusing on ophthalmology.

Mr. Donovan co-founded the Company and, since February 1989, has served as a member of its Board of Directors. From February 1989 to October 1997, Mr. Donovan served as its Chief Financial Officer, except in the period June to November 1996, and is currently serving as its Vice President, Corporate Business Development. Prior to co-founding the Company, Mr. Donovan served as General Manager of the Medical Division and Chief Financial Officer of Coherent, Inc. Mr. Donovan holds a B.S. degree in business administration from Southern Oregon State College.

Mr. Powers joined the Company in July 1997 as Vice President, Operations. Prior to joining the Company, from November 1988 to July 1997, Mr. Powers held various positions, including Vice President of Operations, at Strato/Infusaid, Inc., a Pfizer subsidiary. Mr. Powers holds a Masters of Management Science degree in manufacturing engineering and a Bachelors of Science degree in industrial technology, both from the University of Lowell in Massachusetts.

ITEM 2. PROPERTIES

The Company relocated its operating facilities in September 1997 to 37,000 square feet of space in Mountain View, California. The new building houses manufacturing, research and development and serves as the Company's headquarter offices. The lease term expires in 2002 and contains a renewal option.

Management believes that its new facility will be adequate for its 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

The Company's Common Stock has been traded on the Nasdaq National Market System under the symbol "IRIX" since the Company's initial public offering on February 15, 1996. The following table sets forth for the periods indicated the high and low closing prices for the Common Stock.

	HIGH	LOW
FISCAL 1996		
First Quarter (from February 15, 1996)	$10.875	$ 9.750
Second Quarter	16.750	10.250
Third Quarter	15.500	6.875
Fourth Quarter	9.500	6.250

FISCAL 1997		
First Quarter	$ 8.750	$ 4.750
Second Quarter	9.625	5.375
Third Quarter	12.625	8.250
Fourth Quarter	12.375	7.500
FISCAL 1998		
First Quarter (through March 19, 1998)	$ 9.125	$ 6.500

On March 19, 1998, the closing price on the Nasdaq National Market for the Company's Common Stock was $8.38 per share. As of December 31, 1997, there were approximately 78 holders of record of the Company's Common Stock.

DIVIDEND POLICY

The Company has never paid cash dividends on its Common Stock. The Company currently intends to retain any earnings for use in its business and does not anticipate paying cash dividends in the foreseeable future. In addition, the payment of cash dividends by the Company to its stockholders is currently prohibited by the Company's bank line of credit. See Note 4 of Notes to Consolidated Financial Statements.

ITEM 6. SELECTED FINANCIAL DATA

The following selected consolidated financial data as of and for the years ended December 31, 1993, 1994, 1995, 1996 and 1997 have been derived from and are qualified by reference to, the consolidated financial statements of the Company audited by Coopers & Lybrand L.L.P., independent accountants. The selected consolidated statement of income data as of December 31, 1993 and 1994 and the consolidated balance sheet data as of December 31, 1993, 1994 and 1995 have been derived from the Company's 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 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 the consolidated financial statements included in Item 8. "Financial Statements and Supplementary Data."

	1993	1994	1995	1996	1997
	(in thousands, except per share data)				
CONSOLIDATED STATEMENT OF INCOME DATA:					
Sales	$ 5,564	$ 7,182	$ 8,801	$ 12,364	$ 18,073
Cost of sales	2,280	2,423	2,798	4,899	7,612
Gross profit	3,284	4,759	6,003	7,465	10,461
Operating expenses:					
Research and development	528	629	742	1,286	1,716
Selling, general and administrative	2,601	3,383	3,787	5,197	6,074
Nonrecurring charge for acquisition of technology(1)	--	--	80	--	--
Total operating expenses	3,129	4,012	4,609	6,483	7,790
Income from operations	155	747	1,394	982	2,671
Other income (expense), net	(24)	(1)	58	699	607
Income before provision for income taxes	131	746	1,452	1,681	3,278
Benefit (provision) for income taxes	--	1,039	(452)	(676)	(1,180)
Net income	$ 131	$ 1,785	$ 1,000	$ 1,005	$ 2,098
Net income per common share (2)	$ 0.11	$ 1.60	$ 0.78	$ 0.18	$ 0.33
Shares used in per common share calculation(2)	1,142	1,118	1,276	5,725	6,406
Net income per common share-assuming dilution(2)	$ 0.03	$ 0.42	$ 0.23	$ 0.16	$ 0.31
Shares used in per common share-assuming dilution calculation(2)	4,248	4,242	4,354	6,410	6,755

	December 31,				
	1993	1994	1995	1996	1997
	(in thousands)				
CONSOLIDATED BALANCE SHEET DATA:					
Cash, cash equivalents and available-for-sale securities	$ 269	$ 684	$1,227	$15,114	$13,488
Working capital	$1,554	$2,973	$4,339	$20,777	$21,716
Total assets	$2,603	$4,436	$6,395	$23,707	$26,686
Total stockholders' equity	$1,642	$3,436	$4,685	$21,478	$23,880

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(1) Reflects the write-off from the purchase of in-process research and development. See Note 2 of Notes to Consolidated Financial Statements.

(2) See Note 10 of Notes to Consolidated Financial Statements for an explanation of shares used in per share calculation.

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

The discussion in Management's Discussion and Analysis of Financial Condition and Results of Operations contains trend analysis and other 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. Actual results could differ materially from those set forth in such forward looking statements as a result of the factors set forth under "Factors That May Affect Future Results" and other risks detailed from time to time in the Company's reports filed with the Securities and Exchange Commission.

OVERVIEW

IRIDEX Corporation ("IRIDEX" or the "Company") is the leading worldwide provider of semiconductor-based laser systems used to treat eye diseases in ophthalmology and skin lesions in dermatology. IRIDEX products are sold in the United States predominantly through a direct sales force and internationally through 53 independent distributors into 72 countries. The Company markets its products using three brand names: IRIS Medical to the ophthalmic market, IRIDERM to the dermatological market, and Light Solutions to the research market.

The Company's ophthalmic products treat eye diseases, including the three leading causes of irreversible blindness. The current family of ophthalmic laser systems includes the IRIS Medical OcuLight SL, OcuLight SLx and OcuLight GL Laser Photocoagulation systems (each an "OcuLight System"). Since its first shipment in 1990, more than 1,800 OcuLight Systems have been sold worldwide, primarily for hospital and office-based use by ophthalmic specialists. The Company's dermatological products treat skin diseases, primarily vascular and pigmented lesions. In June 1997, the Company launched the IRIDERM DioLite 532 Laser System to address the dermatological market. The DioLite 532 Laser System is sold primarily for office-based use by dermatologists. Each ophthalmic and dermatological system consists of a small, portable laser console and interchangeable delivery devices. The Company believes that its semiconductor-based systems are more portable and economical and have a greater degree of reliability and flexibility than competing systems which use traditional vacuum tube-based technology.

The Company's sales consist of the purchase price of its IRIS Medical OcuLight System and IRIDERM DioLite 532 consoles and delivery devices, disposable products and, to a lesser extent, revenues from service and support activities, the sale of Light Solutions products and research grants. Revenue from product sales is generally recognized at the time of shipment (net of allowances or discounts), while revenue from services is recognized upon performance of the applicable services. The Company's sales have increased primarily due to growth in unit sales (including additional unit sales resulting from the introduction of the OcuLight GL during the second half of 1996 and the DioLite 532 in June 1997), greater market penetration and an expanded product offering. The Company believes that future growth in unit sales will be derived both from a growth in the market for photocoagulator products and from the replacement of installed photocoagulators which use vacuum tube-based technology.

Sales in the United States are derived from direct sales to end users and internationally are derived from sales to 53 distributors who resell to hospitals and physicians. Sales to international distributors are made on open credit terms or letters of credit and generally are not subject to a right of return unless the Company terminates a distributor. Although international sales of the Company's products are currently denominated in United States dollars, international sales are subject to a variety of risks including fluctuations in foreign currency exchange rates, shipping delays, generally longer receivables collection periods, changes in applicable regulatory policies, international monetary conditions, domestic and foreign tax policies, trade restrictions, duties and tariffs and economic and political instability. The recent currency devaluation in many Asian countries has had the effect of significantly increasing the purchase price of the Company's products to the Company's distributors and their customers in that region. Conversely, because certain of the Company's competitors are based in Asia, the currency devaluations may put additional downward pressures on the average selling prices of the Company's products. Product sales were lower for the affected Asian region during the fourth quarter of 1997 primarily as a result of the currency problem. The Company expects lower sales to the Asian region to continue into 1998. The Company also expects revenues from international sales to continue to account for a substantial portion of its sales. Accordingly, if the Asian economic difficulties are prolonged, worsen or otherwise negatively impact the saleability of the Company's product, these difficulties could negatively impact the Company's business, results of operations, and financial condition. While these currency factors and other factors listed above have been mitigated by product sales in other regions and in the United States, there can be no assurance that future currency fluctuations or other factors discussed above will not have a material adverse effect on the Company's business, financial condition or results of operations. See "--Factors That May Affect Future Results--Dependence on International Sales."

Cost of sales consists primarily of the cost of purchasing components and sub-systems, assembling, packaging and testing components at the Company's facility, and the direct labor and overhead associated therewith. Cost of service and support consists of expenses related directly to service, support and training activities. Product development expenses consist primarily of personnel costs, materials and research support provided to clinicians at medical institutions developing new applications which utilize the Company's 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.

Prior to 1995, the Company had not incurred any substantial income tax liability because of its historical operating losses. However, during 1996, the Company utilized its remaining net operating loss carryforwards and began incurring income taxes at statutory tax rates.

RESULTS OF OPERATIONS

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

	1995	1996	1997
Sales	100.0%	100.0%	100.0%
Cost of sales	31.8	39.6	42.1
Gross profit	68.2	60.4	57.9
Operating expenses:			
Research and development	8.4	10.4	9.5
Sales, general and administrative	43.1	42.0	33.6
Nonrecurring charge for acquisition of technology	0.9	--	--
Total operating expenses	52.4	52.4	43.1
Income from operations	15.8	8.0	14.8
Other income, net	0.7	5.6	3.3
Income before provision for income taxes	16.5	13.6	18.1
Provision for income taxes	(5.1)	(5.5)	(6.5)
Net income	11.4%	8.1%	11.6%

Sales. Sales were $18.1 million, $12.4 million and $8.8 million in 1997, 1996 and 1995, respectively, representing increases of 46.2% from 1996 to 1997 and 40.5% from 1995 to 1996. The increase in the Company's sales in 1997 as compared to 1996 was primarily due to increased unit volumes, primarily as a result of increased sales of the OcuLight GL and sales of the DioLite following its introduction in June 1997, offset in part by decreased average selling prices, particularly with respect to the Company's more mature products. The increase in the Company's sales in 1996 as compared to 1995 was also primarily attributable to increased unit volumes, primarily resulting from the introduction of the OcuLight GL in the second half of 1996, offset in part by decreased average selling prices. International sales accounted for 51.8%, 49.6% and 48.7% in 1997, 1996 and 1995, respectively. While international sales as a percentage of revenues increased for 1997, international sales were lower during the fourth quarter as compared to the first half of 1997, partially due to the recent currency devaluation in many Asian countries. The impact on the Company of lower sales in Asia was offset by strong sales in the U.S. during the same fourth quarter. While these currency factors have been mitigated by product sales in other regions and in the United States, there can be no assurance that future currency fluctuations or other factors discussed above will not have a material adverse effect on the Company's business, financial condition or results of operations. While the OcuLight GL was introduced in the third quarter of 1996, the Company's ability to ship the OcuLight GL in volume during 1996 and the first half of 1997 was negatively affected by delivery problems associated with a sole source component. The Company qualified a second source for that component in the first quarter of 1997 and began to receive shipments from the second source supplier in the second quarter of 1997. The Company believes that deliveries from the two diode sources should meet its requirements for 1998. The Company expects future growth in sales to be primarily derived from sales of the OcuLight GL and the DioLite 532. See "--Factors That May Affect Future Results--Risks of Manufacturing and Dependence on Key Manufacturers and Suppliers."

Gross Profit. Gross profit was $10.5 million, $7.5 million and $6.0 million in 1997, 1996 and 1995 representing 57.9%, 60.4% and 68.2% of sales in each of such periods, respectively. Gross profit as a percentage of sales decreased in 1997 as compared to 1996 primarily due to increased sales of the Company's OcuLight GL as well as an increase in international sales which, on average, have lower gross profit margins. Gross profit as a percentage of sales was lower in 1996 as compared to 1995 primarily due to the costs associated with starting up manufacturing of the new OcuLight GL. Moreover, increasing competition has continued to result in a downward trend in average selling prices and has thereby lead to lower gross profit margins. The Company intends to continue its efforts to reduce the cost of components and thereby mitigate the impact of price reductions on its

gross profit. Although the Company believes gross profit in dollars will increase as volumes increase, critical components are received on schedule and costs are engineered out of the new product, 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.

