PORTUGAL TELECOM SGPS SA
Form 6-K
January 22, 2004

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 6-K

Report of Foreign Private Issuer
Pursuant to Rule 13a-16 or 15d-16 of the
Securities Exchange Act of 1934

For the month of January 2004

Commission File Number 1-13758

PORTUGAL TELECOM, SGPS, S.A.

(Exact name of registrant as specified in its charter)

Av. Fontes Pereira de Melo, 40
1069 - 300 Lisboa, Portugal
(Address of principal executive office)

Indicate by check mark whether the registrant files or will file annual reports under cover Form 20-F or Form 40-F.

Form 20-F ___X___ Form 40-F _______

Indicate by check mark whether the registrant by furnishing the information contained in this Form is also thereby furnishing the information to the Commission pursuant to Rule 12g3-2(b) under the Securities Exchange Act of 1934.

Yes _______ No ___X____

ANNOUNCEMENT

PORTUGAL TELECOM, SGPS, S.A.

Public Company
Registered Offices: Avenida Fontes Pereira de Melo, 40, Lisbon
Share Capital: Euro 1,254,285,000
Registered in the Conservatory of the Commercial Registry of Lisbon under no. 03602/940706
Collective Person no. 503 215 058

Lisbon, Portugal, January 22, 2004 Portugal Telecom, SGPS, S.A. (NYSE: PT; Euronext: PTCO.IN) today announced that it has reallocated certain operational responsibilities within its Executive Committee. As a result of these changes, Mr. Miguel Horta e Costa, in addition to his role as Group CEO, has also taken on direct responsibility for PT s Wireline Business. Mr. Zeinal Bava and Mr. Iriarte Esteves, in addition to their current roles, will also be appointed Executive Board members of the Wireline business. Mr. Bava and Mr. Esteves will be responsible for the SoHo/residential and corporate segments of the wireline business respectively. Mr. Carlos Vasconcellos Cruz, will now supervise all of PT s International Businesses focusing primarily on Vivo in Brazil.

This information is also available on PT s IR website http://ir.telecom.pt.

Contact: Vitor J. Sequeira - PT Group Investor Relations Director
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Portugal Telecom is listed on the Euronext Lisbon and New York Stock Exchanges. Information may be accessed on the Reuters 2000 Service under the symbols PT and PTCO.IN and on Bloomberg under the symbol PTC PL.

SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Date: January 22, 2004

PORTUGAL TELECOM, SGPS, S.A.

By: /s/ Vitor Sequeira

Vitor Sequeira
Manager of Investor Relations

FORWARD-LOOKING STATEMENTS

This press release may contain forward-looking statements. These statements are statements that are not historical facts, and are based on management's current view and estimates of future economic circumstances, industry conditions, company performance and financial results. The words "anticipates", "believes", "estimates", "expects", "plans" and similar expressions, as they relate to the company, are intended to identify forward-looking statements. Statements regarding the declaration or payment of dividends, the implementation of principal operating and financing strategies and capital expenditure plans, the direction of future operations and the factors or trends affecting financial condition, liquidity or results of operations are examples of forward-looking statements. Such statements reflect the current views of management and are subject to a number of risks and uncertainties. There is no guarantee that the expected events, trends or results will actually occur. The statements are based on many assumptions and factors, including general economic and market conditions, industry conditions, and operating factors. Any changes in such assumptions or factors could cause actual results to differ materially from current expectations.

he months of October 2002 to October 2003 under a consulting agreement and, if the agreement is terminated, for the sum of $110,000 minus whatever we had paid Mr. Hicks prior to such termination, plus costs, attorney's fees and a wage penalty pursuant to Utah law. We dispute the amounts allegedly owed and intend to vigorously defend against such action. On November 7, 2003, a complaint was filed against us by Todd Smith, a former employee, in the Third Judicial District Court, Salt Lake County, State of Utah (Civil No. 030924951 CN). Defendants consist of us and Randall Mackey, a director of the company. The complaint alleges that while an employee, Mr. Smith was granted stock options to purchase 16,800 shares of common stock exercisable at $5.00 per share. Mr. Smith claims unpaid wages in the amount of the fair market value of the stock options he claims he was prevented from exercising, plus attorney's fees and a continuing wage penalty under Utah law. We believe the claims are without merit and intend to vigorously defend against such action. On May 25, 2004, an action was brought against us by Jeffrey F. Poore, former President and Chief Executive Officer of the company, in the Third Judicial District Court of Salt Lake County, State of Utah (Civil No. 040910875). The complaint alleges that we unlawfully terminated the written employment agreement between Mr. Poore and us. As a result, Mr. Poore demanded judgment against us for $350,000, representing his annual salary for the two remaining years under the employment agreement, for money judgment based on the 56 value of his benefits for the two remaining years under the employment agreement, including profit sharing plans, 401(k) and cafeteria plans, health, hospitalization, dental, disability and other insurance plans canceled by us, and for money judgment equal to the value of the stock options granted to him under the employment agreement. We dispute the amounts allegedly owed in the complaint and believe that there was a sufficient basis to terminate Mr. Poore's employment for cause under the terms of the employment agreement. Accordingly, we intend to vigorously defend against the action. On August 9, 2004, a third party complaint was brought against us by Wakefield

Eye Center. The original action was brought by American Express Business Corporation against Westfield Eye Center on May 27, 2004 in the District Court, Clark County, State of Nevada (Civil No. A486307, Dept. No. XXI) concerning the financing of the purchase of a Blood Flow Analyzer(TM) involving Westfield Eye Center. The transaction took place during the latter half of 2001. Westfield Eye Center took the position that if there is liability of Westfield to American Express this liability is ultimately ours and the other third party defendants. The amount being sought against Westfield Eye Center by American Express in the original action includes the sum of $29,765.83, together with interest and attorney's fees. Westfield's alleged claims against us include fraud, breach of contract, promissory estoppel, declaratory relief, negligence, negligent supervision, damages for injuries resulting from actions of employee/contractor, wilful and wanton misconduct, conspiracy, and breach of fiduciary duty as well as costs and attorney's fees. Westfield also seeks punitive damages. We have filed an answer to the third party complaint in which we deny liability. Formal discovery in the matter involving us has not commenced apart from initial disclosure requirements. The case has been referred to arbitration. We intend to vigorously defend against the action. On March 31, 2005, an action was filed against us by Joseph W. Spadafora in the United States District Court, District of Utah (Civil No. 2:05CV00278 TS). The complaint alleges that Dr. Spadafora was a clinical investigator in the study for the FDA involving the Photon(TM) laser system where he performed numerous surgeries using the Photon(TM). Dr. Spadafora contends that in meetings with our personnel he suggested ways in which the handpiece on the Photon(TM) could be improved. Dr. Spadafora further contends that on August 5, 1999, we filed a patent application for an improved handpiece with the United States Patent and Trademark Office but he was not named as one of the inventors or a coinventor on the patent application. On September 24, 2004, we were issued a patent entitled, "Laser Surgical Handpiece with Photon Trap." Because we did not list Dr. Spadafora as one of the inventors or a coinventor on the patent, Dr. Spadafora requested in his complaint that a court order be entered declaring that he is the inventor or coinventor of the patent and, as a result, is entitled to all or part of the royalties and profits that we earned or will earn from the sale of any product incorporating or using the improved handpiece, plus interest and attorney's fees. We filed an answer to the complaint in which we disputed the claims made by Dr. Spadafora. We intend to vigorously defend against such action. We are not a party to any other material legal proceedings outside the ordinary course of its business or to any other legal proceedings which, if adversely determined, would have a material adverse effect on our financial condition or results of operations. MANAGEMENT Directors and Executive Officers As of May 31, 2005, our executive officers and directors, their ages and their positions are set forth below: Name Age Position ---- --- -------- John Y. Yoon 40 President and Chief Executive Officer Aziz A. Mohabbat 44 Vice President of Operations and Chief Operating Officer Randall A. Mackey, Esq. 59 Chairman of the Board, Secretary and Director David M. Silver, Ph.D. 61 Director Keith D. Ignotz 54 Director John C. Pingree 64 Director The directors are elected for one year terms that expire at the next annual meeting of shareholders. Executive officers are elected annually by the Board of Directors to hold office until the first meeting of the Board following the next annual meeting of shareholders and until their successors have been elected and qualified. 57 John Y. Yoon has served as our President and Chief Executive Officer since March 19, 2004. From June 2003 to March 19, 2004, Mr. Yoon served as Senior Director of Marketing, Enterprise Voice Solutions Division of 3 Com Corporation. From 1997 to June 2003, he served as Senior Director of Product Management and Director of Product Management of 3 Com Corporation. During the period from 1996 to 1997, Mr. Yoon was Director of Strategic Planning and Product Development of US Robotics. During the period from 1993 to 1996, he served as Manager of Marketing and Strategic Planning, Senior Director of Product Management and Management of Product Development for Ericsson, Inc. From 1990 to 1993, Mr. Yoon was Manager of Public Service Marketing and Product Line Manager of Mobile Radios for Ericsson, Inc. During the period from 1986 to 1988, he was Product Planner of Business and Industrial Trucking and Marketing Research Analyst for General Electric Mobile Communications. Mr. Yoon received a B.A. degree in Economics from Harvard College and an M.B.A. degree from Duke University. Aziz A. Mohabbat has served as our Chief Operating Officer since March 23, 2004 and from August 2002 to March 2003, and Vice President of Operations since March 23, 2004 and from 2001 to March 2003. From 2000 to 2001, he served as Managing Director of the San Diego Division of our company and from 1999 to 2000 as its Regulatory Affairs and Quality Assurance Manager. From March 2003 to March 2004, Mr. Mohabbat served as Division Manager of the Medical Division of TUV Rheilland of North America, a medical products safety and compliance services company. From 1997 to 1999, he served as Operations and Regulatory Affairs and Quality Assurance Manager of Codan U.S., a subsidiary of Codan GmbH, a manufacturer of disposable sterile and non-sterile medical devices. Prior to 1989, Mr. Mohabbat held various management and bioengineering positions in the medical laboratory and diagnostics field in the Eye Care Clinic of the University Hospital-Eppendorf and the General Hospital of Barmbek in Hamburg, Germany. Mr. Mohabbat received a B.S. degree in Medical Laboratory Technology from St. George Hospital College in Hamburg, Germany. He is a member of the American Society for Quality Assurance. Randall A. Mackey, Esq. has been our Chairman of the Board since August 20, 2002, and a director since January 2000. He had served as a director of the company from November 1995 to September 1998. Mr. Mackey has been President of the Salt Lake City law firm of Mackey Price Thompson & Ostler since 1992, and a shareholder and director of the firm and its predecessor firms since 1989. Mr. Mackey received a B.S. degree in Economics from the University of Utah, an M.B.A. degree from the Harvard Business School, a J.D. degree from Columbia Law School and a B.C.L. degree from Oxford University. Mr. Mackey has also served as Chairman of the Board from June 2001 to May 2003, and as a director from 1998 to May 2003 of Cimetrix, Incorporated, a software development company. Mr. Mackey has additionally served as Chairman of the Board from July 2000 to July 2003 and as a trustee from 1993 to July 2003 of Salt Lake Community College. David M. Silver, Ph.D. has been a director since January 2000. He had served as a director of the company from November 1995 to September 1998. Dr. Silver is a Principal Senior Scientist in the Milton S. Eisenhower Research and Technology Development Center at the Johns Hopkins University Applied Physics Laboratory, where he has been employed since 1970. He served as the J. H. Fitzgerald Dunning Professor of Ophthalmology in the Johns Hopkins Wilmer Eye Institute in Baltimore during 1998-99. He received a B.S. degree from Illinois Institute of Technology, an M.A. degree from Johns Hopkins University and a Ph.D. degree from Iowa State University before holding a postdoctoral fellowship at Harvard University and a visiting scientist position at the University of Paris. Keith D. Ignotz has been a director since November 2000. He has been President and Chief Operating Officer of SpectRx, Inc., a medical technology company that he founded in 1992, which develops, manufactures and markets alternatives to traditional blood based medical tests. From 1986 to 1992, Mr. Ignotz was Senior Vice President of Allergan Humphrey, Inc., a medical electronics company. From 1985 to 1986, he was President of Humphrey Instruments Limited-SKB, a medical electronics company, and from 1980 to 1985, Mr. Ignotz was President of Humphrey Instruments GmbH, also a medical electronics company. Mr. Ignotz also served on the Board of Directors of Vismed, Inc., d/b/a Dicon from 1992 to June 2000. Mr. Ignotz received a B.A. degree in Sociology and Political Science from San Jose University and an M.B.A. degree from Pepperdine University. Mr. Ignotz has served as a trustee of Pennsylvania College of Optometry since 1990, as a director for FluoRx, Inc. since 1997, and as a member of the American Marketing Association of the American Association of Diabetes Education. John C. Pingree has been a director since April 2004. He has been the Executive Director of the Semnani Foundation since August 2001, which funds projects to assist women and children in developing countries. From July 1998 to July 2001, Mr. Pingree was a Mission President for the Church of Jesus Christ of Latter-day Saints, serving in Mexico City, Mexico. From 1977 to 1997, Mr. Pingree was General Manager and Chief Executive Officer of Utah Transit 58 Authority. From 1970 to 1975, he was Director of Marketing for Memorex Corporation. From 1967 to 1970, Mr. Pingree was Regional Manager, Sales Planning at Xerox Corporation. He also currently serves as a member of the Utah State Board of Education. Mr. Pingree received a B.A. degree in Economics from the University of Utah and an M.B.A. degree from the Harvard Business School. Appointment of New President and Chief Executive Officer On March 18, 2004, John Y. Yoon was appointed as our President and Chief Executive Officer, replacing Jeffrey F. Poore who had served in those positions from March 19, 2003 to March 18, 2004. Appointment of New Chief Operating Officer and New Vice President of Engineering On March 23, 2004, Aziz A. Mohabbat was appointed as our Vice President of Operations and Chief Operating Officer, replacing David I. Cullumber who had resigned as Chief Operating Officer and Chief Technical Officer. Mr, Cullumber served as Chief Operating Officer from November 6, 2003 to March 22, 2004. Mr. Mohabbat had previously served as our Chief Operating Officer from August 2002 to March 2003, and as Vice President of Operations from 2001 to March 2003. On May 23, 2005, Frederick D. Gerger was appointed as our Vice President of Engineering. Board Meetings and Committees The size of our Board of Directors for the coming year is four members. Three of the directors, or a majority of the Board of Directors, are independent directors. The independent directors have regularly scheduled meetings at which only independent directors are present. The term of office of each director is for a period of one year or until the election and qualification of his successor. The Board of Directors held a total of five meetings during the fiscal year ended December 31, 2004. No directors attended fewer than 75% of all meetings of the Board of Directors during the 2004 fiscal year. There are three committees of the Board of Directors, which meet periodically during the year: the Compensation Committee, the Audit Committee, and the