Research and Development. Research and development expenses increased by 33.4% in 1997 to $1,716,000 and by 73.3% in 1996 to $1,286,000 from $742,000 in 1995, representing 9.5%, 10.4% and 8.4% of sales in these periods, respectively. The increase in research and development expenses during 1997 was primarily attributable to an increase in personnel as the Company strengthened its product development efforts, particularly those directed at the introduction of the DioLite 532. The Company expects these expenses for research and development to continue to increase in absolute dollars during 1998 in connection with new product development activities. The increase in research and development expenses in 1996 as compared to 1995 was primarily attributable to higher expenses incurred in connection with the development of the OcuLight GL. The Company also conducts research and development pursuant to grants from the U.S. Federal Government. Under the terms of many of these grants, the Company typically retains the right to commercially market the technology developed by the Company. The amounts received by the Company for these research and development efforts are recognized as sales, and the related labor and material costs are charged to cost of sales. As a result, the Company's reported research and development expense does not completely reflect the Company's research and development efforts.

Sales, General and Administrative. Sales, general and administrative expenses grew by 16.9% in 1997 to $6.1 million and by 37.2% in 1996 to $5.2 million from $3.8 million in 1995, representing 33.6%, 42.0% and 43.1% of sales in these periods, respectively. The increases in sales, general and administrative expenses in these periods were primarily due to the hiring of additional sales and marketing employees to address new sales opportunities and to support expanding unit volumes, higher sales commissions and the growth in the infrastructure of the Company's finance, administrative and operations group which were necessary to support the Company's expanded operations. Costs associated with the launch of the DioLite 532 and sales of the OcuLight GL during 1997 also increased sales and marketing expenses during this period. In addition, general and administrative expenses increased due to the Company's recent move to a new facility. The increase in sales, general and administrative expenses for these periods were partially offset by decreases in sales expenses associated with increasing international sales to independent, non-employee, non-commissioned distributors.

Nonrecurring Charge for Acquisition of Technology. In the fourth quarter of 1995, the Company wrote off $80,000, or 0.9% of sales in 1995, of in-progress research and development costs in connection with an acquisition.

Other income, net. Other income, net consists primarily of interest income. Interest income was $623,000, $691,000 and $64,000 in 1997, 1996 and 1995, respectively. This income was primarily from interest earned on short-term investments. Interest income decreased in 1997 because of increased investments in lower yield, tax preferred securities and investments in leasehold improvements associated with the Company's new facility.

Income Taxes. The Company had an effective tax rate of 36%, 40% and 31% in 1997, 1996 and 1995, respectively. The rate for 1995 differs from the statutory rate of 40% primarily due to the utilization of net operating losses. In addition, in 1995, the Company reversed $280,000 of its valuation allowance due to management's determination that it was more likely than not that the related deferred tax assets would be utilized. The Company utilized its entire remaining net operating loss carry forwards during 1996. The tax rate for 1997 was lower than the statutory rate because of certain tax benefits associated with the Foreign Sales Corporation ("FSC") created in September 1996 and increased investments in tax preferred securities.

LIQUIDITY AND CAPITAL RESOURCES

In February 1996, the Company sold 1,982,500 shares of its Common Stock in connection with its initial public offering ("IPO"). The net proceeds of this offering were approximately $15.7 million after deducting underwriting discounts and commissions and expenses of the offering. The Company has used a portion of the net proceeds from the IPO for purchases of inventory, leasehold improvements and payment of certain accrued liabilities.

At December 31, 1997, the Company's primary sources of liquidity included cash, cash equivalents and short term investments of $13.5 million. In addition, the Company has available $1,000,000 under its unsecured line of credit which bears interest at the bank's prime rate and expires in September 1998. At December 31, 1997, no borrowings were outstanding under this credit facility. The Company believes that, based on current estimates, its current cash balances, short term investments, net cash provided by operating activities and its credit facility will be sufficient to meet its working capital and capital expenditure requirements at least through the next twelve months. However, the Company believes that the level of financial resources is a significant competitive factor in its industry, and accordingly the Company may choose prior to the end of 1998 to raise additional capital through debt or equity financing.

Net cash used in operations totaled $88,000 and $1,256,000 in 1997 and 1996, respectively. Net cash provided from operations totaled $896,000 in 1995. In 1997, sources of cash included net income of $2.1 million and increases in accounts payable and accrued liabilities of $584,000, offset by increases in inventories of $2.1 million and increases in accounts receivable of $732,000. In 1996, sources of cash included net income of $1.1 million and increases in accounts payable and accrued liabilities of $525,000, offset by increases in accounts receivable of $2.8 million and increases in inventories of $603,000. The increase in inventories is primarily due to an increase in supplies of key components and dual sourcing. During 1996, while the Company waited for FDA approval of the OcuLight GL, the Company built up its inventory of the OcuLight SL in order to be able to allocate substantial manufacturing resources to producing the OcuLight GL. When the introduction of the OcuLight GL was delayed due to delays in FDA approval and the inability to obtain certain components, the Company experienced increases in inventory levels and manufacturing labor inefficiencies. To improve manufacturing efficiency in 1997, the Company engineered dual sources for key components of the OcuLight GL and initiated a purchasing program to increase the amount of safety stock of key components. These measures resulted in increased levels of materials inventory which the Company reduced in part in 1997 as the Company reduced the inventory level of the OcuLight SL. The Company intends to continue to maintain an increased level of inventory of certain key components.

The Company used approximately $4,418,000, $1,646,000 and $235,000 for investing activities in 1997, 1996 and 1995, respectively, primarily for the purchase of available-for-sale securities in 1997 and 1996, and the acquisition of fixed assets in 1997, 1996 and 1995. Net cash provided by financing activities during 1997 and 1996 were $299,000 and $15,782,000, respectively, which consisted primarily of issuance of stock, including the Company's 1996 initial public offering. Net cash used in financing activities in 1995 consisted of approximately $118,000 for the repayment of funds previously borrowed under the Company's bank line of credit.

RECENT ACCOUNTING PRONOUNCEMENTS

In June 1997, the FASB issued Statement of Financial Accounting Standards (SFAS) No. 130, "Reporting Comprehensive Income." SFAS No. 130 establishes standards for the reporting and display of comprehensive income and its components in a full set of general purpose financial statements. Comprehensive income is defined as the change in equity of a business enterprise during a period from transactions and other events and circumstances from nonowner sources. The impact of adopting SFAS No. 130, which is effective for the Company in 1998, has not been determined.

In June 1997, the FASB issued SFAS No. 131, "Disclosure about Segments of an Enterprise and Related Information." SFAS No. 131 requires publicly-held companies to report financial and other information about key revenue-producing segments of the entity for which such information is available and is utilized by the chief operating decision maker. Specific information to be reported for individual segments includes profit or loss, certain revenue and expense items and total assets. A reconciliation of segment financial information to amounts reported to the financial statements would be provided. SFAS No. 131 is effective for the Company in 1998 and the impact of adoption has not been determined.

FACTORS THAT MAY AFFECT FUTURE RESULTS

Continued Market Acceptance of the Company's Products. The Company currently markets visible and invisible light semiconductor-based photocoagulator medical laser systems to the ophthalmic market and a visible light semiconductor-based photocoagulator medical laser system to the dermatological market. The Company believes that continued and increased sales, if any, of these medical laser systems is dependent upon the continued market acceptance of these products. Medical equipment purchasing decisions and continued market acceptance of the Company's products may in turn depend on opinions of medical professionals, performance and price,product and treatment familiarity, procedure reimbursement economics and other factors. The Company believes that recommendations by ophthalmologists and dermatologists as to the use of semiconductor-based laser systems is essential for the continued market acceptance of the Company's products. Such medical professionals may not recommend these laser systems or related treatments unless they conclude, based on clinical data and other factors, that the performance of these laser systems and treatments are a beneficial alternative to competing technologies and treatments. Favorable recommendations from such medical professionals is particularly important to the Company because the ophthalmic and dermatological communities historically have used more established visible light, argon gas or other ion-based photocoagulation laser systems. The Company's semiconductor-based laser systems are relatively new to the marketplace. The Company's infrared laser systems deliver invisible light to provide additional and, in some instances, improved treatments. Because many ophthalmologists and dermatologists have been trained in medical school using visible argon gas or other ion-based laser systems, they may be reluctant or unwilling to convert to semiconductor-based or infrared laser systems. In addition, ophthalmic procedures are typically reimbursed by third party payers who are increasingly scrutinizing the level of reimbursement for treatment procedures. Furthermore, changes in government legislation or regulation could effect reimbursement levels. A reduction in the level of reimbursement for treatments administered with the Company's ophthalmic products would negatively impact the saleability of such products. Dermatological procedures are typically paid for by the treated patient. Any reduction in the perceived value of such treatments would reduce the price level that dermatologists can charge and would negatively impact the saleability of such products. There can be no assurance that the Company's medical laser systems will continue to be accepted by the market. The failure of medical professionals to recommend the Company's laser systems, the introduction of improved alternative technologies or treatments, the reluctance or unwillingness of ophthalmologists or dermatologists to convert to semiconductor-based laser systems or to infrared laser systems, or reductions in treatment reimbursements would negatively impact the market acceptance of the Company's products. Any significant decline in market acceptance of the Company's products would have a material adverse effect on the Company's business, results of operations and financial condition.

Competition. Competition in the market for devices used for ophthalmic and dermatological treatments is intense and may increase. This market is also characterized by rapid technological innovation and change, and the Company's products could be rendered obsolete as a result of future innovations. The Company's 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, the Company's products compete with pharmaceutical treatments, other technologies and other surgical techniques.

The Company's principal competitors in ophthalmology are Coherent, Inc., Nidek, Inc. ("Nidek"), Carl Zeiss, Inc. ("Zeiss"), Alcon International ("Alcon"), Keeler Instruments, Inc. ("Keeler") and HGM Medical Laser Systems, Inc. ("HGM"). Of these companies, Nidek, Zeiss, Alcon and Keeler currently offer a semiconductor-based laser system in ophthalmology, and other companies may introduce a semiconductor-based laser system. The Company's principal competitors in dermatology are Laserscope and HGM, neither of which currently offers a semiconductor-based laser system in dermatology. Other competitors have substantially greater financial, engineering, product development, manufacturing, marketing and technical resources than the Company. Such companies may also have greater name recognition than the Company and long-standing customer relationships. In addition, there can be no assurance that other medical companies, academic and research institutions or others will not 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 ophthalmic and dermatological conditions targeted by the Company or are less expensive than the Company's current or future products. Moreover, there can be no assurance that the Company's technologies and products would not be rendered obsolete by such developments. Any such developments could have a material adverse effect on the business, financial condition and results of operations of the Company.

Risks of Manufacturing and Dependence on Key Manufacturers and Suppliers. The manufacture of the Company's infrared and visible light semiconductor-based photocoagulator medical laser systems and the related delivery devices is a highly complex and precise process which requires the integration of components with unique characteristics. Accordingly, problems may occur in the manufacture of the Company's products which could prevent shipping of some products or could result in reduced bookings, manufacturing rework costs, delays in collecting accounts receivable, additional service and warranty costs and a decline in the Company's competitive position. There can be no assurance that the Company will be able to continue to manufacture its existing products or future products on a cost-effective and timely basis. Although the Company assembles critical subassemblies as well as the final product at its facility in Mountain View, California, the Company relies on third parties to manufacture substantially all of the components used in its products. There are risks associated with the use of independent manufacturers, unavailability of or delays in obtaining adequate supplies of components such as optics and laser diodes and potentially reduced control of quality, production costs and the timing of delivery. The Company has qualified two or more sources for most of the components used in its products. However, certain of the Company's products remain significantly dependent on sole source suppliers. Certain diodes purchased from SDL, Inc. ("SDL") were not readily available from other suppliers until the second quarter of 1997. During 1996 and the first quarter of 1997, the Company experienced delays in its manufacturing of the OcuLight GL because of the inability of SDL to deliver components in volume and on a timely basis. The Company continues to work with this supplier to ensure such difficulties do not recur. During the first quarter of 1997, the Company qualified Opto Power as a second source of this diode component. Because laser diode components are extremely complex and difficult to manufacture, there can be no assurance that the Company's suppliers of such components will be able to timely deliver components in sufficient quantities to meet the Company's requirements. Similar manufacturing issues or delays in the delivery of other key components of the Company's products could also have a material adverse impact on the Company. The Company does not have long-term or volume purchase agreements with any of its suppliers and currently purchases components on a purchase order basis. No assurance can be given that these components will be available in the quantities required by the Company, on reasonable terms, or at all. Establishing its own capabilities to manufacture these components would require significant scale-up expenses and additions to facilities and personnel and could significantly decrease the Company's profit margins. The Company's inability to obtain components as required at a reasonable cost, or at all, would have a material adverse affect on the Company's business, results of operations and financial condition.

Dependence on International Sales. The Company derives, and expects to continue to derive, a large portion of its revenue from international sales. In 1997, 1996 and 1995, the Company's international sales were $9.4 million, $6.1 million, and $4.3 million, representing 51.8%, 49.6% and 48.7%, respectively, of total sales.