Nominating and Corporate Governance Committee. The Compensation Committee is responsible for recommending to the Board of Directors for approval the annual compensation of each executive officer of the Company, developing policy in the areas of compensation and fringe benefits, contribution under the 401(k) Retirement Savings Plan, granting of options under the stock option plans, and creating other employee compensation plans. The Compensation Committee consists of Messrs. Keith D. Ignotz, John C. Pingree and Dr. David M. Silver (Chairman of the Committee). During 2004, the Compensation Committee met on one occasion. The Audit Committee directs the auditing activities of our registered public independent accounting firm and reviews the services performed by the registered public independent accounting firm and evaluates our accounting practices and procedures and our system of internal accounting controls. The Audit Committee consists of Messrs. Keith D. Ignotz (Chairman of the Committee), John C. Pingree and Dr. David M. Silver. During 2004, the Audit Committee met on one occasion. The Board of Directors has determined that Keith D. Ignotz and John C. Pingree, who currently serve as directors as well as members of the audit committee, are independent audit committee financial experts. The Nominating and Corporate Governance Committee identifies individuals qualified to become board members consistent with criteria approved by the board, recommends to the board the persons to be nominated by the board for election as directors at a meeting of stockholders, and develops and recommends to the board a set of corporate governance principles. The Nominating and Corporate Governance Committee consists of Messrs. Keith D. Ignotz, John C. Pingree (Chairman of the Committee) and Dr. David M. Silver. The Nominating and Corporate Governance Committee is composed solely of independent directors. Director Nominating Process The process for identifying and evaluating nominees for directors include the following steps: (1) the Nominating and Corporate Governance Committee, Chairman of the Board or other board members identify a need to fill vacancies or add newly created directorships; (2) the Chairman of the Nominating and Corporate Governance Committee initiates a search and seeks input from board members and senior management and, if necessary, obtains advice from legal or other advisors (but does not hire an outside search firm); (3) director 59 candidates, including any candidates properly proposed by stockholders in accordance with our bylaws, are identified and presented to the Nominating and Corporate Governance Committee; (4) initial interviews with candidates are conducted by the Chairman of the Nominating and Corporate Governance Committee; (5) the Nominating and Corporate Governance Committee meets to consider and approve final candidate(s) and conduct further interviews as necessary; and (6) the Nominating and Corporate Governance Committee makes recommendations to the board for inclusion in the slate of directors at the annual meeting. The evaluation process will be the same whether the nominee is recommended by a stockholder or by a member of the Board of Directors. The Nominating and Corporate Governance Committee operates pursuant to a written charter. The full text of the charter is published on the Company's website at www.paradigm-medical.com. A copy of the charter may also be obtained without charge by written request to the attention of Luis A. Mostacero, Controller, Paradigm Medical Industries, Inc., 2355 South 1070 East, Salt Lake City, Utah 84119. Meetings of Non-Management Directors Our non-management directors regularly meet without management participation. In addition, an executive session including only the independent directors is held at least annually. Corporate Governance Corporate Governance Guidelines. Our Board of Directors has adopted the Paradigm Medical Industries, Inc. Corporate Governance Guidelines. These guidelines outline the functions of the board, director qualifications and responsibilities, and various processes and procedures designed to insure effective and responsive governance. The guidelines are reviewed from time to time in response to regulatory requirements and best practices and are revised accordingly. The full text of the guidelines is published on our website at www.paradigm-medical.com. A copy of the Corporate Governance Guidelines may also be obtained at no charge by written request to the attention of Luis A. Mostacero, Controller, Treasurer and Secretary, Paradigm Medical Industries, Inc., 2355 South 1070 East, Salt Lake City, Utah 84119. Code of Business Conduct. All of our officers, employees and directors are required to comply with our Code of Business Conduct and Ethics to help insure that our business is conducted in accordance with appropriate standards of ethical behavior. Our Code of Business Conduct and Ethics covers all areas of professional conduct, including customer relationships, conflicts of interest, insider trading, financial disclosures, intellectual property and confidential information, as well as requiring adherence to all laws and regulations applicable to our business. Employees are required to report any violations or suspected violations of the Code. The Code includes an anti-retaliation statement. The full text of the Code of Business Conduct and Ethics is published on our website at www.paradigm-medical.com. A copy of the Code of Business Conduct and Ethics may also be obtained at no charge by written request to the attention of Luis A. Mostacero, Controller, Treasurer and Secretary, Paradigm Medical Industries, Inc., 2355 South 1070 East, Salt Lake City, Utah 84119.

Executive Compensation The following table sets forth, for each of the last three fiscal years, the compensation received by John Y. Yoon, President and Chief Executive Officer and other executive officers whose salary and bonus for all services in all capacities exceed $100,000 for the fiscal years ended December 31, 2004, 2003 and 2002. 60 Summary Compensation Table Annual Compensation Long Term Compensation Awards Payouts Other Securities Annual Restricted Underlying Long-term All Other Name and Compen- Stock Options/ Incentive Compensa-- Principal Position Year Salary$ Bonus($) sation($) Awards($) SARs(#) Payouts($) tion($) ------------------ ---- ------- -------- --------- ----------- ---------- ---------- ---------- John Y. Yoon 2004(1) $110,961(4) $18,494(4) 0 1,000,000(5) 0 0 President and Chief Executive Officer Aziz A. Mohabbat 2004(1) $106,244 0 0 0 0 0 0 Vice President of 2003(2) $ 24,219 0 0 0 0 0 0 Operations and 2002(3) $126,878 0 0 0 0 0 $9,634(7) Chief Operating Officer(6) Jeffrey F. Poore 2004(1) $ 41,052 0 0 0 0 0 0 Former President 2003(2) $136,015 0 0 0 1,000,000(8) 0 0 and Chief Executive Officer David I. Cullumber, 2004(1) $ 15,894 0 $18,059(9) 0 0 0 0 Former Chief 2003(2) $ 22,312 0 $16,616(9) 0 150,000(10) 0 0 Operating Officer and Chief Technical Officer Gregory C. Hill 2004(1) 0 0 0 0 0 0 0 Former Vice 2003(2) $34,000 0 0 0 0 0 0 President of Finance and Chief Financial Officer Thomas F. Motter 2004(1) 0 0 0 0 0 0 0 Former Chairman of 2003(2) 0 0 0 0 0 0 0 the Board and Chief 2002(3) $187,483(11) 0 0 0 0 0 $19,750(12)(13) Executive Officer Mark R. Miehle 2004(1) 0 0 0 0 0 0 0 Former President 2003(2) 0 0 0 0 0 0 0 and Chief Operating 2002(3) $134,202 0 0 0 55,000(14) 0 $18,000(12)(15) Officer Heber C. Maughan 2004(1) 0 0 0 0 0 0 0 Former Vice 2003(2) $ 36,855 0 0 0 150,000(17) 0 0 President of Finance 2002(3) $114,416 0 0 0 0 0 0 and Chief Financial Officer(16) -------------------- (1) For the fiscal year ended December 31, 2004 (2) For the fiscal year ended December 31, 2003 (3) For the fiscal year ended December 31, 2002 (4) Of the salary payable to Mr. Yoon pursuant to his employment agreement, $110,961 was paid to him during 2004 and the remaining amount of $18,494 payable in 2004 was deferred until our board of directors has determined that our financial condition is improved. (5) On March 18, 2004, our board of directors granted Mr. Yoon options to purchase 1,000,000 shares of our common stock at an exercise price of $.13 per share. 61 (6) Mr. Mohabbat has served a Vice President of Operations and Chief Operating Officer since March 22, 2004 and as Chief Operating Officer from August 30, 2002 to March 2003. He was not an officer in prior years. (7) The amounts under "All Other Compensation" for 2004 consist of payments to Mr. Mohabbat for accrued vacation days prior to his resignation from the Company in March 2003. (8) On March 19, 2003, our board of directors granted Mr. Poore options to purchase 1,000,000 shares of our common stock at an exercise price of $.16 per share. These options were terminated on March 18, 2003 when our board of directors terminated Mr. Poore's employment for cause as defined in the employment agreement. (9) We paid A-Mech Engineering, Inc. a total of $16,616 and $18,059 for consulting services during 2003 and 2004, respectively. From 1982 to March 2004, Mr. Cullumber served as President of A-Mech Engineering, Inc. (10) On November 6, 2003, our board of directors granted Mr. Cullumber options to purchase 150,000 shares of our common stock at an exercise price of $.21 per share. These options were terminated on June 20, 2003, 90 days after Mr. Cullumber resigned as our Chief Operating Officer and Chief Technical Officer. (11) Although Mr. Motter resigned as Chairman and Chief Executive Officer on August 30, 2002, he continued to receive his salary under the terms of his employment agreement through December 16, 2002. (12) The amounts under "All Other Compensation" for 2004, 2003 and 2002 include payments related to the operation of automobiles and/or automobiles and insurance by the named executives. (13) The amounts under "All Other Compensation" for 2002 include payments related to the residential housing accommodations for our employees, living outside of Utah while they were working at our corporate headquarters in Salt Lake City, leased from Mr. Motter at $2,500 per month. (14) On January 29, 2002, our Board of Directors granted Mr. Miehle options to purchase the 55,000 shares of our common stock at an exercise price of $2.75 per share. These options were terminated on February 28, 2004, one year after expiration of a six month consulting agreement with the Company, which expired on February 28, 2003. (15) On September 3, 2002, we entered into a consulting agreement with Mr. Miehle in which we were required to pay him monthly consulting fees of $5,000 over a period of six months. We paid him a total of $15,000 for consulting services during the months of September, October and November of 2002. (16) Mr. Maughan served as Interim Chief Executive Officer from August 30, 2002 to March 19, 2003. He served as Vice President of Finance, Treasurer and Chief Financial Officer from October 1, 2001 until his resignation on May 31, 2003. (17) On May 13, 2003, our Board of Directors granted Mr. Maughan options to purchase 150,000 shares of our common stock at an exercise price of $.16 per share. These options were terminated on August 29, 2003, 90 days after Mr. Maughan resigned as Vice President of Finance and Chief Financial Officer. Options The following table sets forth information regarding stock options granted during the fiscal year ended

December 31, 2004, to each named executive officer. Option Grants in Last Fiscal Year Individual Grants Percentage of Total Number of Securities Options Granted to Exercise Price UnderlyingOptions Employees in Per Share Expiration Name Granted (#) Fiscal Year(%) ($/Sh) Date ---- -------------------- -------------------- -------------- ---------- John Y. Yoon........................ 1,000,000(1) 56.3% $.13 4/1/09 Aziz A. Mohabbat.................... 200,000(2) 11.3% $.12 4/1/09 (1) Options vest in 36 monthly installments of 27,778 shares, beginning on April 30, 2004, until such shares are vested. (2) Options vest in 36 monthly installments of 5,556 shares, beginning on April 30, 2004, until such shares are vested. The following table sets forth information regarding unexercised options to acquire shares of our common stock held as of December 31, 2004, by each named executive officer. 62 Aggregated Option Exercises in Last Fiscal Year and Fiscal Year-End Option Values Number of Securities Underlying Value of Unexercised Unexercised Options In-the-Money Options at December 31, 2004(#) at December 31, 2004($) ---------------------- ---------------------- Shares Acquired Value Name on Exercise Realized($) Exercisable Unexercisable Exercisable Unexercisable ---- -------------- ---------- ---------- ------------ ---------- ------------ John Y. Yoon............ 0 0 250,002 749,998 0 0 Aziz A. Mohabbat........... 0 0 50,004 149,996 0 0 Director Compensation On April 19, 2004, John C. Pingree, a director of our company, was granted options to purchase 125,000 shares of our common stock at an exercise price of $.12 per share. On September 30, 2004, Messrs. Randall A. Mackey, Dr. David M. Silver and Keith D. Ignotz, directors of our company, were each granted options to purchase 125,000 shares of our common stock at an exercise price of $.13 per share. In addition, outside directors are also reimbursed for their expenses in attending board and committee meetings. Directors are not precluded from serving us in any other capacity and receiving compensation therefore. The options were not issued at a discount to the then market price. Employee 401(k) Plan In October 1996, our board of directors adopted a 401(k) Retirement Savings Plan. Under the terms of the 401(k) plan, effective as of November 1, 1996, we may make discretionary employer matching contributions to our employees who choose to participate in the plan. The plan allows the board to determine the amount of the contribution at the beginning of each year. The Board adopted a contribution formula specifying that such discretionary employer matching contributions would equal 100% of the participating employee's contribution to the plan up to a maximum discretionary employee contribution of 3% of a participating employee's compensation, as defined by the plan. All persons who have completed at least six months' service with us and satisfy other plan requirements are eligible to participate in the plan. 1995 Stock Option Plan We adopted a 1995 Stock Option Plan, for the officers, employees, directors and consultants of our company on November 7, 1995. The plan authorized the granting of stock options to purchase an aggregate of not more than 300,000 shares of our common stock. On February 16, 1996, options for substantially all 300,000 shares were granted. On June 9, 1997, our shareholders approved an amendment to the plan to increase the number of shares of common stock reserved for issuance thereunder from 300,000 shares to 600,000 shares. On September 3, 1998, our shareholders approved an amendment to the plan to increase the number of shares of common stock reserved for issuance thereunder from 600,000 shares to 1,200,000 shares. On November 29, 2000, our shareholders approved an amendment to the plan to increase the number of shares of common stock reserved for issuance thereunder from 1,200,000 shares to 1,700,000 shares. On September 11, 2001, our shareholders approved an amendment to the 1995 plan to increase the number of shares of common stock reserved for issuance thereunder from 1,700,000 shares to 2,700,000 shares. On June 13, 2003, our shareholders approved an amendment to the plan to increase the number of shares of common stock reserved for issuance thereunder from 2,700,000 shares to 3,700,000 shares. The compensation committee administers the 1995 Stock Option Plan. In general, the compensation committee will select the person to whom options will be granted and will determine, subject to the terms of the plan, the number, exercise, and other provisions of such options. Options granted under the plan will become exercisable at such times as may be determined by the compensation committee. Options granted under the plan may be either incentive stock options, as such term is defined in the Internal Revenue Code, or non-incentive stock options. Incentive stock options may only be granted to persons who are our employees. Non-incentive stock options may be granted to any person, including, but not limited to, our employees, independent agents, consultants as the compensation committee believes has contributed, or will contribute, to our success. The compensation committee determines the exercise price of options granted under the 1995 Stock Option Plan, provided that, in the case of incentive stock options, such price is not less than 100% (110% in the case of incentive stock options granted to holders of 10% of voting power of our stock) of the fair market value (as defined in the plan) of the common stock on the date of grant. The aggregate fair market value (determined at the time of option grant) of stock with respect to which incentive stock options become exercisable for the first time in any year cannot exceed $100,000. The term of each option shall not be more than ten years (five years in the case of incentive stock options granted to holders of 10% of the voting power of our stock) from the date of grant. The Board of Directors has a right to amend, suspend or terminate the 1995 Stock Option Plan at any time; provided, however, that unless ratified by our shareholders, no amendment or change in the 63 plan will be effective that would increase the total number of shares that may be issued under the plan, materially increase the benefits accruing to persons granted under the plan or materially modify the requirements as to eligibility and participation in the plan. No amendment, supervision or termination of the plan shall, without the consent of an employee to whom an option shall heretofore have been granted, affect the rights of such employee under such option. Employment Agreements We entered into an employment agreement with Thomas F. Motter, which commenced on January 1, 1998 and expired on December 31, 2002. The employment agreement required Mr. Motter to devote substantially all of his working time as our Chairman and Chief Executive Officer, provided that he may be terminated for "cause" (as provided in the agreements) and prohibited him from competing with us for two years following the termination of his employment agreement. The employment agreement provided for the payment of an initial base salary of $135,000, effective as of January 1, 1998. The employment agreement also provided for salary increases and bonuses as would be determined at the discretion of the board of directors. Effective as of October 1, 1999, the board of directors approved an increase in Mr. Motter's annual base salary to $160,000, and effective as of July 1, 2000, the board approved an increase in his annual base salary to $200,000, which remained in effect during 2002. Mr. Motter resigned as Chairman and Chief Executive Officer on August 30, 2002. He continued to receive his salary under the terms of the employment agreement through December 16, 2002. We entered into an employment agreement with Mark R. Miehle, which commenced on June 5, 2000, and expired on June 4, 2003. The employment agreement required Mr. Miehle to devote substantially all of his working time as our President and Chief Operating Officer, provided that he may be terminated for "cause" (as provided in the agreement) and prohibited him from competing with us for two years following the termination of his employment agreement. The employment agreement provided for the payment of an initial annual base salary of $150,000, effective as of June 5, 2000, and the issuance of stock options to purchase 150,000 shares of our common stock at $6.00 per share, to be vested in equal annual amounts over a three year period. The employment agreement also provided for salary increases and bonuses as to be determined at the discretion of the Board of Directors. The stated annual compensation remained in effect through December 31, 2001 and into 2002. The Board of Directors terminated the employment agreement with Mr. Miehle on August 30, 2002. He entered into a six month consulting agreement, which expired on February 28, 2003, for $5,000 per month. Mr. Miehle was paid $15,000 in 2002 under the terms of the consulting agreement. We entered into an employment agreement with Jeffrey F. Poore, which commenced on March 19, 2003 and expires on March 19, 2006. The employment agreement requires Mr. Poore to devote substantially all of his working time as our President and Chief Executive Officer, provided that he may be terminated for "cause" (as provided in the agreements) and prohibits him from competing with us for two years following the termination of the employment agreement. The employment agreement provided for the payment of an initial base salary of $175,000, effective as of March 19, 2003. The employment agreement also provided for salary increases and bonuses as shall be determined at the discretion of our Board of Directors. The employment agreement further provided for the issuance of stock options to purchase 1,000,000 shares of our common stock at $.16 per share, of which options to purchase 800,000 shares of common stock were vested on March 19, 2003, options for an additional 100,000 shares of common stock were vested on March 19, 2004, and options for an additional 100,000 shares of common stock were vested on March 19, 2005. On March 18, 2004, our Board of Directors terminated Mr. Poore's employment for cause as defined in the employment agreement. As a result of the termination of the employment agreement, we believe that we have no further obligations to make salary or bonus payments or provide benefits to Mr. Poore and all of his stock options have terminated. On May 25, 2004, Mr. Poore brought a lawsuit against us. In his complaint he alleges that we unlawfully terminated his employment and, as a consequence, demands judgment against us for $350,000, representing his annual salary for the two remaining years under the employment agreement, for money judgment for the value of his benefits for the two remaining years under the employment agreement, and for the value of the stock options granted to him. We dispute the claims in the complaint and believe there was a sufficient basis to terminate Mr. Poore's employment for cause under the terms of the employment agreement. We entered into an employment agreement with John Y. Yoon, which commenced on March 18, 2004 and expires on March 18, 2007. The employment agreement requires Mr. Yoon to devote substantially all of his working time as our President and Chief Executive Officer, provided that he may be terminated for "cause" (as provided in the agreement) and prohibits him from competing with us for two years following the termination of the employment agreement. The employment agreement provides for the payment of an initial base salary of $175,000, effective as of April 1, 2004. The employment agreement also provides for salary increases and bonuses as shall be determined at the discretion of our Board of Directors. The employment agreement further provides for the issuance of stock options to purchase 1,000,000 shares of our common stock at $.13 per share. These options vest in 36 equal monthly installments of 27,778 shares, beginning on April 30, 2004, until such shares are vested. 64 In the event of a change of control of the company, then all outstanding stock options granted to Mr. Yoon shall be immediately vested. A change of control shall be deemed to have occurred if (i) a tender offer shall be made and consummated for the ownership of more than 25% of our outstanding shares; (ii) we are merged or consolidated with another corporation and, as a result, less than 25% of the outstanding common shares of the surviving corporation shall be owned in the aggregate by our former shareholders, as the same shall have listed prior to such merger or consolidation; (iii) we sell all or substantially all of its assets to another corporation that is not a wholly owned subsidiary or affiliate; (iv) as a result of any contested election for our Board of Directors, or any tender or exchange offer, merger of business combination or sale of assets, the persons who were our directors before such a transaction shall cease to constitute a majority of our Board of Directors; or (v) a person other than an officer or director of the company shall acquire more than 20% of the outstanding shares of our common stock. We entered into an employment agreement with Aziz A. Mohabbat on October 5, 2004, which was effective as of April 1, 2004, and expires on March 18, 2006. However, the term shall be extended an additional one year period to March 18, 2007 in the event Mr. Mohabbat moves from San Diego, California to Salt Lake City, Utah and becomes a resident of the state of Utah. The employment agreement requires Mr. Mohabbat to devote substantially all of his working time as our Vice President of Operations and Chief Operating Officer, provided that he may be terminated for "cause" (as provided in the agreement) and prohibits him from competing with us for two years following the termination of the employment agreement. The employment agreement provides for the payment of an initial base salary of $144,500, effective as of April 1, 2004. The employment agreement also provides for salary increases and bonuses as shall be determined at the discretion of our Board of Directors. The employment agreement further provides for the issuance of stock options to purchase 200,000 shares of our common stock at $.12 per share. These options vest in 36 equal monthly installments of 5,556 shares, beginning on April 30, 2004, until such shares are vested. In the event of a change of control of the company, then all outstanding stock options granted to Mr. Mohabbat shall be immediately vested. A change of control shall be deemed to have occurred if (i) a tender offer shall be made and consummated for the ownership of more than 25% of our outstanding shares; (ii) we are merged or consolidated with another corporation and, as a result, less than 25% of the outstanding common shares of the surviving corporation shall be owned in the aggregate by our former shareholders, as the same shall have listed prior to such merger or consolidation; (iii) we sell all or substantially all of its assets to another corporation that is not a wholly owned subsidiary or affiliate; (iv) as a result of any contested election for our Board of Directors, or any tender or exchange offer, merger of business combination or sale of assets, the persons who were our directors before such a transaction shall cease to constitute a majority of our Board of Directors; or (v) a person other than an officer or director of the company shall acquire more than 20% of the outstanding shares of our common stock. Severance Agreement On August 30, 2002, the Board of Directors terminated the employment agreement with Mark R. Miehle who had been serving as our President and Chief Operating Officer. Under the terms of the termination of Mr. Miehle's employment agreement, the stock options issued to him on April 19, 2000 to purchase 150,000 shares of our common stock at $6.00 per share, on September 11, 2001 to purchase 110,000 shares of our common stock at $2.75 per share, and on January 28, 2002 to purchase 55,000 shares of our common stock at $2.75 per share were fully vested as of the date of such termination and continue to be exercisable for a period of one year following the termination of a consulting agreement, at which time such options would expire. The termination of the employment agreement also required us to enter into a consulting agreement with Mr. Miehle. Under the terms of the consulting agreement, Mr. Miehle was to provide consulting services to us for a period of six months for a fee of $5,000 per month. The consulting agreement was to be automatically renewed for an additional six months at a fee of $3,000 per month unless we delivered written notice to Miehle at least 30 days prior to the end of the initial six month term that we would not renew the agreement. We paid Mr. Miehle a total of $15,000 under the consulting agreement for consulting services during the months of September, October and November of 2002. We also provided written notice to Mr. Miehle more than 30 days prior to the end of the initial six month term of the consulting agreement of our intention not to review the agreement. Limitation of Liability and Indemnification We reincorporated in Delaware in February 1996, in part, to take advantage of certain provisions in Delaware's corporate law relating to limitations on liability of corporate officers and directors. We believe that the reincorporation into Delaware, the provisions of its Certificate of Incorporation and Bylaws and the separate indemnification agreements outlined below are necessary to attract and retain qualified persons as directors and officers. Our Certificate of Incorporation limits the liability of directors to the maximum extent permitted by Delaware law. This provision is intended to allow our directors the benefit of Delaware General Corporation Law that provides that directors of Delaware corporations may be relieved of monetary 65 liabilities for breach of their fiduciary duties as directors, except under certain circumstances, including breach of their duty of loyalty, acts or omissions not in good faith or involving intentional misconduct or a knowing violation of law, unlawful payments of dividends or unlawful stock repurchases or redemptions or any transaction from which the director derived an improper personal benefit. Our Bylaws provide that we shall indemnify our officers and directors to the fullest extent provided by Delaware law. Our Bylaws authorize the use of indemnification agreements and we have entered into such agreements with each of our directors and executive officers. There is pending litigation against Thomas F. Motter, Mark R. Miehle and John W. Hemmer, former officers of the company, to whom we have indemnification obligations. The pending litigation consists of class action complaints for alleged violations of the federal securities laws filed in the United States District Court, District of Utah, captioned Richard Meyer, individually and on behalf of others similarly situated v. Paradigm Medical Industries, Inc., Thomas Motter, Mark Miehle and John Hemmer, Case No. 2:03 CV00448TC, Michael Marrone v. Paradigm Medical Industries, Inc., Thomas Motter, Mark Miehle, and John Hemmer, Case No. 2:03 CV00513PGC, and Milian v. Paradigm Medical Industries, Inc., Thomas Motter, Mark Miehle and John Hemmer, Case No. 2:03 CV00617PGC. We have retained legal counsel to review the complaints, which appear to be focused on alleged false and misleading statements pertaining to the Blood Flow Analyzer(TM) and concerning a purchase order from Valdespino Associates Enterprises and Westland Financial Corporation. More specifically, each of the complaints alleges that we falsely stated in our Securities and Exchange Commission filings and press releases that we had received authorization to use an insurance reimbursement CPT code from the CPT Code Research and Development Division of the American Medical Association in connection with the Blood Flow Analyzer(TM), adding that the CPT code provides for a reimbursement to doctors of $57.00 per patient for use of the Blood Flow Analyzer(TM). The complaints also allege that on July 11, 2002, we issued a press release falsely announcing that we had received a purchase order from Valdespino Associates Enterprises and Westland Financial Corporation for 200 sets of our entire portfolio of products, with $70 million in systems to be delivered over a two-year period, then another $35 million of orders to be completed in the third year. As a result of these statements, the complaints contend that the price of our shares of common stock was artificially inflated during the period from April 25, 2001 through May 14, 2003, and the persons who purchased our common shares during that period suffered substantial damages. The complaints request judgment for unspecified damages, together with interest and attorneys' fees. These three cases have been consolidated into a single action. If we are not successful in defending and protecting our interests in these cases, resulting in a judgment against us for substantial damages, and U.S. Fire Insurance Company denies coverage in the cases under the Directors and Officers Liability and Company Reimbursement Policy, we would not be able to pay the indemnification obligations and, as a result, would be forced to seek bankruptcy protection. There is also pending litigation against Messrs. Motter, Miehle and Hemmer in an action filed in the United States District Court, District of Utah by Innovative Optics, Inc. The complaint claims that Innovative and Barton entered into an asset purchase agreement with us on January 31, 2002, in which we agreed to purchase all the assets of Innovative in consideration for the issuance of 1,310,000 shares of the Company's common stock to Innovative. The complaint also claims that we allegedly made false and misleading statements pertaining to the Blood Flow Analyzer(TM) and concerning a purchase order from Valdespino Associates Enterprises and Westland Financial Corporation. The purpose of these statements, according to the complaint, was to induce Innovative to sell its assets and purchase the shares of our common stock at artificially inflated prices while simultaneously deceiving Innovative and Barton into believing that the Company's shares were worth more than they actually were. Had Innovative and Barton known the truth, the complaint contends, they would not have sold Innovative to us, would not have purchased our stock for the assets of Innovative, or would not have purchased the stock at the inflated prices that were paid. The complaint further contends that as a result of these statements, Innovative and Barton suffered substantial damages in an amount to be proven at trial. The complaint further claims that 491,250 of the shares to be issued to Innovative in the asset purchase transaction were not issued on a timely basis and we also did not file a registration statement with the Securities and Exchange Commission within five months of the closing date of the asset purchase transaction. As a result, the complaint alleges that the value of the shares of our common stock issued to Innovative in the transaction declined, and Innovative and Barton suffered damages in an amount to be proven at trial. We filed an answer to the complaint and also filed counterclaims against Innovative and Barton for breach of contract. If we are not successful in defending and protecting our interests in this action, resulting in a judgment against us for substantial damages, and U.S. Fire denies coverage in the cases under the Directors and Officers Liability and Company Reimbursement Policy, we would not be able to pay the indemnification obligations and, as a result, would be forced to seek bankruptcy protection. Finally, there is also pending litigation against Messrs. Motter, Miehle and Hemmer and Randall A. Mackey, Chairman of the Board and Secretary, to whom we have indemnification obligations, in a class action complaint filed in the Third Judicial District Court, Salt Lake County, State of Utah, captioned Albert Kinzinger, Jr., individually and on behalf of all others similarly situated vs. Paradigm Medical Industries, Inc., Thomas Motter, Mark Miehle, Randall A. Mackey, and John Hemmer, Case No. 030922608. We have retained legal counsel to review the complaint, which appears to be focused on alleged false or 66 misleading statements pertaining to the Blood Flow Analyzer(TM). More specifically, the complaint alleges that we falsely stated in its Securities and Exchange Commission filings and press releases that it had received authorization to use an insurance reimbursement CPT code from the CPT Code Research and Development Division of the American Medical Association in connection with the Blood Flow Analyzer(TM), adding that the CPT code provides for a reimbursement to doctors of $57.00 per patient for the Blood Flow Analyzer(TM). The purpose of these statements, according to the complaint, was to induce investors to purchase shares of our Series E preferred stock in a private placement transaction at artificially inflated prices. The complaint contends that as a result of these statements, the investors that purchased shares of our Series E preferred stock in the private offering suffered substantial damages to be proven at trial. The complaint also alleges that we sold Series E preferred shares without registering the sale of such shares or obtaining an exemption from registration. The complaint requests rescission, compensatory damages and treble damages, including interest and attorneys' fees. We filed an answer to the complaint. If we are not successful in defending and protecting our interests in the action, resulting in a judgment against us for substantial damages, and U.S. Fire denies coverage in this action under the Directors and Officers Liability and Company Reimbursement Policy, we would not be able to pay the indemnification obligations and, as a result, would be forced to seek bankruptcy protection. Except for these litigation matters, there is no pending litigation or proceedings involving a director, officer, employee or other agent of our company as to which indemnification is being sought, nor are we aware of any threatened litigation that may result in claims for indemnification by any director, officer, employee or other agent. Insofar as indemnification for liabilities arising under the Securities Act of 1933 may be permitted to directors, officers and controlling persons pursuant to the foregoing provisions, or otherwise, we have been advised that in the opinion of the Securities and Exchange Commission, such indemnification is against public policy as expressed in the Securities Act of 1933, as amended, and is, therefore, unenforceable. Compliance with Section 16(a) of the Securities Exchange Act of 1934 Section 16(a) of the Securities Exchange Act of 1934 requires our executive officers, directors and persons who own more than 10% of any class of our common stock to file initial reports of ownership and reports of changes of ownership of common stock. Such persons are also required to furnish us with all Section 16(a) reports they file. Based solely on our review of the copies of such reports received by us with respect to fiscal 2004, or written representations from certain reporting persons, we believe that all filing requirements applicable to its directors, officers and greater than 10% beneficial owners were complied with, except that Dr. David M. Silver, a director of the company, through an oversight, filed a late stock transaction report covering four transactions. No other late filings occurred during 2004. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT The following table sets forth certain information with respect to beneficial ownership of our common stock as of May 31, 2005 for (i) each executive officer (ii) each director, (iii) each person known to us to be the beneficial owner of more than 5% of the outstanding shares, and (iv) all directors and officers as a group. Number of Percent of Name and Address(1) Shares Ownership ------------------ --------- ---------- Douglas A. MacLeod, M.D. (2) 3,068,451 11.1% 502 South M Street Tacoma Washington 98405 Dr. David M. Silver (3) 761,166 2.7% Randall A. Mackey (3) 725,000 2.6% Keith D. Ignotz (3) 454,560 1.6% John Y. Yoon (3) 222,224 * John C. Pingree (3) 231,500 * Aziz A. Mohabbat (3) 44,448 * --------- Executive officers and directors as a group (six persons) 2,438,898 8.8% ----------------- *Less than 1%. 67 (1) Unless otherwise indicated, the address of each listed stockholder is c/o Paradigm Medical Industries, Inc., 2355 South 1070 West, Salt Lake City, Utah, 84119. (2) Based on our shareholder records, Dr. McLeod owns 1,218,451 shares and is our largest sole shareholder. Dr. McLeod's beneficial ownership is believed to also include 400,000 shares held by the Douglas A. MacLeod, M.D. Profit Sharing Trust, 200,000 shares held by St. Mark's Eye Institute and 720,000 shares held by Milan Holdings, Ltd., which we believe Dr. MacLeod to have sole or shared voting and dispositive powers with regard to such shares. Dr. McLeod's beneficial ownership further includes shares that may be acquired currently or within 60 days after January 31, 2005 through the exercise of warrants as follows: Dr. MacLeod, 200,000 shares; Douglas A. MacLeod, M.D. Profit Sharing Trust; 100,000 shares; St. Mark's Eye Institute, 50,000 shares; and Milan Holdings, Ltd., 180,000 shares. (3) The amounts shown include shares that may be acquired currently, or within 60 days after January 31, 2005 through the exercise of stock options are follows: Dr. Silver, 725,000 shares; Mr. Mackey, 725,000 shares; Mr. Ignotz, 453,851 shares; Mr. Yoon, 222,224; Mr. Pingree, 125,000 shares; and Mr. Mohabbat, 44,448 shares. CERTAIN TRANSACTIONS The information set forth herein describes certain transactions between us and certain affiliated parties. Future transactions, if any, will be approved by a majority of the disinterested members and will be on terms no less favorable to us than those that could be obtained from unaffiliated parties. Thomas F. Motter, our former Chairman of the Board and Chief Executive Officer, leased his former residence to us for $2,500 per month. The primary use of the residential property was for housing accommodations for our employees living outside of Utah while they were working at our corporate headquarters in Salt Lake City. We paid $2,500 and $14,000 in rent during 2003 and 2002, respectively. This agreement was terminated on January 31, 2003. We entered into a consulting agreement with Mark R. Miehle, our former President and Chief Operating Officer for a period of six months commencing on September 3, 2002. The agreement was renewable for additional six month terms. We did not renew the contract upon its expiration. We paid $1,000 and $15,000 under this agreement during 2003 and 2002, respectfully, and had an accrual of $5,000 as of December 31, 2002. Randall A. Mackey, a director since January 21, 2000, and from September 1995 to September 3, 1998 and Chairman of the Board since August 30, 2002, is President and a shareholder of the law firm of Mackey Price Thompson & Ostler, which rendered legal services in connection with various corporate matters. Legal fees and expenses paid to Mackey Price Thompson & Ostler for legal services during the fiscal years ended December 31, 2004 and 2003, totaled $90,000 and $97,000, respectively. Legal fees and expenses paid to Mackey Price Thompson & Ostler for legal services during the three months ended March 31, 2005 totaled $25,000. As of December 31, 2004, we owed this firm $188,705, which is included in accounts payable. SELLING STOCKHOLDERS The table below sets forth information concerning the resale of the shares of common stock by the selling stockholders. We will not receive any proceeds from the resale of the common stock by the selling stockholders. We will receive proceeds from the exercise of the warrants unless the selling stockholders exercise the warrants on a cashless basis. Assuming all the shares registered below are sold by the selling stockholders, none of the selling stockholders will continue to own any shares of our common stock. The following table also sets forth the name of each person who is offering the resale of shares of common stock by this prospectus, the number of shares of common stock beneficially owned by each person, the number of shares of common stock that may be sold in this offering, and the number of shares of common stock each person will own after the offering, assuming they sell all of the shares offered. 68 Shares Beneficially Owned Prior to Number of Shares Beneficially Offering Shares Being Owned After Offering Shareholders Number Percent Offered Number Percent ------------ ------ ------- ------------ ------ ------- AJW Offshore Ltd. 4,712,694 4.99% 91,600,529 0 * AJW Qualified Partners 4,712,694 4.99% 62,288,360 0 * AJW Partners, LLC 4,712,694 4.99% 25,648,148 0 * New Millennium Capital Partners, LLC 1,318,254 1.40% 3,664,022 0 * TOTAL ---------------- * less than 1% (1) Applicable percentage ownership is based on 28,530,074 shares of common stock outstanding as of June 24, 2005, together with securities exercisable or convertible into shares of common stock within 60 days of June 24, 2005 for each stockholder. Beneficial ownership is determined in accordance with the rules of the Securities and Exchange Commission and generally include voting or investment power with respect to securities. Shares of common stock that are currently exercisable within 60 days of June 24, 2005 are deemed to be beneficially owned by the person holding such securities for the purpose of computing the percentage ownership of such person, but are not for the purpose of computing the percentage ownership of any other person. (2) Assumes that all securities registered will be sold and that all securities of common stock underlying the callable secured convertible notes and warrants will be issued. (3) Represents shares underlying callable secured convertible notes and warrants, up to the maximum permitted ownership under the callable secured convertible notes and warrants of 4.99% of our outstanding common stock. The selling stockholders or affiliates of each other because they are under common control. AJW Partners, LLC is a private investment fund that is owned by its investors and managed by SMS Group, LLC. SMS Group, LLC, of which Corey S. Ribotsky is the fund manager, has voting and investment control over the securities owned by AJW Partners, LLC. AJW Offshore, Ltd. is a private investment fund that is owned by its investors and managed by First Street Manager II, LLC. First Street Manager II, LLC, of which Corey S. Ribotsky is the fund manager, has voting and investment control over the securities owned by AJW Offshore, Ltd. AJW Qualified Partners, LLC is a private investment fund that is owned by its investors and managed by AJW Manager, LLC, of which Corey S. Ribotsky and Lloyd A. Groveman are the fund managers, have voting and investment control over the securities owned by AJW Qualified Partners, LLC. New Millennium Capital Partners II, LLC is a private investment fund that is owned by its investors and managed by First Street Manager II, LLC. First Street Manager II, LLC, of which Corey S. Ribotsky is the fund manager, has voting and investment control over the securities owned by New Millennium Capital Partners II, LLC. We have been notified by the selling stockholders that they are not broker-dealers or affiliates of broker-dealers. Terms of Callable Secured Convertible Notes and Warrants To obtain funding for our ongoing operations, we entered into a Securities Purchase Agreement with four accredited investors on April 27, 2005 for the sale of (i) $2,500,000 in callable secured convertible notes and (ii) warrants to purchase 16,534,392 shares of our common stock. The sale of the callable secured convertible notes and warrants is to occur in three traunches and the investors are obligated to provide us with an aggregate of $2,500,000 as follows: o $850,000 was disbursed on April 27, 2005; o $800,000 was disbursed on June 23, 2005 after filing a registration statement on June 22, 2005, which covered the shares of common stock underlying the callable secured convertible notes and the warrants; and o $850,000 will be disbursed within five days of the effectiveness of the registration statement. Each closing under the Securities Purchase Agreement is subject to the following conditions: o We must have delivered to the investors duly executed callable secured convertible notes and warrants; o No litigation, statute, regulation or order shall have been commenced, enacted or entered by or in any court, governmental authority or any self-regulatory organization that prohibits consummation of the transactions contemplated by the Securities Purchase Agreement; and o No event shall have occurred that could reasonably be expected to have a material adverse effect on our business. 69 We also agreed not, without the prior written consent of a majority-in-interest of the investors, to negotiate or contract with any party to obtain additional equity financing (including debt financing with an equity component) that involves (i) the issuance of common stock at a discount to the market price of the common stock on the date of issuance (taking into account the value of any warrants or options to acquire common stock in connection therewith), (ii) the issuance of convertible securities that are convertible into an indeterminate number of shares of common stock, or (iii) the issuance of warrants during the lock-up period beginning April 27, 2005 and ending on the later of (A) 270 days from April 27, 2005, and (B) 180 days from the date the registration statement is declared effective. In addition, we agreed not to conduct any equity financing (including debt financing with an equity component) during the period beginning April 27, 2005 and ending two years after the end of the above lock-up period unless we have first provided each investor an option to purchase its pro-rata share (based on the ratio of each investor's purchase under the Securities Purchase Agreement) of the securities being offered in any proposed equity financing. Each investor must be provided written notice describing any proposed equity financing at least 20 business days prior to the closing of such proposed equity financing and the option must be extended to each investor during the 15-day period following delivery of such notice. The callable secured convertible notes bear interest at 8% per annum from the date of issuance. Interest is computed on the basis of a 365-day year and is payable quarterly in cash, with six months of interest payable up front. The interest rate resets to zero percent for any month in which the stock price is greater than 125% of the initial market price, or $.0945, for each trading day during that month. Any amount of principal or interest on the callable secured convertible notes that is not paid when due will bear interest at the rate of 15% per annum from the date due thereof until such amount is paid. The callable secured convertible notes mature in three years from the date of issuance, and are convertible into our common stock at the selling stockholders' option, at the lower of (i) $.09 or (ii) 60% of the average of the three lowest intraday trading prices for the common stock on the OTC Bulletin Board for the 20 trading days before but not including the conversion date. Accordingly, there is no limit on the number of shares into which the notes may be converted. As of June 15, 2005, the average of the three lowest intraday trading prices of our common stock during the preceding 20 trading days as reported on the OTC Bulletin Board was $.05 and, therefore, the conversion price for the callable secured convertible notes was $.03. Based on this conversion price, the $2,500,000 callable secured convertible notes, excluding interest, were convertible into 83,333,333 shares of our common stock. As of June 15, 2005, none of the callable secured convertible notes have been converted. The callable secured convertible notes are secured by our assets, including our inventory, accounts receivable and intellectual property. Moreover, we have a call option under the terms of the notes. The call option provides us with the right to prepay all of the outstanding callable secured convertible notes at any time, provided there is no event of default by us and our stock is trading at or below $.09 per share. An event of default includes the failure by us to pay the principal or interest on the callable secured convertible notes when due or to timely file a registration statement as required by us or obtain effectiveness with the Securities and Exchange Commission of the registration statement. Prepayment of the callable secured convertible notes is to be made in cash equal to either (i) 125% of the outstanding principal and accrued interest for prepayments occurring within 30 days following the issue date of the notes; (ii) 130% of the outstanding principal and accrued interest for prepayments occurring between 31 and 60 days following the issue date of the notes; and (iii) 145% of the outstanding principal and accrued interest for prepayments occurring after the 60th day following the issue date of the notes. The warrants are exercisable until five years from the date of issuance at a purchase price of $.20 per share. The investors may exercise the warrants on a cashless basis if the shares of common stock underlying the warrants are not then registered pursuant to an effective registration statement. In the event the investors exercise the warrants on a cashless basis, then we will not receive any proceeds therefrom. In addition, the exercise price of the warrants will be adjusted in the event we issue common stock at a price below market, with the exception of any securities issued as of the date of the warrants or issued in connection with the callable secured convertible notes issued pursuant to the Securities Purchase Agreement. The selling stockholders have agreed to restrict their ability to convert their callable secured convertible notes or exercise their warrants and receive shares of our common stock such that the number of shares of common stock held by them in the aggregate and their affiliates after such conversion or exercise does not exceed 4.99% of the then issued and outstanding shares of common stock. However, the selling stockholders may repeatedly sell shares of common stock in order to reduce their ownership percentage, and subsequently convert additional callable secured convertible notes. We are required to register the shares of our common stock issuable upon the conversion of the callable secured convertible notes and the exercise of the warrants. The registration statement must be filed with the Securities and Exchange Commission within 60 days of the April 27, 2005 closing date and the effectiveness of the registration is to be within 135 days of such closing date. Penalties of 2% of the outstanding principal balance of the callable secured convertible notes plus accrued interest are to be applied for each month the registration is not effective within the required time. The penalty may be paid in cash or stock at our option. 70 Simple Conversion Calculation The number of shares of common stock issuable upon conversion of the callable secured convertible notes is determined by dividing that portion of the principal of the notes to be converted and interest, if any, by the conversion price. For example, assuming conversion of $2,500,000 of notes on June 20, 2005 and a conversion price of $.03 per share, the number of shares issuable upon conversion would be: $2,500,000/$.03 = 83,333,333 shares. Our obligation to issue shares upon conversion of our callable secured convertible notes is essentially limitless. The following is an example of the amount of shares of common stock that are issuable upon conversion of $2,500,000 principal amount of callable secured convertible notes (excluding accrued interest), based on market prices 25%, 50%, and 75% below the market price, as of June 20, 2005 of $.07. % Below Price Per With 40% Number of % of Market Share Discount Shares Issuable Outstanding* ------- --------- -------- -------------- ------------ 25% $.0525 $.0315 79,365,079 278.2% 50% $.0350 $.0210 119,047,619 417.3% 75% $.0175 $.0205 238,095,238 834.5% *Based on 28,530,074 shares outstanding. As illustrated, the number of shares of common stock issuable upon conversion of our callable secured convertible notes will increase if the market price of our stock declines, which will cause dissolution to our existing stockholders. DESCRIPTION OF SECURITIES Our authorized capital stock consists of 80,000,000 shares of common stock, $.001 par value per share, of which 28,530,074 shares were issued and outstanding as of June 24, 2005, and 5,000,000 shares of undesignated preferred stock, $.001 par value per share. We have created seven classes of preferred stock, designated as Series A preferred stock, Series B preferred stock, Series C convertible preferred stock, Series D convertible preferred stock, Series E convertible preferred stock, Series F convertible preferred stock and Series G convertible preferred stock. The following is a summary of the material terms and provisions of our capital stock and related securities. Because it is a summary, it does not include all of the information that is included in our certificate of incorporation. The text of our certificate of incorporation, which is attached as an exhibit to this registration statement, is incorporated into this section by reference. Common Stock Voting Rights. The holders of our common stock will have one vote per share and are not entitled to vote cumulatively for the election of directors. Generally, all matters to be voted on by stockholders must be approved by a majority or, in the case of election of directors, by plurality of the votes cast at a meeting at which a quorum is present and voting together as single class, subject to any voting rights granted to the holders of any then outstanding preferred stock. Dividends. Holders of common stock are entitled to receive any dividends declared by our board of directors, subject to the preferential rights of any preferred stock then outstanding. Dividends consisting of shares of common stock may be paid to holders of shares of common stock. Other Rights. Upon our liquidation, dissolution or winding up, the holders of common stock are entitled preferential to share ratably in any assets available for distribution to holders of shares of common stock. No holders of shares are subject to redemption or have preemptive rights to purchase additional shares of common stock. Preferred Stock Our certificate of incorporation provides that 5,000,000 shares of preferred stock may be issued from time to time in one or more series. Our board of directors is authorized to fix the voting rights, if any, designations, powers, preferences, qualifications, limitations and restrictions, applicable to 71 the shares of each series. Our board of directors may, without stockholder approval, issue preferred stock with voting and other rights that could adversely affect the voting power and other rights of the holders of the common stock and could have anti-takeover effects, including preferred stock or rights to acquire preferred stock in connection with implementing a stockholder rights plan. The ability of our board of directors to issue preferred stock without stockholder approval could have the effect of delaying, deferring or preventing a change of control with respect to our company or the removal of existing management. As of May 31, 2005, we have created and issued shares of seven classes of preferred stock. Series A, B, C, D, E, F and G Preferred Stock. The Board of Directors has authorized the issuance of 500,000 shares of Series A Preferred Stock, 500,000 shares of Series B Preferred Stock, 30,000 shares of Series C Preferred Stock, 1,140,000 shares of Series D Preferred Stock, 50,000 shares of Series E Preferred Stock, 50,000 shares of Series F Preferred Stock, and 2,000,000 shares of Series G Preferred Stock. Each of the shares of preferred stock are convertible into shares of common stock at a different conversion price. As of May 31, 2005, there were issued and outstanding 5,627 shares of Series A Preferred Stock convertible into 6,753 shares of our common stock; 8,986 shares of Series B Preferred Stock convertible into 10,783 shares of our common stock; no shares of Series C Preferred Stock; 5,000 shares of Series D Preferred Stock; 1,000 shares of Series E Preferred Stock convertible into 53,333 shares of common stock; 4,598.75 shares of Series F Preferred Stock convertible into 245,267 shares of our common stock; and 1,726,560 shares of Series G Preferred Stock convertible into 1,726,560 shares of our common stock The voting rights, dividends, conversion rights, redemption rights, and liquidation rights of the Series A, Series B, Series C, Series D, Series E, Series F and Series G Preferred Stock are more fully described below. Series A Preferred Stock Voting Rights. Except as provided by applicable law, the Series A preferred stockholders have neither voting power, nor the right to receive notice of any meetings of our stockholders. Except as required by law, the consent of the Series A preferred stockholders is not required or authorized to take any corporate action. Dividends. Our Series A preferred stock is entitled to noncumulative preferred dividends at $.24 per share per annum payable, at our option, in cash from surplus earnings. Conversion. At any time the Series A preferred stockholder may convert each share of Series A preferred stock into 1.2 shares of our common stock, subject to adjustment for stock splits, stock dividends, recapitalizations and similar transactions involving our common stock. Other Rights. Upon our liquidation, dissolution, or sale of substantially all of our assets, the Series A preferred stockholders are entitled to distributions equal to $1.00 per share, plus accrued and unpaid dividends. The shares of Series A preferred stock are subject to redemption but have no preemptive rights to purchase additional shares of Series A preferred stock or our common stock. Series B Preferred Stock Voting Rights. Except as provided by applicable law, the Series B preferred stockholders have neither voting power, nor the right to receive notice of any meetings of our stockholders. Except as required by law, the consent of the Series B preferred stockholders is not required or authorized to take any corporate action. Dividends. Our Series B preferred stock is entitled to noncumulative preferred dividends at $.24 per share per annum payable, at our option, in cash from surplus earnings. Conversion. At any time the Series B preferred stockholder may convert each share of Series B preferred stock into 1.2 shares of our common stock, subject to adjustment for stock splits, stock dividends, recapitalizations and similar transactions involving our common stock. Other Rights. Upon our liquidation, dissolution, or sale of substantially all of our assets, the Series B preferred stockholders are entitled to distributions equal to $4.00 per share, plus accrued and unpaid dividends. The Series B preferred stockholders are entitled to preferential distributions over all other classes of capital stock, other than Series A preferred stock. The shares of Series B preferred stock are subject to redemption but have no preemptive rights to purchase additional shares of Series B preferred stock or our common stock. 72 Series C Preferred Stock Voting Rights. Except as provided by applicable law, the Series C preferred stockholders have neither voting power, nor the right to receive notice of any meetings of our stockholders. Except as required by law, the consent of the Series C preferred stockholders is not required or authorized to take any corporate action. Dividends. Our Series C preferred stock is entitled to 12% noncumulative preferred dividends payable, at our option, in common stock or cash from surplus earnings. Conversion. At any time the Series C preferred stockholder may convert each share of Series C preferred stock into 57.14 shares of common stock, subject to adjustment for stock splits, stock dividends, recapitalizations and similar transactions involving our common stock. Any shares of Series C preferred stock outstanding after January 1, 2002, are automatically converted into our shares to common stock at the conversion price then in effect. Other Rights. Upon our liquidation, dissolution or sale of substantially all of our assets, the Series C preferred stockholders are entitled to distributions equal to the greater of (i) the amount of distributions such shares would have received had such holders converted the Series C preferred stock into common stock immediately prior to liquidation, or (ii) the stated value of $100.00 per share, plus declared but unpaid dividends. The Series C preferred stockholders are entitled to preferential distributions over all other classes of capital stock, other than Series A and Series B preferred stock. No shares of Series C preferred stock are subject to redemption or have preemptive rights to purchase additional shares of Series C preferred stock or our common stock. Series D Preferred Stock Voting Rights. Except as provided by applicable law, the Series D preferred stockholders have neither voting power, nor the right to receive notice of any meetings of our stockholders. Except as required by law, the consent of the Series D preferred stockholders is not required or authorized to take any corporate action. Dividends. Our Series D preferred stock is entitled to 8%noncumulative preferred dividends payable, at our option, in common stock or cash from surplus earnings. Conversion. At any time the Series D preferred stockholder may convert each share of Series D preferred stock into one share of common stock, subject to adjustment for stock splits, stock dividends, recapitalizations and similar transactions involving our common stock. Any shares of Series D preferred stock outstanding after January 1, 2002, are automatically converted into our shares of common stock at the conversion price then in effect. Other Rights. Upon our liquidation, dissolution or sale of substantially all of our assets, the Series D preferred stockholders are entitled to distributions equal to the greater of (i) the amount of distributions such shares would have received had such holders converted the Series D preferred stock into common stock immediately prior to liquidation, or (ii) the stated value of $1.75 per share, plus declared but unpaid dividends. The Series D preferred stockholders are entitled to preferential distributions over all other classes of capital stock, other than Series A, Series B and Series C preferred stock. No shares of Series D preferred stock are subject to redemption or have preemptive rights to purchase additional shares of Series D preferred stock or our common stock. Series E Preferred Stock Voting Rights. Except as provided by applicable law, the Series E preferred stockholders have neither voting power, nor the right to receive notice of any meetings of our stockholders. Except as required by law, the consent of the Series E preferred stockholders is not required or authorized to take any corporate action. Dividends. Our Series E preferred stock is entitled to 8% noncumulative preferred dividends payable, at our option, in common stock or cash from surplus earnings. Conversion. At any time the Series E preferred stockholder may convert each share of Series E preferred stock into 53.33 shares of common stock, subject to adjustment for stock splits, stock dividends, recapitalizations and similar transactions involving our common stock. Any shares of Series E preferred stock outstanding are automatically converted into shares of our common stock (i) after January 1, 2005, or (ii) after a registration statement registering our common shares issuable upon conversion has been effective for a least 30 days and the average closing price of our common stock for the 20-day period is at least $3.50 per share. 73 Other Rights. Upon our liquidation, dissolution or sale of substantially all of our assets, the Series E preferred stockholders are entitled to distributions equal to the greater of (i) the amount of distributions such shares would have received had such holders converted the Series E preferred stock into common stock immediately prior to liquidation, or (ii) the stated value of $100.00 per share, plus declared but unpaid dividends. The Series E preferred stockholders are entitled to preferential distributions over all other classes of capital stock, other than Series A, Series B, Series C and Series D preferred stock. No shares of Series E preferred stock are subject to redemption or have preemptive rights to purchase additional shares of Series E preferred stock or our common stock. Series F Preferred Stock Voting Rights. Except as provided by applicable law, the Series F preferred stockholders have neither voting power, nor the right to receive notice of any meetings of our stockholders. Except as required by law, the consent of the Series F preferred stockholders is not required or authorized to take any corporate action. Dividends. Our Series F preferred stock is entitled to 8% noncumulative preferred dividends payable, at our option, in common stock or cash from surplus earnings. Conversion. At any time the Series F preferred stockholder may convert each share of Series F preferred stock into 53.33 shares of common stock, subject to adjustment for stock splits, stock dividends, recapitalizations and similar transactions involving our common stock. Any shares of Series F preferred stock outstanding are automatically converted into shares of our common stock (i) after January 1, 2005, or (ii) after a registration statement registering our common shares issuable upon conversion has been effective for a least 30 days and the average closing price of our common stock for the 20-day period is at least $3.50 per share. Other Rights. Upon our liquidation, dissolution or sale of substantially all of our assets, the Series F preferred stockholders are entitled to the greater of (i) the amount of distributions such shares would have received had such holders converted the Series F preferred stock into common stock immediately prior to liquidation, or (ii) the stated value of $1.00 per share, plus declared but unpaid dividends. The Series F preferred stockholders are entitled to preferential distributions over all other classes of capital stock, other than Series A, Series B, Series C, Series D and Series E preferred stock. No shares of Series F preferred stock are subject to redemption or have preemptive rights to purchase additional shares of Series F preferred stock or our common stock. Series G Preferred Stock Voting Rights. Except as provided by applicable law, the Series G preferred stockholders have neither voting power, nor the right to receive notice of any meetings of our stockholders. Except as required by law, the consent of the Series G preferred stockholders is not required or authorized to take any corporate action. Dividends. Our Series G preferred stock is entitled to 8% noncumulative preferred dividends payable, at our option, in common stock or cash from surplus earnings. Conversion. At any time the Series G preferred stockholder may convert each share of Series G preferred stock into one share of common stock, subject to adjustment for stock splits, stock dividends, recapitalizations and similar transactions involving our common stock. Any shares of Series G preferred stock outstanding are automatically converted into shares of our common stock (i) after August 1, 2005, or (ii) after a registration statement registering our common shares issuable upon conversion has been effective for a least 30 days and the average closing price of our common stock for the 20-day period is at least $.50 per share. Other Rights. Upon our liquidation, dissolution or sale of substantially all of our assets, the Series G preferred stockholders are entitled to the greater of (i) the amount of distributions such shares would have received had such holders converted the Series G preferred stock into common stock immediately prior to liquidation, or (ii) the stated value of $.25 per share, plus declared but unpaid dividends. The Series G preferred stockholders are entitled to preferential distributions over all other classes of capital stock, other than Series A, Series B, Series C, Series D, Series E and Series F preferred stock. No shares of Series G preferred stock are subject to redemption or have preemptive rights to purchase additional shares of Series G preferred stock or our common stock. Under the terms of the private offering of Series G preferred shares, we are required to file a registration statement with the Securities and Exchange Commission to register the common shares issuable to the Series G preferred stockholders upon conversion of their Series G preferred shares and exercise of their warrants. If the registration statement has not been declared effective within 120 days of the initial closing of such offering on August 29, 2003, there is a penalty of 2% per month payable to the Series G preferred stockholders in common shares (or 39,631 common shares per month) until the registration statement is declared effective. As of September 30, 2004, we had recorded a liability of $43,000 related to the 356,682 common shares to be issued to the Series G preferred stockholders because the registration statement had not been declared effective as of that date. 74 Warrants Between June 10, 1997 and June 24, 2005, we issued warrants to individuals and entities that are currently outstanding to purchase a total of 15,371,881 shares of our common stock at exercise prices ranging from $.15 per share to $8.125 per share. The warrants all contain provisions that protect the holders against dilution by adjustment of the exercise price per share and the number of shares issuable upon exercise thereof upon the occurrence of certain events, including stock splits, stock dividends, mergers, and the sale of substantially all of our assets. We are not required to issue fractional shares of common stock, and in lieu thereof we will make a cash payment based upon the current market value of such fractional shares. A holder of these warrants will not possess any rights as a shareholder unless and until the holder exercises the warrants. The warrants that are currently issued and have not been exercised, and the exercise price and expiration date of such warrants are as follows: o Class A Warrants to purchase 1,000,000 shares of common stock at an exercise price of $7.50 per share, exercisable through July 10, 2006. o Warrants issued to Series E preferred stockholders to purchase 241,095 shares of common stock at an exercise price of $4.00 per share, exercisable through May 23, 2006. o Warrants issued to Series F preferred stockholders to purchase 251,114 shares of common stock at an exercise price of $4.00 per share, exercisable through August 20, 2006. o Warrants issued to Kenneth Jerome & Company, Inc. to purchase 200,000 shares of common stock at exercise prices ranging from $7.50 to $8.125 per share, exercisable through July 10, 2005. o Warrants issued to Cyndel & Company, Inc. to purchase 475,000 shares of common stock at exercise prices ranging from $3.00 to $4.00 per share, exercisable during the period from August 10, 2005 to February 7, 2006. o Warrants issued to Dr. Michael B. Lindberg to purchase 300,000 shares of common stock at exercise prices ranging from $4.00 to $6.75 per share, exercisable during the period of from December 1, 2008 through June 1, 2011. o Warrants issued to Helen Kohn and Ronit Sucoff to purchase 50,000 shares each of common stock at an exercise price of $4.00 per share, exercisable through February 7, 2006. o Warrants issued to Rodman & Renshaw to purchase 35,000 shares of common stock at an exercise price of $2.00 per share, exercisable through May 13, 2006. o Warrants issued to Paul L. Archanbeau, M.D., John H. Banzhaf, Daniel S. Lipson, Douglas A. MacLeod, M.D., Douglas A. MacLeod, M.D. Profit Sharing Trust, St. Mark's Eye Institute, Milan Holdings, Inc., Frank G. Mauro, and Delbert G. Reichardt to purchase an aggregate of 788,750 shares of common stock at an exercise price of $.25 per share, exercisable through September 6, 2005. o Warrants issued to certain investors in a private placement transaction to purchase an aggregate of 422,634 shares of common stock at an exercise price of $.75 per share, exerciseable through June 25, 2005. o Warrants issued to Series G preferred warrantholders to purchase 470,589 shares of common stock at an exercise price of $.50 per share, exercisable through September 1, 2006. o Warrants issued to Alpha Advisory Services, Inc. to purchase 25,000 shares of common stock at an exercise price of $.15 per share, exerciseable through September 28, 2007. o Warrants issued to Valvidia Trading, Inc. to purchase 200,000 shares of common stock at an exercise price of $.15 per share, exerciseable through January 14, 2008. o Warrants issued to AJW Partners, LLC, AJW Offshore, Ltd., AJW Qualified Partners, LLC and New Millennium Capital Partners II, LLC to purchase 5,621,694 shares of common stock at an exercise price of $.20 per share, exercisable through April 2, 2010. o Warrants issued to AJW Partners, LLC, AJW Offshore, Ltd., AJW Qualified Partners, LLC and New Millennium Capital Partners II, LLC to purchase 5,291,005 shares of common stock at an exercise price of $.20 per share, exercisable through June 23, 2010. 75 Convertible Notes and Warrants To obtain funding for our ongoing operations, we entered into a securities purchase agreement with four accredited investors on April 27, 2005 for the sale of (i) $2,500,000 in callable secured convertible notes and (ii) warrants to purchase 16,534,392 shares of our common stock. The sale of the callable secured convertible notes and warrants is to occur in three traunches and the investors are obligated to provide us with an aggregate of $2,500,000 as follows: o $850,000 was disbursed on April 27, 2005; o $800,000 was disbursed on June 23, 2005 after filing a registration statement on June 22, 2005, which covered the shares of common stock underlying the callable secured convertible notes and the warrants; and o $850,000 will be disbursed within five days of the effectiveness of the registration statement. Each closing under the securities purchase agreement is subject to the following conditions: o We must have delivered to the investors duly executed callable secured convertible notes and warrants; o No litigation, statute, regulation or order shall have been commenced, enacted or entered by or in any court, governmental authority or any self-regulatory organization that prohibits consummation of the transactions contemplated by the Securities Purchase Agreement; and o No event shall have occurred that could reasonably be expected to have a material adverse effect on our business. We also agreed not, without the prior written consent of a majority-in-interest of the investors, to negotiate or contract with any party to obtain additional equity financing (including debt financing with an equity component) that involves (i) the issuance of common stock at a discount to the market price of the common stock on the date of issuance (taking into account the value of any warrants or options to acquire common stock in connection therewith), (ii) the issuance of convertible securities that are convertible into an indeterminate number of shares of common stock, or (iii) the issuance of warrants during the lock-up period beginning April 27, 2005 and ending on the later of (A) 270 days from April 27, 2005, and (B) 180 days from the date the registration statement is declared effective. In addition, we agreed not to conduct any equity financing (including debt financing with an equity component) during the period beginning April 27, 2005 and ending two years after the end of the above lock-up period unless we have first provided each investor an option to purchase its pro-rata share (based on the ratio of each investor's purchase under the Securities Purchase Agreement) of the securities being offered in any proposed equity financing. Each investor must be provided written notice describing any proposed equity financing at least 20 business days prior to the closing of such proposed equity financing and the option must be extended to each investor during the 15-day period following delivery of such notice. The callable secured convertible notes bear interest at 8% per annum from the date of issuance. Interest is computed on the basis of a 365-day year and is payable quarterly in cash, with six months of interest payable up front. The interest rate resets to zero percent for any month in which the stock price is greater than 125% of the initial market price, or $.0945, for each trading day during that month. Any amount of principal or interest on the callable secured convertible notes that is not paid when due will bear interest at the rate of 15% per annum from the date due thereof until such amount is paid. The callable secured convertible notes mature in three years from the date of issuance, and are convertible into our common stock at the selling stockholders' option, at the lower of (i) $.09 or (ii) 60% of the average of the three lowest intraday trading prices for the common stock on the Over-the-Counter Bulletin Board for the 20 trading days before but not including the conversion date. Accordingly, there is no limit on the number of shares into which the notes may be converted. As of June 22, 2005, the average of the three lowest intraday trading prices of our common stock during the preceding 20 trading days as reported on the Over-the-Counter Bulletin Board was $.05 and, therefore, the conversion price for the callable secured convertible notes was $.03. Based on this conversion price, the $2,500,000 callable secured convertible notes, excluding interest, were convertible into 83,333,333 shares of our common stock. As of June 20, 2005, none of the callable secured convertible notes have been converted. The callable secured convertible notes are secured by our assets, including our inventory, accounts receivable and intellectual property. Moreover, we have a call option under the terms of the notes. The call option provides us with the right to prepay all of the outstanding callable secured convertible notes at any time, provided there is no event of default by us and our stock is trading at or below $.09 per share. An event of default includes the failure by us to pay the principal or interest on the callable secured convertible notes when due or to timely file a registration statement as required by us or obtain effectiveness with the Securities and Exchange Commission of the registration statement. Prepayment of the callable secured 76 convertible notes is to be made in cash equal to either (i) 125% of the outstanding principal and accrued interest for prepayments occurring within 30 days following the issue date of the notes; (ii) 130% of the outstanding principal and accrued interest for prepayments occurring between 31 and 60 days following the issue date of the notes; and (iii) 145% of the outstanding principal and accrued interest for prepayments occurring after the 60th day following the issue date of the notes. The warrants are exercisable until five years from the date of issuance at a purchase price of $.20 per share. The investors may exercise the warrants on a cashless basis if the shares of common stock underlying the warrants are not then registered pursuant to an effective registration statement. In the event the investors exercise the warrants on a cashless basis, then we will not receive any proceeds therefrom. In addition, the exercise price of the warrants will be adjusted in the event we issue common stock at a price below market, with the exception of any securities issued as of the date of the warrants or issued in connection with the callable secured convertible notes issued pursuant to the Securities Purchase Agreement. The selling stockholders have agreed to restrict their ability to convert their callable secured convertible notes or exercise their warrants and receive shares of our common stock such that the number of shares of common stock held by them in the aggregate and their affiliates after such conversion or exercise does not exceed 4.99% of the then issued and outstanding shares of common stock. However, the selling stockholders may repeatedly sell shares of common stock in order to reduce their ownership percentage, and subsequently convert additional callable secured convertible notes. We are required to register the shares of our common stock issuable upon the conversion of the callable secured convertible notes and the exercise of the warrants. The registration statement must be filed with the Securities and Exchange Commission within 60 days of the April 27, 2005 closing date and the effectiveness of the registration is to be within 135 days of such closing date. Penalties of 2% of the outstanding principal balance of the callable secured convertible notes plus accrued interest are to be applied for each month the registration is not effective within the required time. The penalty may be paid in cash or stock at our option. See the "Risk Factors" and "Selling Stockholders" sections for a complete description of the callable secured convertible notes and warrants. Certain Provisions of Certificate of Incorporation. Our Certificate of Incorporation provides that to the fullest extent permitted by Delaware law, our directors shall not be liable to us and our stockholders. The Certificate of Incorporation also contains provisions entitling the officers and directors to indemnification by us to the fullest extent permitted by the Delaware General Corporation Law. Indemnification Agreements. We have entered into indemnification agreements with our officers and directors. Such indemnification agreements provide that we will indemnify its officers and directors against expenses (including attorneys' fees), judgments, fines and amounts paid in settlement arising out of threatened, pending or completed legal action against any officer or director to the fullest extent permitted by the Delaware General Corporate Law. Transfer and Warrant Agent. Our transfer agent and registrar for our common stock and the Warrant Agent for the Class A warrants is Continental Stock Transfer & Trust Company, New York, New York. PLAN OF DISTRIBUTION The selling stockholders and any of their respective pledgees, donees, assignees and other successors-in-interest may, from time to time, sell any or all of their shares of common stock on any stock exchange, market or trading facility on which the shares are traded or in private transactions. These sales may be at fixed or negotiated prices. The selling stockholders may use any one or more of the following methods when selling shares: o Ordinary brokerage transactions and transaction in which the broker-dealer solicits the purchaser; o Block trades in which the broker-dealer will attempt to sell the shares as agent but may position and resell a portion of the block as principal to facilitate the transaction; o