A large portion of the Company's revenues will continue to be subject to the risks associated with international sales, including fluctuations in foreign currency exchange rates, shipping delays, generally longer receivables collection periods, changes in applicable regulatory policies, international monetary conditions, domestic and foreign tax policies, trade restrictions, duties and tariffs, and economic and political instability. The recent currency devaluation in many Asian countries has had the effect of significantly increasing the purchase price of the Company's products to the Company's distributors and their customers in that region. Conversely, because certain of the Company's competitors are based in Asia, the currency devaluations may put additional downward pressures on the average selling prices of the Company's products. Product sales were lower for the affected Asian region during the fourth quarter of 1997 primarily as a result of the currency problem. The Company expects lower sales to the Asian region to continue into 1998. The Company also expects revenues from international sales to continue to account for a substantial portion of its sales. Accordingly, if the Asian economic difficulties are prolonged, worsen or otherwise negatively impact the saleability of the Company's product, these difficulties could negatively impact the Company's business, results of operations, and financial condition. While these currency factors and other factors listed above have been mitigated by product sales in other regions and in the United States, there can be no assurance that future currency fluctuations or other factors discussed above will not have a material adverse effect on the Company's business, financial condition or results of operations.

Quarterly Fluctuations in Operating Results. Although the Company has been profitable on an annual and quarterly basis for the last five years, the Company's sales and operating results have varied substantially on a quarterly basis, and such fluctuations are expected to continue in future periods. The Company's operating results are affected by a number of factors, many of which are beyond the Company's control. Factors contributing to these fluctuations include the timing of the introduction and market acceptance of new products or product enhancements by the Company and its competitors, the cost and availability of components and subassemblies, changes in pricing by the Company and its competitors, the timing of the development and market acceptance of new applications for the Company's products, the relatively long and highly variable sales cycle for the Company's products to hospitals and other health care institutions, fluctuations in economic and financial market conditions, such as the recent currency devaluation in Asia, and resulting changes in customers' or potential customers' budgets and increased product development costs. For example, the Company's gross profits as a percentage of sales have declined in part as a result of increased competition which have led to decreases in average selling prices, particularly with respect to the Company's older products. Any inability to obtain adequate quantities of the critical components used in the system products would adversely impact the Company's ability to ship the OcuLight SL, OcuLight GL and the DioLite 532. In addition to these factors, the Company's quarterly results have been and are expected to continue to be affected by seasonal factors. For example, domestic sales often decline slightly prior to the meeting of the American Academy of Ophthalmology in the fourth quarter of the year. The Company manufactures its products to forecast rather than to outstanding purchase orders, and products are typically shipped shortly after receipt of a purchase order. While backlog increased in 1996 and 1997, the Company does not expect significant backlog in the future and the amount of backlog at any particular date is generally not indicative of its future level of sales. Although the Company's manufacturing procedures are designed to assure rapid response to customer orders, they may in certain instances create a risk of excess or inadequate inventory levels if orders do not match forecasts. The Company's expense levels are based, in part, on expected future sales. If sales levels in a particular quarter do not meet expectations, the Company may be unable to adjust operating expenses quickly enough to compensate for the shortfall, and the Company's results of operations may be adversely affected. In addition, the Company has historically made a significant portion of each quarter's product shipments near the end of the quarter. If that pattern continues, even short delays in shipment of products at the end of a quarter could have a material adverse effect on results of operations for such quarter. As a result of the above factors, sales for any future quarter are not predictable with any significant degree of accuracy and operating results in any period should not be considered indicative of the results to be expected for any future period. There can be no assurance that the Company will remain profitable in the future or that operating results will not vary significantly.

Dependence on Development of New Products and New Applications. The Company's future success is dependent upon, among other factors, its ability to develop, obtain regulatory approval, manufacture and introduce on a timely and cost-effective basis as well as 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, including price, safety, efficacy, reliability, marketing and sales efforts, the development of new applications for these products and general economic conditions affecting purchasing patterns. Even if the Company's products achieve clinical acceptance, there can be no assurance that the Company can successfully manage the introduction of such products into the ophthalmic, dermatological or other markets. The failure of the Company to successfully develop and introduce new products or enhanced versions of existing products could have a material adverse effect on the Company's business, operating results and financial condition. The Company is seeking to expand the market for its existing and new products by working with clinicians and third parties to identify new applications for its products, validating new procedures which utilize its products and responding more effectively to new procedures. There can be no assurance that the Company's efforts to develop new applications for its products will be successful, that it can obtain regulatory approvals to use its products in new clinical applications in a timely manner, or at all, or gain satisfactory market acceptance for such new applications. Failure to develop and achieve market acceptance of new applications or new products would have a material adverse effect on the Company's business, results of operations and financial condition.

Management of Growth. With the introduction of new products, the Company has recently experienced, and may continue to experience growth in production, the number of employees, the scope of its business, its operating and financial systems and the geographic area of its operations. This growth has resulted in new and increased responsibilities for management personnel and has placed and continues to place a significant strain upon the Company's management, operating, inventory and financial systems and resources. To accommodate recent growth and to compete effectively and manage future growth, if any, the Company has been required to continue to implement and improve operational, financial and management information systems, procedures and controls and to expand, train, motivate and manage its work force. The Company is in the process of implementing a new enterprise resource planning ("ERP") system to run the Company's business transaction processes. The Company expects that the installation and implementation of this new system will continue through the third quarter of 1998. The transition to the ERP system is a highly complex and technical process, and it is not uncommon for companies engaged in such a transition to experience unexpected delays and technical problems. Because the Company's operations are currently dependent on its existing system and will be dependent upon the new system once it comes on line, the failure of the Company to successfully implement the ERP system or difficulties encountered in the changeover to the new system may have a material adverse effect on the Company's business and results of operations. There can be no assurance that the Company will be able to successfully install and implement the ERP system, and failure to do so or difficulties encountered in the implementation process could have a material adverse effect on the Company's business, results of operations and financial condition. The Company's future success will depend on the successful installation of these systems as well as on the ability of its current and future executive officers to operate effectively, both independently and as a group. There can be no assurance that the Company's personnel, systems, procedures and controls will be adequate to support the Company's existing and future operations. Any failure to implement and improve the Company's operational, financial and management systems or to expand, train, motivate or manage employees could have a material adverse effect on the Company's business, results of operations and financial condition.

Dependence on Collaborative Relationships. The Company has entered into collaborative relationships with academic medical centers and physicians in connection with the research and development and clinical testing of its products. The Company plans to collaborate with third parties to develop and commercialize existing and new products. In May 1996, the Company executed an agreement with Miravant Medical Technologies, formerly known as PDT, Inc., ("Miravant"), a maker of photodynamic drugs, under which the Company and Miravant have collaborated to develop a device that emits a laser beam to activate a photodynamic drug developed by Miravant to achieve a desired therapeutic result in the treatment of age-related macular degeneration. The development, clinical testing and regulatory approval of this new photodynamic system will require three to five years and significant financial and other resources. There can be no assurance that this collaborative development

effort will continue or that it will result in the successful development and introduction of a photodynamic system. The Company believes that these current and future relationships are important because they may allow the Company greater access to funds, to research, development and testing resources and to manufacturing, sales and distribution resources. However, the amount and timing of resources to be devoted to these activities are not within the Company's control. There can be no assurance that such parties will perform their obligations as expected or that the Company's reliance on others for clinical development, manufacturing and distribution of its products will not result in unforeseen problems. Further, there can be no assurance that the Company's collaborative partners will not develop or pursue alternative technologies either on their own or in collaboration with others, including the Company's competitors, as a means of developing or marketing products for the diseases targeted by the collaborative programs and by the Company's products. The failure of any current or future collaboration efforts could have a material adverse effect on the Company's ability to introduce new products or applications and therefore could have a material adverse effect on the Company's business, results of operations and financial condition.

Patents and Proprietary Rights. The Company's success and ability to compete is dependent in part upon its proprietary information. The Company relies on a combination of patents, trade secrets, copyright and trademark laws, nondisclosure and other contractual agreements and technical measures to protect its intellectual property rights. The Company files patent applications to protect technology, inventions and improvements that are significant to the development of its business. The Company has been issued six United States patents on the technologies related to its products and processes. There can be no assurance that any of the Company's patent applications will issue as patents, that any patents now or hereafter held by the Company will offer any degree of protection, or that the Company's patents or patent applications will not be challenged, invalidated or circumvented in the future. Moreover, there can be no assurance that the Company's competitors, many of which have substantial resources and have made substantial investments in competing technologies, will not seek to apply for and obtain patents that will prevent, limit or interfere with the Company's ability to make, use or sell its products either in the United States or in international markets.

In addition to patents, the Company relies on trade secrets and proprietary know-how which it seeks to protect, in part, through proprietary information agreements with employees, consultants and other parties. The Company's proprietary information agreements with its employees and consultants contain industry standard provisions requiring such individuals to assign to the Company without additional consideration any inventions conceived or reduced to practice by them while employed or retained by the Company, subject to customary exceptions. There can be no assurance that proprietary information agreements with employees, consultant and others will not be breached, that the Company would have adequate remedies for any breach, or that the Company's trade secrets will not otherwise 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 and 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 competitors of the Company. Because patent applications are maintained in secrecy in the United States until patents are issued and are maintained in secrecy for a period of time outside the United States, the Company has not conducted any searches to determine whether the Company's technology infringes any patents or patent applications. The Company has from time to time been notified of, or has otherwise been made aware of claims that it may be infringing upon patents or other proprietary intellectual property owned by others. If it appears necessary or desirable, the Company may seek licenses under such patents or proprietary intellectual property. Although patent holders commonly offer such licenses, no assurance can be given that licenses under such patents or intellectual property will be offered or that the terms of any offered licenses will be reasonable or will not adversely impact the Company's operating results. Recently, a company has challenged one of the patents held by Light Solutions Corporation, a wholly subsidiary of IRIDEX. The Company believes that this dispute will be settled without a material adverse effect to the Company's business and financial condition.

Any claims, with or without merit, could be time-consuming, result in costly litigation and diversion of technical and management personnel, cause shipment delays or require the Company to develop noninfringing technology or to enter into royalty or licensing agreements. Although patent and intellectual property disputes in the medical device area have often been settled through licensing or similar arrangements, costs associated with such arrangements may be substantial and could include ongoing royalties. An adverse determination in a judicial or administrative proceeding or failure to obtain necessary licenses could prevent the Company from manufacturing and selling its products, which would have a material adverse effect on the Company's business, results of operations and financial condition. Conversely, litigation may be necessary to enforce patents issued to the Company, to protect trade secrets or know-how owned by the Company 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.

Government Regulation. The medical devices marketed and manufactured by the Company are subject to extensive regulation by the FDA and by foreign and state governments. Pursuant to the FDA Act and the regulations promulgated thereunder, 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 manufacturer must obtain market clearance through either the 510(k) premarket notification process or the lengthier premarket approval ("PMA") application process. Obtaining these approvals can take a long time and delay the introduction of a product. For example, the introduction of the OcuLight GL in the United States was delayed about three months from the Company's expectations due to the longer than expected time period required to obtain FDA premarket clearance. Noncompliance with applicable requirements, including QSR, can result in, among other things, fines, injunctions, civil penalties, recall or seizure of products, total or partial suspension of production, failure of the government to grant premarket clearance or premarket 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 the Company. The failure of the Company to obtain government approvals or any delays in receipt of such approvals would have a material adverse effect on the Company's business, results of operations and financial condition.

Product Liability and Insurance. The Company may be subject to product liability claims in the future. The Company's products are highly complex and are used to treat extremely delicate eye tissue as well as to treat skin conditions primarily on the face. The Company's products are often used in situations where there is a high risk of serious injury or adverse side effects. In addition, although the Company recommends that its disposable products only be used once and so prominently labels these products, the Company believes that certain customers may nevertheless reuse these disposable products. Were such a disposable product not adequately sterilized by the customer between such uses, a patient could suffer serious consequences, possibly resulting in a suit against the Company for damages. Accordingly, the manufacture and sale of medical products entails significant risk of product liability claims. Although the Company maintains product liability insurance with coverage limits of $6.0 million per occurrence and an annual aggregate maximum of $7.0 million, there can be no assurance that the coverage of the Company's insurance policies will 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 the Company in excess of its insurance coverage could have a material adverse effect on the Company's business, results of operations and financial condition. To date, the Company has not experienced any product liability claims.

Volatility of Stock Price. The trading price of the Company's Common Stock has been subject to wide fluctuations in response to a variety of factors since the Company's initial public offering in February 1996, including quarterly variations in operating results, announcements of technological innovations or new products by the Company or its competitors, developments in patents or other intellectual property rights, general conditions in the ophthalmic laser industry, revised earning estimates, comments or recommendations issued by analysts who follow the Company, its competitors or the ophthalmic laser industry and general economic and market conditions.

Additionally, the stock market in general, and the market for technology stocks in particular, have experienced extreme price volatility in recent years. Volatility in price and volume has had a substantial effect on the market prices of many technology companies for reasons unrelated or disproportionate to the operating performance of such companies. These broad market fluctuations could have a significant impact on the market price of the Common Stock.

Year 2000 Compliance. The Company uses a significant number of computer software programs and operating systems in its internal operations, including applications for various financial, business and administrative functions. In addition, many of the Company's suppliers use similar applications. These applications may contain source code that is unable to properly interpret calendar years beginning with the upcoming year 2000. Systems that do not properly recognize such date-sensitive information may fail or create erroneous results. Because there are no internal calendars embedded in any of the Company's products, the Company does not anticipate any problems with its products related to the Year 2000 problem will develop. The Company is currently installing a new enterprise resource planning ("ERP") system which it believes will be fully Year 2000 compliant. Based on this and other information currently available to the Company, the Company believes that its internal systems currently are or, by such time as is necessary to avoid a material adverse impact on the Company, will be Year 2000 compliant. Also based on information thus far available to the Company, the Company does not believe that it will incur expenditures in dealing with Year 2000 issues that will have a material adverse effect on the financial condition of the Company. In addition to the risks from failure of the Company's own internal systems, the Company may also be exposed to risks from computer systems of parties with whom the Company transacts business. For example, if the internal systems of one of the Company's key suppliers developed problems such that the supplier could not deliver parts to the Company on a timely basis, the Company's financial condition could be materially adversely affected. The Company intends to work with its suppliers to ascertain what actions, if any, are needed. There can be no assurances, however, that unknown costs necessary to update the Company's systems or address potential system interruptions of the Company's or its suppliers' systems will not have a material adverse effect on the Company's business, financial condition or results of operations.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.

Not applicable.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

Balance sheets of the Company as of December 31, 1997 and 1996 and statements of income, stockholders' equity and cash flows for each of the three years in the period ended December 31, 1997, together with the related notes and the report of Coopers & Lybrand L.L.P., independent accountants, are set forth on the following pages. Other required financial information is set forth herein, as more fully described in Item 14 hereof.

REPORT OF INDEPENDENT ACCOUNTANTS

To the Board of Directors and Stockholders
IRIDEX Corporation
Mountain View, California:

We have audited the accompanying consolidated balance sheets of IRIDEX Corporation and subsidiaries as of December 31, 1997 and 1996 and the related consolidated statements of income, stockholders' equity and cash flows for each of the three years in the period ended December 31, 1997. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on those financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards 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. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of IRIDEX Corporation and subsidiaries as of December 31, 1997 and 1996, and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 1997, in conformity with generally accepted accounting principles.

/s/ COOPERS & LYBRAND L.L.P.

San Jose, California
January 22, 1998

IRIDEX CORPORATION

CONSOLIDATED BALANCE SHEETS
(IN THOUSANDS, EXCEPT SHARE DATA)

	DECEMBER 31,	
	1997	1996
ASSETS		
Current assets:		
Cash and cash equivalents	$ 9,900	$14,107
Available-for-sale securities	3,588	1,007
Accounts receivable, net of allowance for doubtful accounts of $305 in 1997 and $265 in 1996	6,057	5,390
Inventories	3,976	1,859
Prepaids and other current assets	451	122
Deferred income taxes	550	519
Total current assets	24,522	23,004
Property and equipment, net	2,133	655
Deferred income taxes	31	48
Total assets	$ 26,686	$23,707
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 752	$ 535
Accrued expenses	2,051	1,684
Current portion of capital lease obligations	3	8
Total current liabilities	2,806	2,227
Capital lease obligations, net of current portion	--	2
Total liabilities	2,806	2,229
Commitments (Note 5)		
Stockholders' Equity:		
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: 6,455,483 shares in 1997 and 6,350,180 shares in 1996	65	63
Additional paid-in capital	21,552	21,248
Unrealized losses on available-for-sale securities	(2)	--
Retained earnings	2,265	167
Total stockholders' equity	23,880	21,478
Total liabilities and stockholders' equity	$ 26,686	$23,707

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

IRIDEX CORPORATION

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

	YEAR ENDED DECEMBER 31,		
	1997	1996	1995
Sales	$ 18,073	$ 12,364	$ 8,801
Cost of sales	7,612	4,899	2,798
Gross profit	10,461	7,465	6,003
Operating expenses:			
Research and development	1,716	1,286	742
Sales, general and administrative	6,074	5,197	3,787
Nonrecurring charge for acquisition of technology	--	--	80
Total operating expenses	7,790	6,483	4,609
Income from operations	2,671	982	1,394
Interest expense	--	--	(16)
Interest income	623	691	64
Other income (expense)	(16)	8	10
Income before provision for income taxes	3,278	1,681	1,452
Provision for income taxes	(1,180)	(676)	(452)
Net income	$ 2,098	$ 1,005	$ 1,000
Net income per common share	$ 0.33	$ 0.18	$ 0.78
Shares used in per common share calculation	6,406	5,725	1,276
Net income per common share-assuming dilution	$ 0.31	$ 0.16	$ 0.23
Shares used in per common share-assuming dilution calculation	6,755	6,410	4,354

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

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

	CONVERTIBLE PREFERRED STOCK		COMMON STOCK		ADDITIONAL PAID-IN CAPITAL	UNREALIZED LOSSES ON AVAILABLE-FOR-SALE SECURITIES
	SHARES	AMOUNT	SHARES	AMOUNT		
Balances, December 31, 1994 ...	1,891,663	$ 19	1,164,817	$ 12	$ 5,243	
Issuance of Common Stock			90,800	1	181	
Issuance of Common Stock under stock option plan.			249,807	2	65	
Net income						
Balances, December 31, 1995 ...	1,891,663	19	1,505,424	15	5,489	--
Issuance of Common Stock, net of issuance costs ..			1,982,500	20	15,639	
Issuance of Common Stock under Stock Option Plan.			9,096		9	
Issuance of Common Stock under Employee Stock Purchase Plan			15,665		120	
Conversion of Preferred Stock	(1,891,663)	(19)	2,837,495	28	(9)	
Net Income						
Balances, December 31, 1996 ...	--	--	6,350,180	63	21,248	--
Issuance of Common Stock under Stock Option Plan.			65,896	1	59	
Issuance of Common Stock under Employee Stock Purchase Plan			43,503	1	245	
Unrealized losses on available-for-sale securities.....						$ (2)
Net income						
Balances, December 31, 1997 ...	--	$ --	6,455,483	$ 65	$ 21,552	$ (2)

	RETAINED EARNINGS (DEFICIT)	TOTAL
Balances, December 31, 1994 ...	(1,838)	$ 3,436
Issuance of Common Stock		182
Issuance of Common Stock under stock option plan.		67
Net income	1,000	1,000
Balances, December 31, 1995 ...	(838)	4,685
Issuance of Common Stock, net of issuance costs ..		15,659
Issuance of Common Stock under Stock Option Plan.		9
Issuance of Common Stock under Employee Stock Purchase Plan		120
Conversion of Preferred Stock		--
Net Income	1,005	1,005
Balances, December 31, 1996 ...	167	21,478
Issuance of Common Stock under Stock Option Plan.		60
Issuance of Common Stock under Employee Stock Purchase Plan		246
Unrealized losses on available-for-sale securities.....		(2)
Net income	2,098	2,098
Balances, December 31, 1997 ...	$ 2,265	$ 23,880

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

IRIDEX CORPORATION

CONSOLIDATED STATEMENTS OF CASH FLOWS (IN THOUSANDS)

	Year Ended December 31,		
	1997	1996	1995
Cash flows from operating activities:			
Net income	$ 2,098	$ 1,005	$ 1,000
Adjustments to reconcile net income to net cash provided by (used in) operating activities:			
Depreciation and amortization	357	238	92
Provision for doubtful accounts	65	(118)	20
Nonrecurring charge for acquisition of technology	--	--	80
Changes in operating assets and liabilities:			
Accounts receivable	(732)	(2,794)	(548)
Inventories	(2,117)	(603)	(350)
Prepaids and other current assets	(329)	163	10
Deferred income taxes	(14)	328	144
Accounts payable	217	242	75
	367	283	373
Net cash provided by (used in) operating activities	(88)	(1,256)	896
Cash flows from investing activities:			
Purchases of available-for-sale securities	(61,684)	(61,305)	--
Proceeds from sale of available-for-sale securities	59,103	60,298	--
Acquisition of property and equipment	(1,837)	(639)	(235)
Net cash used in investing activities	(4,418)	(1,646)	(235)
Cash flows from financing activities:			
Payment on bank borrowings	--	--	(175)
Payments of capital lease obligations	(7)	(6)	(10)
Issuance of Common Stock, net	306	15,788	67
Net cash provided by (used in) financing activities	299	15,782	(118)
Net increase (decrease) in cash and cash equivalents	(4,207)	12,880	543
Cash and cash equivalents, beginning of year	14,107	1,227	684
Cash and cash equivalents, end of year	$ 9,900	$ 14,107	$ 1,227
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:			
Cash paid during the period for:			
Interest	$ --	$ --	$ 16
Income taxes	$ 671	$ 24	$ 27
SUPPLEMENTAL DISCLOSURE OF NONCASH INVESTING AND FINANCING ACTIVITIES:			
Issuance of Common Stock in connection with acquisition	$ --	$ --	$ 182
Assets acquired in connection with acquisition	$ --	$ --	$ 549
Liabilities assumed in connection with acquisition	--	--	447
Unrealized loss on available-for-sale securities	$ (2)	$ --	$ --

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

IRIDEX CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Description of Business

IRIDEX Corporation ("IRIDEX" or the "Company") is the leading worldwide provider of semiconductor-based laser systems used to treat eye diseases in ophthalmology and skin lesions in dermatology. IRIDEX products are sold in the United States predominantly through a direct sales force and internationally through 53 independent distributors into 72 countries. The Company markets its products using three brand names: IRIS Medical to the ophthalmic market, IRIDERM to the dermatological market, and Light Solutions to the research market.

Financial Statement Presentation

The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries. All significant intercompany accounts and transactions have been eliminated.

Cash and Cash Equivalents

The Company considers all highly liquid investments with original maturities of 90 days or less at the time of purchase to be cash equivalents.

Available-for-Sale Securities

All marketable securities as of December 31, 1997 are considered to be available-for-sale and therefore are carried at fair value. Available-for-sale securities classified as current assets have scheduled maturities of less than one year, while available-for-sale securities classified as non current assets 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 the first-in, first-out (FIFO) method. Appropriate consideration is given to obsolescence, excessive levels, deterioration and other factors in evaluating lower of cost or market.

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 property and equipment under capital lease obligations is computed using the straight-line method over the shorter of the remaining lease term or the estimated useful life of the related assets, typically three years.

Revenue Recognition

The Company recognizes product sales upon shipment of product to the customer, upon fulfillment of acceptance terms, if any, and when no significant contractual obligations remain outstanding.

Research and Development

Research and development expenditures are charged to operations as incurred.

Advertising

The Company expenses advertising costs as they are incurred. Advertising expenses for 1997, 1996 and 1995 were $170,000, $175,000 and $49,000, respectively.

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.

Computation of Net Income Per Common Share and Per Common Share-Assuming Dilution

See Note 10.

Concentration of Credit Risk

The Company's cash and cash equivalents are deposited in three financial institutions and comprise demand and money market accounts.

The Company markets it products to distributors and end-users throughout the world. Sales to international distributors are generally made on open credit terms. The Company also offers extended payment terms on selected sales transactions. Management performs ongoing credit evaluations of the Company's customers and maintains an allowance for potential credit losses, but historically has not experienced any significant losses related to individual customers or group of customers in any particular geographic area.

Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Recent Accounting Pronouncements

In June 1997, the FASB issued Statement of Financial Accounting Standards (SFAS) No. 130, "Reporting Comprehensive Income." SFAS No. 130 establishes standards for the reporting and display of comprehensive income and its components in a full set of general purpose financial statements. Comprehensive income is defined as the change in equity of a business enterprise during a period from transactions and other events and circumstances from nonowner sources. The impact of adopting SFAS No. 130, which is effective for the Company in 1998, has not been determined.

In June 1997, the FASB issued SFAS No. 131, "Disclosure about Segments of an Enterprise and Related Information." SFAS No. 131 requires publicly-held companies to report financial and other information about key revenue-producing segments of the entity for which such information is available and is utilized by the chief operating decision maker. Specific information to be reported for individual segments includes profit or loss, certain revenue and expense items and total assets. A reconciliation of segment financial information to amounts reported to the financial statements would be provided. SFAS No. 131 is effective for the Company in 1998 and the impact of adoption has not been determined.

Reclassifications

Certain amounts in the financial statements have been reclassified to conform with the current year's presentation. The reclassification had no impact on previously reported income from operations or net income.

2. ACQUISITION

Effective October 27, 1995, the Company acquired the assets of Light Solutions Corporation. Consideration paid consisted of the assumption of certain liabilities and the issuance of 90,800 shares of the Company's Common Stock.

The acquisition has been accounted for as a purchase. The fair market value of assets acquired, research and development acquired and liabilities assumed is as follows (in thousands):

Liabilities assumed	$ 447
Common Stock issued	182
Tangible assets acquired	(318)
Contracts	(231)
Purchased in-process research and development	(80)
	$ --

The amount allocated to purchase in-process technology was expensed on the acquisition date.

3. BALANCE SHEET DETAIL

Available-for-sale securities (in thousands):

	Amortized Cost	Unrealized Losses	Estimated Fair Value	Maturity Dates
As of December 31, 1997, available-for-sale securities consisted of the following:				
Obligations of state and local government agencies	$ 3,590	$ (2)	$ 3,588	1/98 - 6/98
As of December 31, 1996, available-for-sale securities consisted of the following:				
Corporate notes	1,007	--	1,007	7/97

There were no realized gains or losses recognized in 1997 and 1996.