Purchases by a broker-dealer as principal and resale by a broker-dealer for its account; o An exchange distributions in accordance with the rules of the applicable exchange; o Privately-negotiated transactions; 77 o Short sales that are not violations of laws and regulations of any state or the United States; o Broker-dealers may agree with the selling stockholders to sell a specified number of such shares at a stipulated price per share; o Through the writing of options on the shares; o A combination of any such method of sales; and o Any other method permitted pursuant to applicable law. The selling stockholders may also sell shares under Rule 144 under the Securities Act of 1933, as amended, if available, rather than under this prospectus. The selling stockholders shall have the sole and absolute discretion not to accept any purchase order or make any sale of sales if they deem the purchase price to be unsatisfactory at any particular time. The selling stockholders may also engage in short sales against the box, puts and calls, and other transactions in our securities or derivatives of our securities and may sell or deliver shares in connection with these trades. The selling stockholders or their respective pledgees, donees, transferees or other successors-in-interest, may also sell the shares directly to market makers acting a principals and/or broker-dealers acting as agents for themselves or the customers. Such broker-dealers may receive compensation in the form of discounts, concessions or commissions from the selling stockholders and/or the purchasers of shares for whom such broker-dealers may act as agents or to whom they sell as principal or both, which compensation as to a particular broker- dealer might be in excess of customary commissions. Market makers and block purchasers purchasing the shares will do so for their own account and at their risk. It is possible that a selling stockholder will attempt to sell shares of common stock at block transaction to market makers or other purchasers at a price per share which may be below the then market price. The selling stockholders cannot assure that all or any of the shares offered in this prospectus will be issued to, or sold by, the selling stockholders. The selling stockholders and any brokers, dealers or agents, upon effecting the sale of any of the shares offered in this prospectus, may be deemed to be "underwriters" as that term is defined in the Securities Act of 1933, as amended, or the Securities Exchange Act of 1934, as amended, or the rules and regulations under such acts. In such event, any commissions received by any such broker dealers or agents and any profit on the resale of the shares purchased by them may be deemed to be underwriting commissions or discounts under the Securities Act of 1933, as amended. We are required to pay all fees and expenses incident to the registration of the shares, including fees and disbursements of counsel to the selling stockholders, but excluding brokerage commissions or underwriter discounts. The selling stockholders, alternatively, may sell all or any part of the shares offered in this prospectus through an underwriter. No selling stockholder has entered into any agreement with a prospective underwriter and there is no assurance that any such agreement will be entered into. The selling stockholders may pledge their shares to the brokers under the margin provisions of customer agreements. If a selling stockholder defaults on a margin loan, the broker may, from time to time, offer and sell the pledged shares. The selling stockholders and any other persons participating in the sale or distribution of the shares will be subject to applicable provisions of the Securities Exchange Act of 1934, as amended, and the rules and regulations under such act, including without limitation, Regulation M. These provisions may restrict certain activities of, and limit the timing of purchases and sales of any of the shares by, the selling stockholders or any other such person. In the event that the selling stockholders are deemed affiliated purchasers or distribution participants within the meaning of Regulation M, then the selling stockholders will not be permitted to engage in short sales of common stock. Furthermore, under Regulation M, the persons engaged in a distribution of securities are prohibited from simultaneously engaging in market making and certain other activities with respect to such securities for a specified period of time prior to the commencement of such distributions, subject to specified exceptions or exemptions. In regards to short sales, the selling stockholder can only cover its short position with the securities it receives from us upon conversion. In addition, if such short sale is deemed to be a stabilizing activity, then the selling stockholder will not be permitted to engage in a short sale of our common stock. All of these limitations will affect the marketability of the shares. 78 We agreed to indemnity the selling stockholders, or their transferees or assignees, against certain liabilities, including liabilities under the Securities Act of 1933, as amended, or to contribute to payments to selling stockholders or their respective pledgees, donees, transferees or other successors-in-interest, may be required to make in respect to such liabilities. If the selling stockholders notify us that they have a material arrangement with a broker-dealer for the resale of the common stock, then we will be required to amend the registration statement of which this prospectus is a part, and file a prospectus supplement to describe the agreements between the selling stockholders and the broker-dealer. From time to time this prospectus will be supplemented and amended as required by the Securities Act of 1933, as amended. During any time when a supplement or amendment is so required, the Selling Securityholders are to cease sales until the prospectus has been supplemented or amended. Pursuant to the registration rights granted to certain of the Selling Securityholders, we have agreed to update and maintain the effectiveness of this prospectus. Certain of the Selling Securityholders also may be entitled to sell their shares without the use of this prospectus, provided that they comply with the requirements of Rule 144 promulgated under the Securities Act. EXPERTS Our consolidated financial statements for year ended December 31, 2003 included in this prospectus have been audited by Tanner LC, independent auditors, as stated in their report appearing herein. We have included consolidated financial statements in this prospectus in reliance on such report given upon their authority as experts in auditing and accounting. Our consolidated financial statements for the year ended December 31, 2004 included in this prospectus have been audited by Chisholm, Bierwolf & Nilson, independent auditors, as stated in their report appearing herein. We have included consolidated financial statements in this prospectus in reliance on such report given upon their authority as experts in auditing and accounting. LEGAL MATTERS The validity of the shares of common stock in this offering will be passed upon for us by Mackey Price Thompson & Ostler, Salt Lake City, Utah. Randall A. Mackey, the President, a director and a shareholder of the law firm of Mackey Price Thompson & Ostler is our Chairman of the Board and Secretary. Legal fees and expenses paid to Mackey Price Thompson & Ostler for legal services during the fiscal years ended December 31, 2004 and 2003 totaled $90,000 and $97,000, respectively. Legal fees and expenses paid to Mackey Price Thompson & Ostler for legal services during the three months ended March 31, 2005 totaled $25,000. As of December 31, 2004, we owed the firm $188,705, which is included in the accounts payable. WHERE YOU CAN FIND MORE INFORMATION We have filed with the Securities and Exchange Commission, or SEC, a registration statement on Form SB-2 (including the exhibits and schedules thereto) under the Securities Act of 1933 and the rules and regulations promulgated thereunder, for the registration of the common stock offered hereby. This prospectus is part of the registration statement. This prospectus does not contain all the information included in the registration statement because we have omitted certain parts of the registration statement as permitted by the SEC rules and regulations. For further information about us and our common stock, you should refer to the registration statement. Statements contained in this prospectus as to any contract, agreement or other document referred to are not necessarily complete. Where the contract or other document is an exhibit to the registration statement, each statement is qualified by the provisions of that exhibit. You can inspect and copy the registration statement and the exhibits and schedules thereto at the public reference facility maintained by the SEC at Room 1024, 450 Fifth Street, N.W., Washington, D.C. 20549, and at the SEC's regional offices at 233 Broadway, New York, New York 10279, and 500 West Madison Street, Suite 1400, Chicago, Illinois 60661. You may call the SEC at 1-800-732-0330 for further information about the operation of the public reference rooms. Copies of all or any portion of the registration statement can be obtained from the Public Reference Section of the SEC, 450 Fifth Street, N.W., Washington, D.C. 20549, at prescribed rates. In addition, the registration statement is publicly available through the SEC's site on the Internet's World Wide Web, located at http://www.sec.gov. We also file annual, quarterly and current reports, proxy statements and other information with the SEC. You can also request copies of these documents, for a copying fee, by writing to the SEC. Our SEC filings are also available to the public from the SEC's website at http://www.sec.gov. We furnish to our stockholders annual reports containing audited financial statements for each fiscal year. 79 PARADIGM MEDICAL INDUSTRIES, INC. FORM 10-QSB FOR THE QUARTER ENDED MARCH 31, 2005 INDEX PART I - FINANCIAL INFORMATION Item 1. Financial Statements...F-1 Condensed Balance Sheet (unaudited) - March 31, 2005.............................F-1 Condensed Statements of Operations (unaudited) for the three months ended March 31, 2005 and March 31, 2004..F-2 Condensed Statements of Cash Flows (unaudited) for the three months ended March 31, 2005 and March 31, 2004 ....F-3 Notes to Condensed Financial Statements (unaudited)..............................F-4 Report of Chisholm, Bierwolf & Nilson..F-8 Report of Tanner LC..F-9 Balance Sheet as of December 31, 2004..F-10 Statements of Operations for the years ended December 31, 2004 and 2003...F-11 Statements of Stockholders' Equity for the years ended December 31, 2004 and 2003..F-12 Statements of Cash Flows for the years ended December 31, 2004 and 2003..F-13 Notes to Financial Statements...F-14 PARADIGM MEDICAL INDUSTRIES, INC. CONDENSED BALANCE SHEET (UNAUDITED) March 31, 2005 ----------------- ASSETS Current Assets Cash & Cash Equivalents $ 70,000 Receivables, Net 535,000 Inventory 745,000 Prepaid Expenses 43,000 ----------------- Total Current Assets 1,393,000 Intangibles, Net 679,000 Property and Equipment, Net 86,000 ----------------- Total Assets $

2,158,000 ================= LIABILITIES AND STOCKHOLDERS' EQUITY Current Liabilities: Trade Accounts Payable $ 745,000 Accrued Expenses 797,000 Current Portion of Long-term Debt 42,000 ----------------- Total Current Liabilities 1,584,000 Long-term Debt 5,000 ----------------- Total Liabilities (Commitment) 1,589,000 ----------------- Stockholders' Equity: Preferred Stock, Authorized: 5,000,000 shares, $.001 par value Series A Authorized: 500,000 shares; issued and outstanding: 5,627 shares at March 31, 2005 - Series B Authorized: 500,000 shares; issued and outstanding: 8,986 shares at March 31, 2005 - Series C Authorized: 30,000 shares; issued and outstanding: zero shares at March 31, 2005 - Series D Authorized: 1,140,000 shares; issued and outstanding: 5,000 shares at March 31, 2005 - Series E Authorized: 50,000 shares; issued and outstanding: 1,000 shares at March 31, 2005 - Series F Authorized: 50,000 shares; issued and outstanding: 4,598.75 shares at March 31, 2005 - Series G Authorized: 2,000,000 shares; issued and outstanding: 1,726,560 shares at March 31, 2005 2,000 Common Stock, Authorized: 80,000,000 shares, $.001 par value; issued and outstanding: 28,280,074 at March 31, 2005 28,000 Additional paid-in-capital 57,669,000 Accumulated Deficit (57,130,000) ----------------- Total Stockholders' Equity 569,000 ----------------- Total Liabilities and Stockholders' Equity $ 2,158,000 ================= See accompanying notes to condensed financial statements F-1 PARADIGM MEDICAL INDUSTRIES, INC. CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS (UNAUDITED) Three Months Ended March 31, 2005 2004 ------------ ------------ Sales $ 528,000 $ 583,000 Cost of Sales 214,000 227,000 ------------ ------------ Gross Profit 314,000 356,000 ------------ ------------ Operating Expenses: Marketing and Selling 180,000 185,000 General and Administrative 258,000 304,000 Research, Development and Service 210,000 227,000 ------------ ------------ Total Operating Expenses 648,000 716,000 ------------ ------------ Operating Income (Loss) (334,000) (360,000) Other Income and (Expense): Interest Income - 2,000 Interest Expense (4,000) (6,000) Other Income (Expense) 15,000 - ------------ ------------ Total Other Income and (Expense) 11,000 (4,000) Net Income (Loss) Before Provision for Income Taxes (323,000) (364,000) Income Taxes - - ------------ ------------ Net Income (Loss) $ (323,000) $ (364,000) ============ ============ Net Loss Per Common Share - Basic and Diluted $ (0.01) $ (0.01) ============ ============ Weighted Average Outstanding Shares - Basic and Diluted 27,121,000 25,373,000 ============ ============ See accompanying notes to condensed financial statements. F-2 PARADIGM MEDICAL INDUSTRIES, INC. CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED) Three Months Ended March 31, 2005 2004 ---------------------------- Cash Flows from Operating Activities: ------------------------------------ Net Loss $ (323,000) $ (364,000) Adjustment to Reconcile Net Loss to Net Cash Used In Operating Activities: Depreciation and Amortization 23,000 41,000 Issuance of Common Stock for Satisfaction of Penalty 52,000 - Issuance of Stock Option/Warrant for Services - - Increase/Decrease in Inventory Reserve - - Provision for Losses on Receivables (7,000) - (Increase) Decrease from Changes in: Trade Accounts Receivable 129,000 218,000 Inventories (25,000) 135,000 Prepaid Expenses 22,000 (102,000) Increase (Decrease) from Changes in: Trade Accounts Payable (7,000) (20,000) Accrued Expenses and Deposits (61,000) 73,000 ----------- ----------- Net Cash Used in Operating Activities (197,000) (19,000) ----------- ----------- Cash Flow from Investing Activities: ----------------------------------- Net Cash Paid in Acquisition - - ----------- ----------- Net Cash (Used) Provided By Investing Activities - - ----------- ----------- Cash Flows from Financing Activities: ------------------------------------ Principal Payments on Notes Payable (14,000) (13,000) Proceeds from Issuance of Common Stocks 150,000 - ----------- ----------- Net Cash (Used) Provided by Financing Activities 136,000 (13,000) ----------- ----------- Net Decrease in Cash and Cash Equivalents (61,000) (32,000) Cash and Cash Equivalents at Beginning of Period 131,000 132,000 ----------- ----------- Cash and Cash Equivalents at End of Period $ 70,000 $ 100,000 =========== =========== Supplemental Disclosure of Cash Flow Information: Cash Paid for Interest $ 4,000 $ 6,000 =========== =========== Cash Paid for Income Taxes $ - $ - =========== =========== See accompanying notes to financial statements F-3 PARADIGM MEDICAL INDUSTRIES, INC. NOTES TO FINANCIAL STATEMENTS (UNAUDITED) Significant Accounting Policies ------------------------------- The accompanying condensed financial statements of the Company have been prepared by the Company, without audit, pursuant to the rules and regulations of the Securities and Exchange Commission. Certain information and disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States have been condensed or omitted pursuant to such rules and regulations. These condensed financial statements reflect all adjustments (consisting only of normal recurring adjustments) that, in the opinion of management, are necessary to present fairly the results of operations of the Company for the periods presented. These condensed financial statements should be read in conjunction with the financial statements and the notes thereto included in the Company's Form 10-KSB for the year ended December 31, 2004. The results of operations for the three months ended March 31, 2005, are not necessarily indicative of the results that may be expected for the fiscal year ending December 31, 2005. Going Concern ------------ The accompanying financial statements have been prepared on a going concern basis, which contemplates the realization of assets and the satisfaction of liabilities in the normal course of business. Historically, the Company has not demonstrated the ability to generate sufficient cash flows from operations to satisfy its liabilities and sustain operations, and the Company has incurred significant losses. These factors raise substantial doubt about the Company's ability to continue as a going concern. The Company's continuation as a going concern is dependent on its ability to generate sufficient income and cash flow to meet its obligations on a timely basis and/or obtain additional financing as may be required. The Company is actively seeking options to obtain additional capital and financing. In addition, the Company has taken significant steps to reduce costs and increase operating efficiencies. Specifically, the Company has significantly reduced the use of consultants, which has resulted in a large decrease in expenses. In addition, the Company has reduced the number of its direct sales representatives, which has resulted in less payroll, travel and other expenses. Although these cost savings have significantly reduced the Company's losses and ongoing cash flow needs, if the Company is unable to obtain equity or debt financing, it may be unable to continue development of its products and may be required to substantially curtail or cease operations. Net Loss Per Share ----------------- Net loss per common share is computed on the weighted average number of common and common equivalent shares outstanding during each period. Common stock equivalents consist of convertible preferred stock, common stock options and warrants. Common equivalent shares are excluded from the computation when their effect is anti-dilutive. Other common stock equivalents consisting of options and warrants to purchase 8,760,000 and 5,879,000 shares of common stock and preferred stock convertible into 2,047,000 and 2,302,000 shares of common stock at March 31, 2005 and 2004, respectively, have not been included in loss periods because they are anti-dilutive. For the three months ended March 31, 2005, the options and warrants to purchase 8,760,000 shares of common stock were excluded because of the treasury stock method. The following table is a reconciliation of the net loss numerator of basic and diluted net loss per common share for the three and six month periods ended March 31, 2005 and March 31, 2004: F-4 Three Months Ended March 31, 2005 2004 ------------------------- Basic weighted average shares outstanding 27,121,000 $25,373,000 Common stock equivalents - convertible preferred stock 2,047,000 2,302,000 ----------- ----------- Diluted weighted average shares outstanding 29,168,000 27,675,000 ========= ========= Preferred Stock Conversions -------------------------- Under the Company's Articles of Incorporation, holders of the Company's Class A and Class B preferred stock have the right to convert such stock into shares of the Company's common stock at the rate of 1.2 shares of common stock for each share of preferred stock. During the three months ended March 31, 2005, no shares of Series A preferred stock and no shares of Series B preferred stock were converted to the Company's common stock. Holders of Series D preferred have the right to convert such stock into shares of the Company's common stock at the rate of one share of common stock for each share of preferred stock. During the three months ended March 31, 2005, no shares of Series D preferred stock were converted to the Company's common stock. Holders of Series E preferred have the right to convert such stock into shares of the Company's common stock at the rate of 53.3 shares of common stock for each share of preferred stock. During the three months ended March 31, 2005, no shares of Series E preferred stock were converted to the Company's common stock. Holders of Series F preferred have the right to convert such stock into shares of the Company's common stock at the rate of 53.3 shares of common stock for each share of preferred stock. During the three months ended March 31, 2005, no shares of Series F preferred stock were converted to shares of the Company's common stock. Holders of Series G preferred have the right to convert such stock into shares of the Company's common stock at the rate of one share of common stock for each share of preferred stock. During the three months ended March 31, 2005, no shares of Series G preferred stock were converted to shares of the Company's common stock. Warrants -------- The fair value of warrants granted as described herein is estimated at the date of grant using the Black-Scholes option pricing model. The exercise price per share is reflective of the then current market value of the stock. No grant exercise price was established at a discount to market. All warrants are fully vested, exercisable and nonforfeitable as of the grant date. As a result of the issuance of 2,000,000 shares of the Company's common stock for $150,000 cash, the Company granted 200,000 warrants to purchase the Company's common stock during the period ended March 31, 2005. The warrants have an exercise price of $.15 per share and expire on January 14, 2008. Stock - Based Compensation ------------------------- For stock options and warrants granted to employees, the Company employs the footnote disclosure provisions of Statement of Financial Accounting Standards (SFAS) No.