	December 31, 1997	December 31, 1996
	(in thousands)	
Inventories:		
Raw materials and work in process	$ 3,378	$ 924
Finished goods	598	935
Total inventories	$ 3,976	$ 1,859
Property and Equipment:		
Equipment	$ 1,466	$ 1,226
Leasehold improvements	1,597	--
Less accumulated depreciation and amortization	(930)	(571)
Total property and equipment	$ 2,133	$ 655
Accrued Expenses:		
Accrued payroll and related expenses	$ 593	$ 562
Accrued vacation	194	169
Distributor commissions	141	129
Accrued warranty	114	114
Income taxes payable	567	505
Other accrued expenses	442	205
Total accrued expenses	$ 2,051	$ 1,684

4. BANK BORROWINGS

The Company has a revolving line of credit agreement with a bank expiring on September 30, 1998, which provides for borrowings of up to $1,000,000 at the bank's prime rate (8.50% at December 31, 1997). The agreement contains restrictive covenants including prohibiting payment of dividends without the bank's prior consent. The Company was in compliance with these requirements at December 31, 1997. There were no borrowings against the credit line at December 31, 1997.

5. COMMITMENTS

Lease Agreements

The Company leases its operating facilities under a noncancelable operating lease. The lease expires in 2002 and contains a renewal option. Rent expense totaled $224,000, $108,000 and $105,000 for the years ended December 31, 1997, 1996 and 1995, respectively. Rental income related to a facility sublease was $48,000, $7,000 and $29,000 for the years ended December 31, 1997, 1996 and 1995, respectively.

Future minimum lease payments under current operating leases at December 31, 1997 are summarized as follows (in thousands):

Fiscal Year	Amount
1998	$ 491
1999	509
2000	531
2001	554
2002	93
	$2,178

License Agreements

The Company is obligated to pay royalties equivalent to 5% of sales from certain products under certain license agreements. Royalty expense was $58,900, $37,000 and $28,000 for the years ended December 31, 1997, 1996 and 1995, respectively.

5. STOCKHOLDERS' EQUITY

INITIAL PUBLIC OFFERING AND REINCORPORATION

In February 1996, the Company was reincorporated from California into Delaware, at which time each share of the Company's outstanding California Common Stock was exchanged for one share of the Delaware Common Stock. Prior to this, on January 10, 1996, the Company effected a 1-for-2 reverse stock split of the Company's Common Stock. All Common and Common equivalent shares and per share amounts in these financial statements have been adjusted retroactively to give effect to the split.

In February 1996, the Company issued 1,600,000 shares of its Common Stock in an initial public offering in which an additional 950,000 shares of Common Stock were sold by existing stockholders. In March 1996, the Company issued an additional 382,500 shares of its Common Stock pursuant to exercise of an over allotment option granted to the underwriters in connection with the initial-public offering. In connection with the initial public offering and the underwriters over-allotment option, the Company received proceeds of $15,659,000, net of offering expenses of $2,184,000. In connection with the offering, all shares of Convertible Preferred Stock totaling 1,891,663 shares were converted into 2,837,495 shares of Common Stock.

CONVERTIBLE PREFERRED STOCK

During 1996, the Company amended its Articles of Incorporation to 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 31, 1997, the Company had no preferred stock issued and outstanding.

STOCK OPTION PLANS

Amended and Restated 1989 Incentive Stock Plan

The Amended and Restated 1989 Plan (the "1989 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 1989 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 the Company's 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 1989 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 the Company's outstanding capital stock must not exceed five years. In the case of SPRs, unless the Administrator determines otherwise, the Company has a repurchase option exercisable upon the voluntary or involuntary termination of the purchaser's employment with the Company 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 the Company is the original price paid by the purchaser and may be paid by cancellation of any indebtedness of the purchaser to the Company.

1995 Director Option Plan

In October 1995, the Company 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. An option is exercised by giving written notice of exercise to the Company, specifying the number of full shares of Common Stock to be purchased and tendering payment to the Company of the purchase price. Payment for shares issued upon exercise of an option may consist of cash, check, exchange of the Company's Common Stock or a combination thereof. Options granted under the Director Plan have a term of ten years.

In the event of the merger of the Company with or into another corporation, resulting in a change of control, or the sale of substantially all of the assets of the Company, each 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 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.

Information with respect to activity under these option plans are set forth below:

	SHARES AVAILABLE FOR GRANT	OUTSTANDING OPTIONS			
		NUMBER OF SHARES	PRICE PER SHARE	AGGREGATE PRICE	WEIGHTED AVG EXERCISE PRICE
				(in thousands)	
Balance, December 31, 1994	98,585	481,560	$0.166-$1.00	$229	$ .48
Additional shares reserved	450,000	--	--	--	--
Options granted	(242,000)	242,000	$1.00-$5.00	352	$ 1.45
Options exercised		(249,807)	$0.166 - $1.00	(67)	$ .27
Options terminated	6,755	(6,755)	$0.166-$1.00	(5)	$ .74
Balance, December 31, 1995	313,340	466,998	$0.166-$5.00	$509	$ 1.09
Options granted	(275,850)	275,850	$6.00 - $14.88	2,127	$ 7.71
Options exercised		(9,096)	$0.166 - $1.00	(9)	$ .99
Options terminated	100,508	(100,508)	$0.166 - $14.75	(421)	$ 4.19
Balance, December 31, 1996	137,998	633,244	$0.166 - $14.88	$2,206	$ 3.48
Additional shares reserved	500,000	--	--	--	--
Options granted	(437,775)	437,775	$5.50-$11.125	2,922	$ 6.68
Options exercised		(65,896)	$0.166-$7.75	(60)	$ .91
Options terminated	43,336	(43,336)	$1.00-$14.75	(208)	$ 4.80
Balance, December 31, 1997	243,559	961,787	$0.166-$14.88	$4,860	$ 5.05

At December 31, 1996, options to purchase 245,284 shares of the Company's Common Stock were exercisable.

IRIDEX CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

The following table summarizes information with respect to stock options outstanding at December 31, 1997:

	OPTIONS OUTSTANDING			OPTIONS EXERCISABLE	
RANGE OF EXERCISE PRICES	NUMBER OUTSTANDING AT 12/31/97	WEIGHTED AVERAGE REMAINING CONTRACTUAL LIFE (YEARS)	WEIGHTED AVERAGE EXERCISE PRICE	NUMBER EXERCISABLE AT 12/31/97	WEIGHTED AVERAGE EXERCISE PRICE
$0.166 - $0.166	52,547	2.94	$ 0.166	52,547	$ 0.166
$1.000 - $1.000	178,580	6.69	$ 1.000	147,393	$ 1.000
$2.000 - $2.000	99,375	7.79	$ 2.000	50,644	$ 2.000
$5.000 - $7.750	503,785	9.17	$ 6.347	71,405	$ 6.880
$8.750 - $14.880	127,500	9.43	$ 10.022	7,167	$ 9.765
$0.166 - $14.880	961,787	8.26	$ 5.054	329,156	$ 2.487

The following information concerning the Company's stock option and employee stock purchase plans is provided in accordance with SFAS No. 123, "Accounting for Stock-Based Compensation." The Company accounts 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 option pricing model with the following weighted average assumptions used grants in 1997, 1996 and 1995:

	1997		1996		1995	
	Group A	Group B	Group A	Group B	Group A	Group B
Risk-free interest rates	5.841%-6.722%	5.699%-6.722%	5.76%-6.70%	5.06%-6.64%	5.79%-6.81%	5.69%-7.62%
Expected Life from Date of Vesting	3 yrs.	2 yrs.	3 yrs.	2 yrs.	3 yrs.	2 yrs.
Volatility	0.62	0.62	0.00 - 0.62	0.00-0.62	--	--
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 fair value per share of those options granted in 1997, 1996 and 1995 was $3.85, $4.42 and $0.37, respectively.

The Company has also estimated the fair value for the purchase rights issued under the Company's 1995 Employee Stock Purchase Plan, under the Black-Scholes valuation model using the following assumptions for 1997, 1996 and 1995:

	1997	1996	1995
Risk-free Interest Rates	5.09%	5.37%	N/A
Expected Life	0.5 year	0.5 year	N/A
Volatility	0.62	0.62	N/A
Dividend Yield	--	--	N/A

The weighted average fair value per share of those purchase rights granted in 1997 and 1996 was $2.27 and $3.08, respectively.

The following proforma income information has been prepared following the provisions of SFAS No. 123:

	(amounts in thousands except per share data) 1997	1996	1995
Net income -- as reported	$ 2,098	$ 1,005	$ 1,000
Net income -- proforma	$ 1,564	$ 886	$ 988
Net income per common share -- as reported	$ 0.33	$ 0.18	$ 0.78
Net income per common share -- proforma	$ 0.24	$ 0.17	$ 77
Net income per common share -- assuming dilution-as reported	$ 0.31	$ 0.16	$ 0.23
Net income per common share -- assuming dilution-proforma ...	$ 0.23	$ 0.14	$ 0.23

The above proforma effects on income may not be representative of the effects on net income for future years as option grants typically vest over several years and additional options are generally granted each year.

1995 Employee Stock Purchase Plan

The Company's 1995 Employee Stock Purchase Plan (the "Purchase Plan") was adopted by the Board of Directors in October 1995. On April 28, 1997, the stockholders approved an amendment to increase the total number of shares of common stock for issuance under the Purchase Plan from 50,000 to 100,000. 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 sooner terminated by the Board of Directors.

7. EMPLOYEE BENEFIT PLAN

The Company has 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. No Company contributions have been made to the plan since inception.

8. INCOME TAXES

The provision for income taxes includes:

	Year Ended December 31, 1997	1996	1995
	(In thousands)		
Current:			
Federal	$ 1,010	$ 247	$ 39
State	234	101	269
Deferred:			
Federal	(95)	258	148
State	31	70	(4)
Income tax provision	$ 1,180	676	452

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

	December 31, 1997	1996	1995
Income tax provision at statutory rate	34%	34%	34%
Utilization of net operating loss	--	--	(20)%
State income taxes, net of federal benefit	6%	6%	8%
Change in valuation allowances	--	--	--
Other	4%	--	9%
Effective tax rate	36%	40%	31%

The effective income tax rate in each year was impacted by a reduction in the Company's valuation allowance against deferred tax assets of $0, $0 and $280,000 for the year ended 1997, 1996 and 1995, respectively.

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

	December 31, 1997	1996
Depreciation	$ 7	$ 48
Accrued liabilities	131	226
Allowance for excess and obsolete inventories	164	251
State tax	68	42
Allowance for doubtful accounts	121	--
Other	90	--
Net deferred tax asset	$581	$567

9. MAJOR CUSTOMERS AND BUSINESS SEGMENTS

The Company operates in a single industry segment encompassing the development, manufacture, sales and support of medical devices for the treatment of eye diseases in ophthalmology and skin lesions in dermatology.

In the years ended December 31, 1997, 1996 and 1995, respectively, no customer individually accounted for more than 10% of the Company's revenue.

Revenue information by geographic region is as follows:

	Year Ended December 31,		
	1997	1996	1995
	(In thousands)		
North America	$ 8,865	$ 6,351	$ 4,606
Europe	3,690	3,073	2,257
Central/South America	1,550	697	446
Asia/Pacific Rim	3,968	2,243	1,492
	$18,073	$12,364	$ 8,801

10 COMPUTATION OF NET INCOME PER COMMON SHARE AND PER COMMON SHARE - ASSUMING DILUTION

Effective December 31, 1997, the Company adopted Statement of Financial Accounting Standards (SFAS) No. 128, "Earnings Per Share" and the provisions of the Securities and Exchange Commission Staff Accounting Bulletin No. 98, and accordingly all prior periods have been restated. Net income per common share is computed using the weighted average number of shares of common stock outstanding. Net income per common share - assuming dilution is computed using the weighted average number of shares of common stock and dilutive common equivalent shares from stock options and preferred stock outstanding. The Company has determined that no incremental shares should be included in the computations of earnings per share and in accordance with Staff Accounting Bulletin No. 98.

In accordance with the disclosure requirements of SFAS No. 128, a reconciliation of the numerator and denominator of net income per common share and net income per common share - assuming dilution is provided as follows (in thousands, except per share amounts):

	Year Ended December 31, 1997	1996	1995
Numerator -- Net income per common share and per common share-assuming dilution			
Net income	$2,098	$1,005	$1,000
Denominator -- Net income per common share			
Weighted average common stock outstanding	6,406	5,725	1,276
Net income per common share	$ 0.33	$ 0.19	$ 0.78
Denominator -- Net income per common share-assuming dilution			
Weighted average common stock outstanding	6,406	5,725	1,276
Effect of dilution securities			
Weighted average common stock options	349	331	241
Weighted average convertible preferred stock	--	354	2,837
Total weighted average stock and options outstanding	6,735	6,410	4,354
Net income per common share-assuming dilution	$ 0.31	$ 0.16	$ 0.23

During 1997 and 1996, options to purchase 64,037 and 10,178 shares, respectively, at weighted average exercise prices of $ 9.49 and $ 9.80 per share, respectively were outstanding, but were not included in the computations of net income per common share--assuming dilution because the market price of the common shares exceeded the exercise price of the related options.

ITEM 9. DISAGREEMENTS 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 the Company's definitive proxy statement (the "Proxy Statement"), which the Company will file within 120 days after the end of its fiscal year pursuant to Regulation 14A in time for the Company's Annual Meeting of Stockholders to be held June 8, 1998.

ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT

Information regarding directors of the Company is incorporated by reference to "ELECTION OF DIRECTORS -- Nominees" in the Company's Proxy Statement for the Company's 1998 Annual Meeting of Stockholders. The information concerning current executive officers of the Registrant found under the caption "Executive Officers of the Registrant" in Part I hereof is also incorporated by reference into this Item 10.