123, Accounting for Stock-Based Compensation. SFAS No. 123 encourages entities to adopt a fair-value based method of accounting for stock options or similar equity instruments. However, it also allows an entity to continue measuring compensation cost for stock-based compensation using the intrinsic-value method of accounting prescribed by Accounting Principles Board (APB) Opinion No. 25, Accounting for Stock Issued to Employees (APB 25). The Company has elected to continue to apply the provisions of APB 25 and provide pro forma footnote disclosures required by SFAS No. 123. No stock-based employee compensation cost is reflected in net income, as all options granted under those plans had an exercise price equal to or greater than the market value of the underlying common stock on the date of grant. Stock options and warrants granted to non-employees for services are accounted for in accordance with SFAS 123 which requires expense recognition based on the fair value of the options/warrants granted. The Company calculates the fair value of options and warrants granted by use of the Black-Scholes F-5 pricing model. The following table illustrates the effect on net income and earnings per share if the Company had applied the fair value recognition provisions of FASB Statement No. 123, "Accounting for Stock-Based Compensation," to stock-based employee compensation. Three Months Ended June 30, 2005 2004 ---------------------------- Net income (loss) - as reported $ (322,000) $ (364,000) Deduct: total stock-based employee compensation determined under fair value based method for all awards, net of related tax effects (78,000) - ---------- ----------- Net loss - pro forma $ (401,000) $ (364,000) =========== =========== Earnings per share: Basic and diluted - as reported $ (0.01) $ (0.01) Basic and diluted - pro forma $ (0.01) $ (0.01) Related Party Transactions ------------------------- Payments for legal services to the firm of which the chairman of the board of directors is a partner were approximately $25,000 and $5,000 for the three months ended March 31, 2005 and 2004, respectively. Accrued Expenses --------------- Accrued expenses consist of the following at March 31, 2005: Accrued consulting and litigation reserve $ 457,000 Accrued payroll and employee benefits 127,000 Sales taxes payable 14,000 Customer deposits 29,000 Accrued royalties 14,000 Deferred revenue 4,000 Warranty and return allowance 123,000 Other accrued expenses 30,000 ---------- Total $ 797,000 ========== Stockholders' Equity ------------------- On January 14, 2005, the Company issued 2,000,000 shares of common stock to an accredited investor through a private placement at a price of $.075 per share. The Company received a total of $150,000 in cash from the private placement transaction and issued as a commission warrants to purchase 200,000 shares of the Company's common stock at $.15 per share. On February 1, 2005, the Company issued a total of 515,206 shares of common stock to two accredited investors that had purchased shares of the Company's Series G convertible preferred stock in a private placement transaction. Under the terms of the private offering, the Company was required to file a registration statement with the Securities and Exchange Commission to register the common shares issuable to the Series G preferred stockholders upon conversion of their Series G preferred shares and exercise of their warrants. The 515,206 shares represented a penalty for the Company not having a registration statement declared effective within 120 days of the initial closing of the offering. The value of these shares was $52,000. F-6 Subsequent Event ---------------- On April 27, 2005, the Company completed financing involving the sale of $2,500,000 in secured convertible notes. The notes are to be purchased in three traunches: the first traunche is in the amount of $850,000, which the Company received upon the signing of the definitive investment agreements on April 27, 2005; the second traunche in the amount of $800,000 upon the filing of a registration statement with the Securities and Exchange Commission which the Company received on June 23, 2005; and the third traunche in the amount of $850,000 upon the effectiveness of the registration statement. Under the terms of the notes, the unpaid principal balance of notes, together with any accrued interest thereon, are due and payable three years after the date of issuance. The unpaid principal balance on the notes that were purchased on April 27, 2005 is due on April 27, 2008. Interest is payable on the notes at 8% per annum, payable quarterly in cash, with six months of interest payable up front. However, the interest rate resets to zero percent for any month in which the stock price is greater than 125% of the initial market price, or $.0945, for each trading date during that month. The notes are secured by the Company's assets, including the Company's inventory, accounts receivable and intellectual property. The notes are also convertible. The Purchasers have the right to convert their notes at any time into shares of the Company's common stock. The conversion price of the notes is equal to the lesser of (i) $.09 and (ii) the average of the lowest intra-day trading prices during the 20 trading days immediately prior to the conversion date discounted by 40%. F-7 REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM The Board of Directors Paradigm Medical Industries, Inc. Salt Lake City, Utah We have audited the accompanying balance sheet of Paradigm Medical Industries, Inc. (the Company) as of December 31, 2004, and the related statements of operations, stockholders' equity and cash flows for the year then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, audits of its internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion. In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Paradigm Medical Industries, Inc. as of December 31, 2004, and the results of their operations and their cash flows for the year then ended, in conformity with accounting principles generally accepted in the United States of America. The accompanying financial statements have been prepared assuming the Company will continue as a going concern. As discussed in Note 2 to the financial statements, the Company has a working capital deficit and has suffered recurring operating losses, which raises substantial doubt about its ability to continue as a going concern. Management's plans in regard to these matters are also described in Note 2. The financial statements do not include any adjustments that might result from the outcome of these uncertainties. Chisholm, Bierwolf & Nilson Bountiful, Utah April 8, 2005 F-8 REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM To the Board of Directors and stockholders of Paradigm Medical Industries, Inc. We have audited the statements of operations, stockholders' equity, and cash flows of Paradigm Medical Industries, Inc. (the Company) for the year ended December 31, 2003. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). 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 audit provides a reasonable basis for our opinion. In our opinion, the financial statements referred to above present fairly, in all material respects the results of operations and cash flows of Paradigm Medical Industries, Inc. for the year ended December 31, 2003, in conformity with U.S. generally accepted accounting principles. The accompanying financial statements have been prepared assuming that the Company will continue as a going concern. As discussed in note 2, the Company has incurred significant losses, and has been unable to generate cash flows from operations. These conditions raise substantial doubt about the Company's ability to continue as a going concern. Management's plans in regard to these matters are also described in note 2. The financial statements do not include any adjustments that might result from the outcome of this uncertainty. Tanner LC Salt Lake City, Utah March 5, 2004 F-9 PARADIGM MEDICAL INDUSTRIES, INC. Balance Sheet December 31, 2004 -- Assets ------ Current assets: Cash $ 131,000 Receivables, net 657,000 Inventories, net 720,000 Prepaid and other assets 65,000 ------------------ Total current assets 1,573,000 Intangibles, net 679,000 Property and equipment, net 109,000 ------------------ Total assets $ 2,361,000 ------------------ -- Liabilities and Stockholders' Equity ------------------------------------ Current liabilities: Accounts payable $ 752,000 Accrued liabilities 858,000 Current portion of capital lease obligations 47,000 ------------------ Total current liabilities 1,657,000 ------------------ Capital lease obligations, net of current portion 14,000 ------------------ Commitments and contingencies - Stockholders' equity: Preferred stock, $.001 par value, 5,000,000 shares authorized, 1,751,770 shares issued and outstanding (aggregate liquidation preference of $1,043,000) 2,000 Common stock, $.001 par value, 80,000,000 shares authorized, 25,627,764 shares issued and outstanding 25,000 Additional paid-in capital 57,470,000 Accumulated deficit (56,807,000) ------------------ Total stockholders' equity 690,000 ------------------ Total liabilities and stockholders' equity $ 2,361,000 ------------------ -- See accompanying notes to financial statements. F-10 PARADIGM MEDICAL INDUSTRIES, INC. Statements of

Operations Years Ended December 31,
-- 2004 2003
---------------------------------- Sales $ 3,062,000 $ 3,059,000 Cost of sales 1,217,000 2,086,000
---------------------------------- Gross profit 1,845,000 973,000 ---------------------------------- Operating expenses: General and administrative (874,000) (2,446,000) Marketing and selling (801,000) (920,000) Research and development (768,000) (1,033,000) Impairment of assets - (150,000) Gain on settlement of liabilities 206,000 436,000 ---------------------------------- Total operating expenses (2,237,000) (4,113,000) ---------------------------------- Operating loss (392,000) (3,140,000) ---------------------------------- Other income (expense): Interest income - 3,000 Other expenses (27,000) - Interest expense (22,000) (24,000) Gain on sale of investment 505,000 - ---------------------------------- Total other income (expense) 456,000 (21,000) ---------------------------------- Income (loss) before provision for income taxes 64,000 (3,161,000) Provision for income taxes - - ---------------------------------- Net income (loss) $ 64,000 $ (3,161,000) ---------------------------------- Beneficial conversion feature on Series G preferred stock - (217,000) Series G preferred stock dividend due to registration rights (54,000) - Deemed dividend from Series G preferred detachable warrants - (53,000) ---------------------------------- Net income (loss) applicable to common shareholders $ 10,000 $ (3,431,000) ---------------------------------- Earnings (loss) per common share - basic $ - $ (0.14) ---------------------------------- Earnings (loss) per common share - diluted $ - $ (0.14) ---------------------------------- Weighted average common shares - basic 25,405,000 24,058,000 ---------------------------------- Weighted average common shares - diluted 27,669,000 24,058,000 ---------------------------------- -- See accompanying notes to financial statements. F-11 PARADIGM MEDICAL INDUSTRIES, INC. Statements of Stockholders' Equity Years Ended December 31, 2004 and 2003
-- Preferred Additional Stock Stock Common Paid-In Subscription Accumulated (See Note 8) Shares Amount Capital Receivable Deficit -- Balance at January 1, 2003 $ - 21,954,238 $ 22,000 $ 56,775,000 $ (294,000) $ (53,656,000) Conversion of preferred stock - 115,998 - - - - Issuance of common stock for: Cash - 1,658,032 2,000 428,000 - - Settlement of litigation - 1,562,000 1,000 258,000 - - Commission on sale on sale of common stock - 82,526 - - - - Issuance of stock options and warrants for Services - - - 35,000 - - Issuance of Series G preferred stock for: Cash 2,000 - - 268,000 - - Write off of subscription receivable - - - (294,000) 294,000 - Net loss - - - - - (3,161,000) -- Balance at December 31, 2003 2,000 25,372,794 25,000 57,470,0000 - (56,817,000) Conversion of preferred stock - 255,000 - - - - Series G preferred stock dividend due to registration rights - - - - - (54,000) Net income - - - - - 64,000 -- Balance at December 31, 2004 $ 2,000 25,627,764 $ 25,000 $ 57,470,000 $ - $ (56,807,000) --
-- See accompanying notes to financial statements. F-12 PARADIGM MEDICAL INDUSTRIES, INC. Statements of Cash Flows Years Ended December 31,
-- 2004 2003
---------------------------------- Cash flows from operating activities: Net income (loss) $ 64,000 $ (3,161,000) Adjustments to reconcile net income (loss) to net cash used in operating activities: Depreciation and amortization 137,000 319,000 Issuance of stock option/warrant for services - 35,000 Common stock issued for settlement of litigation - 259,000 Provision for losses on receivables (369,000) 123,000 Provision for losses on inventory (224,000) 403,000 Gain on sale of investment (505,000) - Impairment of Intangibles and investments 150,000 (Gain) loss on settlement of liabilities (206,000) (436,000) (Gain) loss on disposal of assets 13,000 - (Increase) decrease in: Receivables 420,000 113,000 Inventories 507,000 1,243,000 Prepaid and other assets 76,000 (44,000) Increase (decrease) in: Accounts payable 42,000 53,000 Accrued liabilities (432,000) 236,000 ---------------------------------- Net cash used in operating activities (477,000) (707,000) ---------------------------------- Cash flows from investing activities: Purchase of property and equipment - (2,000) Cash proceeds from sales of investment 532,000 - ---------------------------------- Net cash provided by (used in) investing activities 532,000 (2,000) ---------------------------------- Cash flows from financing activities: Proceeds from issuance of Series G preferred stock - 270,000 Principal payments on notes payable and long-term debt (56,000) (53,000) Proceeds from exercise of common stock warrants and options - 430,000 ---------------------------------- Net cash (used in) provided by financing