ITEM 11. EXECUTIVE COMPENSATION

The information required by this Item is incorporated by reference to "EXECUTIVE COMPENSATION" in the Company's Proxy Statement.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

The information required by this Item is incorporated by reference to "SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT" in the Company's Proxy Statement.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

None.

PART IV

ITEM 14. 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

Refer to 14(c) below

(b) REPORTS ON FORM 8-K

No reports on Form 8-K were filed during the fourth quarter of 1997.

(c) EXHIBITS

Exhibits	Exhibit Title
3.1(1)	Amended and Restated Certificate of Incorporation of Registrant
3.2(1)	Bylaws of Registrant.
10.1(1)	Form of Indemnification Agreement with directors and officers.
10.2(1)	Amended and Restated 1989 Incentive Stock Plan and form of agreement thereunder.
10.3(1)	1995 Employee Stock Purchase Plan and form of agreement thereunder.
10.4(1)	1995 Director Option Plan and form of agreement thereunder.
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.
10.7	Business Loan Agreement dated October 1, 1997 between Mid-Peninsula Bank and the Registrant.
10.10(2)*	Development and Distribution Agreement dated as of May 28, 1996 between Miravant, Inc. (formerly PDT, Inc.) and the Company.
21.1	Subsidiaries of Registrant.
23.1	Consent of Independent Accountants.
24.1	Power of Attorney (See page 49).
27.1	Financial Data Schedule.

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* Confidential treatment has been granted with respect to certain portions of this exhibit.

(1) Incorporated by reference to the exhibits filed with the Company's 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 June 30, 1996.

TRADEMARK ACKNOWLEDGMENTS

The IRIDEX logo, IRIS Medical, OcuLight and EndoProbe are registered trademarks of the Company. IRIDEX, IRIDERM, G-Probe, DioPexy, TruFocus and DioLite are trademarks of the Company. All other trademarks or trade names appearing in the Form 10-K are the property of their respective owners.

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 the 31st day of March, 1998.

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 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, of 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 31, 1998
/s/ Robert Kamenski (Robert Kamenski)	Chief Financial Officer and Vice President, Administration (Principal Financial and Accounting Officer)	March 31, 1998
/s/ James L. Donovan (James L. Donovan)	Director	March 31, 1998
/s/ William Boeger, III (William Boeger, III)	Director	March 31, 1998
/s/ Milton Chang (Milton Chang)	Director	March 31, 1998
/s/ Donald L. Hammond (Donald L. Hammond)	Director	March 31, 1998
/s/ Joshua Makower (Joshua Makower)	Director	March 31, 1998
/s/ John M. Nehra (John M. Nehra)	Chairman of the Board	March 31, 1998

INDEPENDENT ACCOUNTANTS' REPORT ON SCHEDULE

Our report on the consolidated financial statements of IRIDEX Corporation is included on page 29 of this Form 10-K. In connection with our audits of such financial statements, we have also audited the related financial statement schedule listed in the index on page 47 of this Form 10-K.

In our opinion, the financial statement schedule referred to above, when considered in relation to the basic financial statements taken as a whole, present fairly, in all material respects, the information required to be included therein.

/s/ COOPERS & LYBRAND L.L.P.

San Jose, California
January 22, 1998

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 31, 1995:				
Allowance for doubtful accounts receivable	$ 365	$ 20	$ (2)	$ 383
Balance for the year ended December 31, 1996:				
Allowance for doubtful accounts receivable	$ 383		$(118)	$ 265
Balance for the year ended December 31, 1997:				
Allowance for doubtful accounts receivable	$ 265	$ 55	$ (15)	$ 305

EXHIBIT INDEX

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(1) Incorporated by reference to the exhibits filed with the Company's 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 June 30, 1996.

Exhibit 10.6

This Lease, executed in duplicate at Palo Alto, California, this 6th

PARTIES day of December, by and between

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 approximate 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 five (5) 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 1, 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 of 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. 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 alterations, 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

MAINTE-NANCE 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

FIRE AND EXTENDED COVERAGE INSURANCE AND SUBROGATION

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 of 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 GOVERN-MENTAL 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

INDEMNI-FICATION 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.

ADVERTISE-MENTS 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 of 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 this paragraph will be prorated 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 interface 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 SUBLET-TING

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 give 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.*** ** AND *** SEE ADDENDUM ATTACHED

CONDEM-NATION

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.

SUBORDI-NATION

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 this 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 mortgage, 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 of 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 a part of that certain Lease dated December 6, 1996 by and between Zappettini Investment Co., Lessor, and lRIDEX 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 lst 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 lst 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, judgments, 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 Premises 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.

Exhibit 10.7

BUSINESS LOAN AGREEMENT

Principal	Loan Date	Maturity	Loan No.	Call	Collateral	Account	Officer	Initials
$1,000,000.00	10-01-1997	09-03-1998	0108213255	512	Unsec			JS

References in the shaded area are for Lender's use only and do not limit the applicability of this document to any particular loan or item.

Borrower: IRIDEX CORPORATION
1212 Terra Bella
Mountain View, CA 94043

Lender: Mid-Peninsula Bank
c/o Greater Bay Bancorp
2860 W. Bayshore Road
Palo Alto, CA 94303

THIS BUSINESS LOAN AGREEMENT between IRIDEX CORPORATION ("Borrower") and Mid-Peninsula Bank ("Lender") is made and executed on the following terms and conditions. Borrower has received prior commercial loans from Lender or has applied to Lender for a commercial loan or loans and other financial accommodations, including those which may be described on any exhibit or schedule attached to this Agreement. All such loans and financial accommodations, together with all future loans and financial accommodations from Lender to Borrower, are referred to in this Agreement individually as the "Loan" and collectively as the "Loans." Borrower understands and agrees that: (a) in granting, renewing, or extending any Loan, Lender is relying upon Borrower's representations, warranties, and agreements, as set forth in this Agreement; (b) the granting, renewing, or extending of any Loan by Lender at all times shall be subject to Lender's sole judgment and discretion; and (c) all such Loans shall be and shall remain subject to the following terms and conditions of this Agreement.

TERM. This Agreement shall be effective as of October 1, 1997, and shall continue thereafter until all indebtedness of Borrower to Lender has been performed in full and the parties terminate this Agreement in writing.

CONDITIONS PRECEDENT TO EACH ADVANCE. Lender's obligation to make the initial Loan Advance and each subsequent Loan Advance under this Agreement shall be subject to the fulfillment to Lender's satisfaction of all of the conditions set forth in this Agreement and in the Related Documents.

LOAN DOCUMENTS. Borrower shall provide to Lender in form satisfactory to Lender the following documents for the Loan: (a) the Note, (b) Security Agreements granting to Lender security interests in the Collateral, (c) Financing Statements perfecting Lender's Security Interests; (d) evidence of insurance as required below; and (e) any other documents required under this Agreement or by Lender or its counsel.

BORROWER'S AUTHORIZATION. Borrower shall have provided in form and substance satisfactory to Lender properly certified resolutions, duly authorizing the execution and delivery of this Agreement, the Note and the Related Documents, and such other authorizations and other documents and instruments as Lender or its counsel, in their sole discretion, may require.

PAYMENT OF FEES AND EXPENSES. Borrower shall have paid to Lender all fees, charges, and other expenses which are then due and payable as specified in this Agreement or any Related Document.

REPRESENTATIONS AND WARRANTIES. The representations and warranties set forth in this Agreement, in the Related Documents, and in any document or certificate delivered to Lender under this Agreement are true and correct.

NO EVENT OF DEFAULT. There shall not exist at the time of any advance a condition which would constitute an Event of Default under this Agreement.

REPRESENTATIONS AND WARRANTIES. Borrower represents and warrants to Lender, as of the date of this Agreement, as of the date of each disbursement of Loan proceeds, as of the date of any renewal, extension or modification of any Loan, and at all times any indebtedness exists:

ORGANIZATION. Borrower is a corporation which is duly organized, validly existing, and in good standing under the laws of the State of Delaware and is validly existing and in good standing in all states in which Borrower is doing business. Borrower has the full power and authority to own its properties and to transact the businesses in which it is presently engaged or presently proposes to engage. Borrower also is duly qualified as a foreign corporation and is in good standing in all states in which the failure to so qualify would have a material adverse effect on its businesses or financial condition.

AUTHORIZATION. The execution, delivery, and performance of this Agreement by Borrower, to the extent to be executed, delivered or performed by Borrower, have been duly authorized by all necessary action by Borrower; do not require the consent or approval of any other person, regulatory authority or governmental body; and do not conflict with, result in a violation of, or constitute a default under (a) any provision of its articles of incorporation or organization, or bylaws, or any agreement or other instrument binding upon Borrower or (b) any law, governmental regulation, court decree, or order applicable to Borrower.

FINANCIAL INFORMATION. Each financial statement of Borrower supplied to Lender truly and completely disclosed Borrower's financial condition as of the date of the statement, and there has been no material adverse change in Borrower's financial condition subsequent to the date of the most recent financial statement supplied to Lender. Borrower has no material contingent obligations except as disclosed in such financial statements.

LEGAL EFFECT. This Agreement constitutes, and any instrument or agreement required hereunder to be given by Borrower when delivered will constitute, legal, valid and binding obligations of Borrower enforceable against Borrower in accordance with their respective terms.

PROPERTIES. Except as contemplated by this Agreement or as previously disclosed in Borrower's financial statements or in writing to Lender and as accepted by Lender, and except for property tax liens for taxes not presently due and payable, Borrower owns and has good title to all of Borrower's properties free and clear of all liens and security interests, and has not executed any security documents or financing statements relating to such properties. All of Borrower's properties are titled in Borrower's legal name, and Borrower has not used, or filed a financing statement under, any other name for at least the last five (5) years.

HAZARDOUS SUBSTANCES. Except as disclosed to Lender in writing, no property of Borrower ever has been, or ever will be so long as this Agreement remains in effect, used for the generation, manufacture, storage, treatment, disposal, release or threatened release of any hazardous waste or substance, as those terms are defined in the "CERCLA," "SARA," applicable state or Federal laws, or regulations adopted pursuant to any of the foregoing. The representations and warranties contained herein are based on Borrower's due diligence in investigating the properties for hazardous waste and hazardous substances. Borrower hereby (a) releases and waives any future claims against Lender for indemnity or contribution in the event Borrower becomes liable for cleanup or other costs under any such laws, and (b) agrees to indemnify and hold harmless Lender against any and all claims and losses resulting from a breach of this provision of this Agreement. This obligation to indemnify shall survive the payment of the indebtedness and the satisfaction of this Agreement.

COMMERCIAL PURPOSES. Borrower intends to use the Loan proceeds solely for business or commercial related purposes.

AFFIRMATIVE COVENANTS. Borrower covenants and agrees with Lender that, while this Agreement is in effect, Borrower will:

LITIGATION. Promptly inform Lender in writing of (a) all material adverse changes in Borrower's financial condition, and (b) all existing and all threatened litigation, claims, investigations, administrative proceedings or similar actions affecting Borrower or any guarantor of the Loan which could materially affect the financial condition of Borrower or the financial condition of any guarantor of the Loan.

FINANCIAL RECORDS. Maintain its books and records in accordance with accounting principles acceptable to Lender, applied on a consistent basis, and permit Lender to examine and audit Borrower's books and records at all reasonable times.

ADDITIONAL INFORMATION. Furnish such additional information and statements, lists of assets and liabilities, agings of receivables and payables, inventory schedules, budgets, forecasts, tax returns, and other reports with respect to Borrower's financial condition and business operations as Lender may request from time to time.

LOAN PROCEEDS. Use all Loan proceeds solely for Borrower's business operations, unless specifically consented to the contrary by Lender in writing.

PERFORMANCE. Perform and comply with all terms, conditions, and provisions set forth in this Agreement and in the Related Documents in a timely manner, and promptly notify Lender if Borrower learns of the occurrence of any event which constitutes an Event of Default under this Agreement or under any of the Related Documents.

OPERATIONS. Maintain executive and management personnel with substantially the same qualifications and experience as the present executive and management personnel; provide written notice to Lender of any change in executive and management personnel; conduct its business affairs in a reasonable and prudent manner and in compliance with all applicable federal, state and municipal laws, ordinances, rules and regulations respecting its properties, charters, businesses and operations, including without limitation, compliance with the Americans With Disabilities Act and with all minimum funding standards and other requirements of ERISA and other laws applicable to Borrower's employee benefit plans.

INSPECTION. Permit employees or agents of Lender at any reasonable time to inspect any and all Collateral for the Loan or Loans and Borrower's other properties and to examine or audit Borrower's books, accounts, and records and to make copies and memoranda of Borrower's books, accounts, and records. If Borrower now or at any time hereafter maintains any records (including without limitation computer generated records and computer software programs for the generation of such records) in the possession of a third party, Borrower, upon request of Lender, shall notify such party to permit Lender free access to such records at all reasonable times and to provide Lender with copies of any records it may request, all at Borrower's expense.

NEGATIVE COVENANTS. Borrower covenants and agrees with Lender that while this Agreement is in effect, Borrower shall not, without the prior written consent of Lender:

INDEBTEDNESS AND LIENS. (a) Except for trade debt incurred in the normal course of business and indebtedness to Lender contemplated by this Agreement, create, incur or assume indebtedness for borrowed money, including capital leases, (b) except as allowed as a Permitted Lien, sell, transfer, mortgage, assign, pledge, lease, grant a security interest in, or encumber any of Borrower's assets, or (c) sell with recourse any of Borrower's accounts, except to Lender.

CONTINUITY OF OPERATIONS. (a) Engage in any business activities substantially different than those in which Borrower is presently engaged, (b) cease operations, liquidate, merge, transfer, acquire or consolidate with any other entity, change ownership, change its name, dissolve or transfer or sell Collateral out of the ordinary course of business, (c) pay any dividends on Borrower's stock (other than dividends payable in its stock), provided, however that notwithstanding the foregoing, but only so long as no Event of Default has occurred and is continuing or would result from the payment of dividends, if Borrower is a "Subchapter S Corporation" (as defined in the Internal Revenue Code of 1986, as amended), Borrower may pay cash dividends on its stock to its shareholders from time to time in amounts necessary to enable the shareholders to pay income taxes and make estimated income tax payments to satisfy their liabilities under federal and state law which arise solely from their status as Shareholders of a Subchapter S Corporation because of their ownership of shares of stock of Borrower, or (d) purchase or retire any of Borrower's outstanding shares or alter or amend Borrower's capital structure.

LOANS, ACQUISITIONS AND GUARANTIES. (a) Loan, invest in or advance money or assets, (b) purchase, create or acquire any interest in any other enterprise or entity, or (c) incur any obligation as surety or guarantor other than in the ordinary course of business.

CESSATION OF ADVANCES. If Lender has made any commitment to make any Loan to Borrower, whether under this Agreement or under any other agreement, Lender shall have no obligation to make Loan advances or to disburse Loan proceeds if: (a) Borrower or any guarantor is in default under the terms of this Agreement or any other agreement that Borrower or any guarantor has with Lender; (b) Borrower or any Guarantor becomes insolvent, files a petition in bankruptcy or similar proceedings, or is adjudged a bankrupt; (c) there occurs a material adverse change in Borrower's financial condition, in the financial condition of any guarantor, or in the value of any collateral securing any Loan; or (d) any guarantor seeks, claims or attempts to limit, modify or revoke such guarantor's guaranty of the Loan or any other loan with Lender.

BORROWER'S FINANCIAL REPORTING. Borrower agrees to provide the following:

1) Quarterly financial statement within 50 days of quarter end or its 10Q within 5 days of filing with the SEC.

2) Annual Certified Public Accountant audited financial statement within 120 days of fiscal year end bearing an unqualified opinion.

RIGHT OF SETOFF. Borrower grants to Lender a contractual possessory security interest in, and hereby assigns, conveys, delivers, pledges, and transfers to Lender all Borrower's right, title and interest in and to, Borrowers accounts with Lender (whether checking, savings, or some other account), including without limitation all accounts held jointly with someone else and all accounts Borrower may open in the future, excluding however all IRA and Keogh accounts, and all trust accounts for which the grant of a security interest would be prohibited by law. Borrower authorizes Lender, to the extent permitted by applicable law, to charge or setoff all sums owing on the indebtedness against any and all such accounts.

EVENTS OF DEFAULT. Each of the following shall constitute an event of default ("Event of Default") under this Agreement:

DEFAULT ON INDEBTEDNESS. Failure of Borrower to make any payment when due on the Loans.

OTHER DEFAULTS. Failure of Borrower to comply with or to perform when due any other term, obligation, covenant or condition contained in this Agreement.

DEFAULT IN FAVOR OF THIRD PARTIES. Should Borrower default under any loan, extension of credit, security agreement, purchase or sales agreement, or any other agreement, in favor of any other creditor or person that may materially affect any of Borrower's property or Borrower's ability to repay the Loans or perform Borrower's obligations under this Agreement or any related document.

FALSE STATEMENTS. Any warranty, representation or statement made or furnished to Lender by or on behalf of Borrower is false or misleading in any material respect at the time made or furnished, or becomes false or misleading at any time thereafter.

INSOLVENCY. The dissolution or termination of Borrower's existence as a going business, the insolvency of Borrower, the appointment of a receiver for any part of Borrower's property, any assignment for the benefit of creditors, any type of creditor workout, or the commencement of any proceeding under any bankruptcy or insolvency laws by or against Borrower.

CREDITOR OR FORFEITURE PROCEEDINGS. Commencement of foreclosure or forfeiture proceedings, whether by judicial proceeding, self-help, repossession or any other method, by any creditor of Borrower, any creditor of any grantor of collateral for the Loan. This includes a garnishment, attachment, or levy on or of any of Borrower's deposit accounts with Lender.

EVENTS AFFECTING GUARANTOR. Any of the preceding events occurs with respect to any Guarantor of any of the indebtedness or any Guarantor dies or becomes incompetent, or revokes or disputes the validity of, or liability under, any Guaranty of the indebtedness. Lender, at its option, may, but shall not be required to, permit the Guarantor's estate to assume unconditionally the obligations arising under the guaranty in a manner satisfactory to Lender, and, in doing so, cure the Event of Default.

CHANGE IN OWNERSHIP. Any change in ownership of twenty-five percent (25%) or more of the common stock of Borrower.

ADVERSE CHANGE. A material adverse change occurs in Borrower's financial condition, or Lender believes the prospect of payment or performance of the indebtedness is impaired.

EFFECT OF AN EVENT OF DEFAULT. If any Event of Default shall occur, except where otherwise provided in this Agreement or the Related Documents, all commitments and obligations of Lender under this Agreement immediately will terminate (including any obligation to make Loan Advances or disbursements), and, at Lender's option, all indebtedness immediately will become due and payable, all without notice of any kind to Borrower, except that in the case of an Event of Default of the type described in the "Insolvency" subsection above, such acceleration shall be automatic and not optional. In addition, Lender shall have all the rights and remedies provided in the Related Documents or available at law, in equity, or otherwise. Except as may be prohibited by applicable law, all of Lender's rights and remedies shall be cumulative and may be exercised singularly or concurrently. Election by Lender to pursue any remedy shall not exclude pursuit of any other remedy, and an election to make expenditures or to take action to perform an obligation of Borrower or of any Grantor shall not affect Lender's right to declare a default and to exercise its rights and remedies.

BORROWER ACKNOWLEDGES HAVING READ ALL THE PROVISIONS OF THIS BUSINESS LOAN AGREEMENT, AND BORROWER AGREES TO ITS TERMS. THIS AGREEMENT IS DATED AS OF OCTOBER 1, 1997.

BORROWER:

IRIDEX CORPORATION

BY: /s/ Robert Kamenski
ROBERT KAMENSKI, VICE PRESIDENT OF FINANCE AND ADMINISTRATION

LENDER:

MID-PENINSULA BANK

BY: /s/ J. H. Stafford
AUTHORIZED OFFICER

PROMISSORY NOTE

Principal	Loan Date	Maturity	Loan No. Call	Collateral	Account	Officer	Initials
$1,000,000.00	10-01-1997	09-03-1998	0108213255512	Unsec		JS	

References in the shaded area are for Lender's use only and do not limit the applicability of this document to any particular loan or item.

Borrower: IRIDEX CORPORATION
1212 Terra Bella
Mountain View, CA 94043

Lender: Mid-Peninsula Bank
c/o Greater Bay Bancorp
2860 W. Bayshore Road
Palo Alto, CA 94303

PRINCIPAL AMOUNT: $1,000,000.00

INITIAL RATE: 8.500%

DATE OF NOTE: OCTOBER 1, 1997

PROMISE TO PAY. IRIDEX CORPORATION ("Borrower") promises to pay to Mid-Peninsula Bank ("Lender'), or order, in lawful money of the United States of America, the principal amount of One Million & 00/100 Dollars ($1,000,000.00) or so much as may be outstanding, together with interest on the unpaid outstanding principal balance of each advance. Interest shall be calculated from the date of each advance until repayment of each advance.

PAYMENT. Borrower will pay this loan on demand, or if no demand is made, in one payment of all outstanding principal plus all accrued unpaid interest on September 30,1998. In addition, Borrower will pay regular monthly payments of accrued unpaid interest beginning October 30, 1997, and all subsequent interest payments are due on the same day of each month after that. The annual interest rate for this Note is computed on a 365/360 basis; that is, by applying the ratio of the annual interest rate over a year of 360 days, multiplied by the outstanding principal balance, multiplied by the actual number of days the principal balance is outstanding. Borrower will pay Lender at Lender's address shown above or at such other place as Lender may designate in writing. Unless otherwise agreed or required by applicable law, payments will be applied first to accrued unpaid interest, then to principal, and any remaining amount to any unpaid collection costs and late charges.

VARIABLE INTEREST RATE. The interest rate on this Note is subject to change from time to time based on changes in an independent index which is the Wall Street Journal Prime (Western Edition) (the "Index"). The Index is not necessarily the lowest rate charged by Lender on its loans. If the Index becomes unavailable during the term of this loan, Lender may designate a substitute index after notice to Borrower. Lender will tell Borrower the current index rate upon Borrower's request. Borrower understands that Lender may make loans based on other rates as well. The interest rate change will not occur more often than each day. The Index currently is 8.500%. The interest rate to be applied to the unpaid principal balance of this Note will be at a rate equal to the Index, resulting in an initial rate of 8.500%. NOTICE: Under no circumstances will the interest rate on this Note be more than the maximum rate allowed by applicable law.

PREPAYMENT; MINIMUM INTEREST CHARGE. Borrower agrees that all loan fees and other prepaid finance charges are earned fully as of the date of the loan and will not be subject to refund upon early payment (whether voluntary or as a result of default), except as otherwise required by law. In any event, even upon full prepayment of this Note, Borrower understands that Lender is entitled to a minimum interest charge of $250.00. Other than Borrower's obligation to pay any minimum interest charge, Borrower may pay without penalty all or a portion of the amount owed earlier than it is due. Early payments will not, unless agreed to by Lender in writing, relieve Borrower of Borrower's obligation to continue to make payments of accrued unpaid interest. Rather, they will reduce the principal balance due.

LATE CHARGE. If a payment is 10 days or more late, Borrower will be charged 5.000% of the regularly scheduled payment or $10.00, whichever is greater.

DEFAULT. Borrower will be in default if any of the following happens: (a) Borrower fails to make any payment when due. (b) Borrower breaks any promise Borrower has made to Lender, or Borrower fails to comply with or to perform when due any other term, obligation, covenant, or condition contained in this Note or any agreement related to this Note, or in any other agreement or loan Borrower has with Lender. (c) Borrower defaults under any loan, extension of credit, security agreement, purchase or sales agreement, or any other agreement, in favor of any other creditor or person that may materially affect any of Borrower's property or Borrower's ability to repay this Note or perform Borrower's obligations under this Note or any of the Related Documents. (d) Any representation or statement made or furnished to Lender by Borrower or on Borrower's behalf is false or misleading in any material respect either now or at the time made or furnished. (e) Borrower becomes insolvent, a receiver is appointed for any part of Borrower's property, Borrower makes an assignment for the benefit of creditors, or any proceeding is commenced either by Borrower or against Borrower under any bankruptcy or insolvency laws. (f) Any creditor tries to take any of Borrower's property on or in which Lender has a lien or security interest. This includes a garnishment of any of Borrower's accounts with Lender. (g) Any guarantor dies or any of the other events described in this default section occurs with respect to any guarantor of this Note. (h) A material adverse change occurs in Borrower's financial condition, or Lender believes the prospect of payment or performance of the indebtedness is impaired.

If any default, other than a default in payment, is curable and if Borrower has not been given a notice of a breach of the same provision of this Note within the preceding twelve (12) months, it may be cured (and no event of default will have occurred) if Borrower, after receiving written notice from Lender demanding cure of such default: (a) cures the default within fifteen (15) days; or (b) if the cure requires more than fifteen (15) days, immediately initiates steps which Lender deems in Lender's sole discretion to be sufficient to cure the default and thereafter continues and completes all reasonable and necessary steps sufficient to produce compliance as soon as reasonably practical.

LENDER'S RIGHTS. Upon default, Lender may declare the entire unpaid principal balance on this Note and all accrued unpaid interest immediately due, without notice, and then Borrower will pay that amount. Upon Borrower's failure to pay all amounts declared due pursuant to this section, including failure to pay upon final maturity, Lender, at its option, may also, if permitted under applicable law, increase the variable interest rate on this Note to 5.000 percentage points over the Index. Lender may hire or pay someone else to help collect this Note if Borrower does not pay. Borrower also will pay Lender that amount. This includes, subject to any limits under applicable law, Lender's attorneys' fees and Lender's legal expenses whether or not there is a lawsuit, including attorneys' fees and legal expenses for bankruptcy proceedings (including efforts to modify or vacate any automatic stay or injunction), appeals, and any anticipated post-judgment collection services. Borrower also will pay any court costs, in addition to all other sums provided by law. This Note has been delivered to Lender and accepted by Lender in the State of California. If there is a lawsuit, Borrower agrees upon Lender's request to submit to the jurisdiction of the courts of Santa Clara County, the State of California. This Note shall be governed by and construed in accordance with the laws of the State of California.

RIGHT OF SETOFF. Borrower grants to Lender a contractual possessory security interest in, and hereby assigns, conveys, delivers, pledges, and transfers to Lender all Borrower's right, title and interest in and to, Borrower's accounts with Lender (whether checking, savings, or some other account), including without limitation all accounts held jointly with someone else and all accounts Borrower may open in the future, excluding however all IRA and Keogh accounts, and all trust accounts for which the grant of a security interest would be prohibited by law. Borrower authorizes Lender, to the extent permitted by applicable law, to charge or setoff all sums owing on this Note against any and all such accounts.

LINE OF CREDIT. This Note evidences a revolving line of credit. Advances under this Note, as well as directions for payment from Borrower's accounts, may be requested orally or in writing by Borrower or by an authorized person. Lender may, but need not, require that all oral requests be confirmed in writing. The following party or parties are authorized to request advances under the line of credit until Lender receives from Borrower at Lender's address shown above written notice of revocation of their authority: Theodore Boutacoff, President and Chief Executive Officer; and Robert Kamenski, Vice President of Finance and Administration. Borrower agrees to be liable for all sums either: (a) advanced in accordance with the instructions of an authorized person or (b) credited to any of Borrower's accounts with Lender. The unpaid principal balance owing on this Note at any time may be evidenced by endorsements on this Note or by Lender's internal records, including daily computer print-outs. Lender will have no obligation to advance funds under this Note if: (a) Borrower or any guarantor is in default under the terms of this Note or any agreement that Borrower or any guarantor has with Lender, including any agreement made in connection with the signing of this Note; (b) Borrower or any guarantor ceases doing business or is insolvent; (c) any guarantor seeks, claims or otherwise attempts to limit, modify or revoke such guarantor's guarantee of this Note or any other loan with Lender; or (d) Borrower has applied funds provided pursuant to this Note for purposes other than those authorized by Lender.

BUSINESS LOAN AGREEMENT. In addition to the terms and conditions contained in the Note, it is also subject to the terms and conditions contained in that certain Business Loan Agreement dated October 1, 1997 executed by Borrower in favor of Lender, which Agreement is hereby incorporated herein by this reference.

GENERAL PROVISIONS. This Note is payable on demand. The inclusion of specific default provisions or rights of Lender shall not preclude Lender's right to declare payment of this Note on its demand. Lender may delay or forgo enforcing any of its rights or remedies under this Note without losing them. Borrower and any other person who signs, guarantees or endorses this Note, to the extent allowed by law, waive any applicable statute of limitations, presentment, demand for payment, protest and notice of dishonor. Upon any change in the terms of this Note, and unless otherwise expressly stated in writing, no party who signs this Note, whether as maker, guarantor, accommodation maker or endorser, shall be released from liability. All such parties agree that Lender may renew or extend (repeatedly and for any length of time) this loan, or release any party or guarantor or collateral; or impair, fail to realize upon or perfect Lender's security interest in the collateral; and take any other action deemed necessary by Lender without the consent of or notice to anyone. All such parties also agree that Lender may modify this loan without the consent of or notice to anyone other than the party with whom the modification is made.

PRIOR TO SIGNING THIS NOTE, BORROWER READ AND UNDERSTOOD ALL THE PROVISIONS OF THIS NOTE. BORROWER AGREES TO THE TERMS OF THE NOTE AND ACKNOWLEDGES RECEIPT OF A COMPLETED COPY OF THE NOTE.

BORROWER:
IRIDEX CORPORATION

BY: /s/ Robert Kamenski

ROBERT KAMENSKI, VICE PRESIDENT OF FINANCE AND ADMINISTRATION

EXHIBIT 21.1

LIST OF SUBSIDIARIES

Name of Subsidiary	Place of Incorporation
IRIS Medical Instruments, Inc.	California
Light Solutions Corporation	California
IRIDEX Foreign Sales Corporation	Barbados

Exhibit 23.1

CONSENT OF COOPERS & LYBRAND L.L.P., INDEPENDENT ACCOUNTANTS

We consent to the incorporation by reference in the Registration Statement of IRIDEX Corporation and subsidiaries in Form S-8 (File No. 333-4264) of our reports dated January 22, 1998, on our audits of the consolidated financial statements and financial statement schedule of IRIDEX Corporation as of December 31, 1997 and 1996 and for each of the three years ended December 31, 1997, which reports are in this Annual Report on Form 10-K.

/s/ Coopers & Lybrand L.L.P.

San Jose, California
March 30, 1998

5
1,000

YEAR	
	DEC-31-1997
	JAN-01-1997
	DEC-31-1997
	9,900
	3,588
	6,362
	(305)
	3,976
	24,522
	3,063
	(930)
	26,686
	2,806
	0
	0
	0
	65
	23,815
	26,686
	18,073
	18,073
	7,612
	7,612
	7,790
	0
	0
	3,278
	(1,180)
	0
	0
	0
	0
	2,098
	0.33
	0.31

5

THIS SCHEDULE CONTAINS SUMMARY FINANCIAL INFORMATION EXTRACTED FROM THE COMPANY'S CONDENSED CONSOLIDATED BALANCE SHEETS AND CONDENSED STATEMENTS OF INCOME AS OF AND FOR THE YEAR ENDED DECEMBER 31, 1995 AND IS QUALIFIED IN ITS ENTIRETY BY REFERENCE TO SUCH ANNUAL REPORT ON FORM SB-2

1,000

YEAR	
DEC-31-1995	
JAN-01-1995	
DEC-31-1995	
	1,227
	0
	2,861
	(383)
	1,256
	6,041
	587
	(333)
	6,395
	1,702
	0
	0
	19
	15
	4,651
	6,395
	8,801
	8,801
	2,798
	2,798
	4,609
	0
	(16)
	1,452
	(452)
	0
	0
	0
	0
	1,000
	.78
	.23

EPS-PRIMARY AND EPS-DILUTED HAS BEEN RESTATED AS REQUIRED BY THE COMPANY'S ADOPTION OF STATEMENT OF FINANCIAL ACCOUNTING STANDARD NO 128.

5

THIS SCHEDULE CONTAINS SUMMARY FINANCIAL INFORMATION EXTRACTED FROM THE COMPANY'S CONDENSED CONSOLIDATED BALANCE SHEETS AND CONDENSED CONSOLIDATED STATEMENTS OF INCOME AS OF AND FOR THE THREE MONTHS ENDED ON MARCH 31, 1996 AND IS QUALIFIED IN ITS ENTIRETY BY REFERENCE TO SUCH QUARTERLY REPORTS ON FORM 10-Q

1,000

3-MOS
DEC-31-1996
JAN-01-1996
MAR-31-1996
17,097
0
2,680
(381)
1,430
21,927
631
(366)
22,292
1,527
0
0
0
63
20,702
22,292
2,417
2,417
932
932
1,326
0
0
251
(26)
0
0
0
0
0
225
.06
.04

EPS-PRIMARY AND EPS-DILUTED HAS BEEN RESTATED AS REQUIRED BY THE COMPANY'S ADOPTION OF STATEMENT OF FINANCIAL ACCOUNTING STANDARD NO 128.

5

THIS SCHEDULE CONTAINS SUMMARY FINANCIAL INFORMATION EXTRACTED FROM THE COMPANY'S CONDENSED CONSOLIDATED BALANCE SHEETS AND CONDENSED CONSOLIDATED STATEMENTS OF INCOME AS OF AND FOR THE SIX MONTHS ENDED ON JUNE 30, 1996 AND IS QUALIFIED IN ITS ENTIRETY BY REFERENCE TO SUCH QUARTERLY REPORTS ON FORM 10-Q

1,000

6-MOS
DEC-31-1996
JAN-01-1996
JUN-30-1996
15,402
1,000
2,849
(265)
1,868
20,786
770
(320)
22,336
1,627
0
0
0
63
20,646
22,336
4,903
4,903
1,880
1,880
2,766
0
0
555
(148)
0
0
0
0
407
.08
.07

EPS-PRIMARY AND EPS-DILUTED HAS BEEN RESTATED AS REQUIRED BY THE COMPANY'S ADOPTION OF STATEMENT OF FINANCIAL ACCOUNTING STANDARD NO 128.

5

THIS SCHEDULE CONTAINS SUMMARY FINANCIAL INFORMATION EXTRACTED FROM THE COMPANY'S CONDENSED CONSOLIDATED BALANCE SHEETS AND CONDENSED CONSOLIDATED STATEMENTS OF INCOME AS OF AND FOR THE NINE MONTHS ENDED ON SEPT 30, 1996 AND IS QUALIFIED IN ITS ENTIRETY BY REFERENCE TO SUCH QUARTERLY REPORTS ON FORM 10-Q

1,000

9-MOS
DEC-31-1996
JAN-31-1996
SEP-30-1996
14,504
1,044
3,424
(265)
2,296
21,943
955
(474)
22,524
1,581
0
0
0
66
20,877
22,524
7,538
7,538
2,848
2,848
4,256
0
0
958
(309)
0
0
0
0
649
.12
.10

EPS-PRIMARY AND EPS-DILUTED HAS BEEN RESTATED AS REQUIRED BY THE COMPANY'S ADOPTION OF STATEMENT OF FINANCIAL ACCOUNTING STANDARD NO 128.

5

THIS SCHEDULE CONTAINS SUMMARY FINANCIAL INFORMATION EXTRACTED FROM THE COMPANY'S CONDENSED CONSOLIDATED BALANCE SHEETS AND CONDENSED CONSOLIDATED STATEMENTS OF INCOME AS OF AND FOR THE YEAR ENDED ON DECEMBER 31, 1996 AND IS QUALIFIED IN ITS ENTIRETY BY REFERENCE TO SUCH ANNUAL REPORT ON FORM 10-K

1,000

YEAR
DEC-31-1996
JAN-01-1996
DEC-31-1996
14,107
1,007
5,655
(265)
1,859
23,004
1,226
(571)
23,707
2,227
0
0
0
63
21,415
23,707
12,364
12,364
4,899
4,899
6,483
0
0
1,681
(676)
0
0
0
0
1,005
.18
.16

EPS-PRIMARY AND EPS-DILUTED HAS BEEN RESTATED AS REQUIRED BY THE COMPANY'S ADOPTION OF STATEMENT OF FINANCIAL ACCOUNTING STANDARD NO 128.

5

THIS SCHEDULE CONTAINS SUMMARY FINANCIAL INFORMATION EXTRACTED FROM THE COMPANY'S CONDENSED CONSOLIDATED BALANCE SHEETS AND CONDENSED CONSOLIDATED STATEMENTS OF INCOME AS OF AND FOR THE THREE MONTHS ENDED MARCH 31, 1997 AND IS QUALIFIED IN ITS ENTIRETY BY REFERENCE TO SUCH QUARTERLY REPORTS ON FORM 10-Q

1,000

3-MOS
DEC-31-1997
JAN-01-1997
MAR-31-1997
4,282
10,221
5,218
(265)
2,050
18,019
1,289
(650)
23,005
1,341
0
0
0
0
64
21,600
23,005
3,320
3,320
1,437
1,437
1,745
0
0
293
(108)
0
0
0
0
0
185
.03
.03

EPS-PRIMARY AND EPS-DILUTED HAS BEEN RESTATED AS REQUIRED BY THE COMPANY'S ADOPTION OF STATEMENT OF FINANCIAL ACCOUNTING STANDARD NO 128.

5

THIS SCHEDULE CONTAINS SUMMARY FINANCIAL INFORMATION EXTRACTED FROM THE COMPANY'S CONDENSED CONSOLIDATED BALANCE SHEETS AND CONDENSED CONSOLIDATED STATEMENTS OF INCOME AS OF AND FOR THE SIX MONTHS ENDED ON JUNE 30, 1997 AND IS QUALIFIED IN ITS ENTIRETY BY REFERENCE TO SUCH QUARTERLY REPORTS ON FORM 10-Q

1,000

6-MOS
DEC-31-1997
JAN-01-1997
JUN-30-1997
9,970
5,106
5,381
(250)
2,571
22,817
1,570
(732)
24,699
2,510
0
0
0
64
22,125
24,699
7,676
7,676
3,280
3,280
3,616
0
0
1,095
(396)
0
0
0
0
699
.11
.11

EPS-PRIMARY AND EPS-DILUTED HAS BEEN RESTATED AS REQUIRED BY THE COMPANY'S ADOPTION OF STATEMENT OF FINANCIAL ACCOUNTING STANDARD NO 128.

5

THIS SCHEDULE CONTAINS SUMMARY FINANCIAL INFORMATION EXTRACTED FROM THE COMPANY'S CONDENSED CONSOLIDATED BALANCE SHEETS AND CONDENSED CONSOLIDATED STATEMENTS OF INCOME AS OF AND FOR THE NINE MONTHS ENDED ON SEPTEMBER 30, 1997 AND IS QUALIFIED IN ITS ENTIRETY BY REFERENCE TO SUCH QUARTERLY REPORTS ON FORM 10-Q

1,000

9-MOS
DEC-31-1997
JAN-01-1997
SEP-30-1997
9,405
4,152
5,838
(350)
3,261
23,308
2,905
(832)
25,429
2,443
0
0
0
64
22,922
25,429
12,317
12,317
5,267
5,267
5,496
0
0
2,026
(731)
0
0
0
0
1,295
.20
.19

EPS-PRIMARY AND EPS-DILUTED HAS BEEN RESTATED AS REQUIRED BY THE COMPANY'S ADOPTION OF STATEMENT OF FINANCIAL ACCOUNTING STANDARD NO 128.