activities (56,000) 647,000 ---------------------------------- Net change in cash (1,000) (62,000) Cash, beginning of year 132,000 194,000 ---------------------------------- Cash, end of year $ 131,000 $ 132,000 ---------------------------------- -- See accompanying notes to financial statements. F-13 PARADIGM MEDICAL INDUSTRIES, INC. Notes to Financial Statements December 31, 2004 and 2003 -- 1. Organization Organization and Significant Paradigm Medical Industries, Inc. (the Company) is a Accounting Delaware Corporation incorporated in October 1989. The Policies Company is engaged in the design, development, manufacture, and sale of high technology surgical and diagnostic eye care products. Its surgical equipment is designed to perform minimally invasive cataract surgery and is comprised of surgical devices and related instruments and accessories, including disposable products. Its diagnostic products include a blood flow analyzer, a pachymeter, an A-Scan, an A/B Scan, ultrasound biomicroscopes, a perimeter, and a corneal topographer. Cash Equivalents For purposes of the statement of cash flows, cash includes all cash and investments with original maturities to the Company of three months or less. The Company maintains its cash in bank deposit accounts which, at times, may exceed federally insured limits. The Company has not experienced any losses in such account and believes it is not exposed to any significant credit risk on cash and cash equivalents. Accounts Receivable Accounts receivable are carried at original invoice amount less an estimate made for doubtful receivables based on a review of all outstanding amounts on a monthly basis. Specific reserves are estimated by management based on certain assumptions and variables, including the customer's financial condition, age of the customer's receivables, and changes in payment histories. Trade receivables are written off when deemed uncollectible. Recoveries of trade receivables previously written off are recorded when received. A trade receivable is considered to be past due if any portion of the receivable balance has not been received by the contractual pay date. Interest is not charge on trade receivables that are past due. Inventories Inventories are stated at the lower of cost or market, cost is determined using the weighted average method. -- F-14 PARADIGM MEDICAL INDUSTRIES, INC. Notes to Financial Statements Continued -- 1. Organization Property and Equipment and Significant Property and equipment are recorded at cost, less Accounting accumulated depreciation. Depreciation on property and Policies equipment is determined using the straight-line method Continued over the estimated useful lives of the assets or terms of the lease. Expenditures for maintenance and repairs are expensed when incurred and betterments are capitalized. Gains and losses on sale of property and equipment are reflected in operations. Intangible Assets As of December 31, 2004, intangible assets consisted of goodwill related to the purchase of Ocular Blood Flow, Ltd., product rights, capitalized payments to manufacturers for engineering and design services and patent costs. The company performed an impairment test on all intangible assets at December 31, 2004. As a result it was not necessary to incur any impairment expense of intangible assets. Intangible assets determined to have indefinite useful lives are not amortized. The Company tests such intangible assets with indefinite useful lives for impairment annually or more frequently if events or circumstances indicate that an asset might be impaired. Intangible assets determined to have definite lives are amortized on a straight-line basis over their useful lives. Product rights, capitalized engineering, and patents were fully amortized as of December 31, 2004. The Company reviews such intangible assets with definite lives for impairment to ensure they are appropriately valued if conditions exist that may indicate the carrying value may not be recoverable. Such conditions may include an economic downturn in a geographic market or a change in the assessment of future operations. Goodwill is not amortized. The Company performs tests for impairment of goodwill annually or more frequently if events or circumstances indicate it might be impaired. Such tests include comparing the fair value of a reporting unit with its carrying value, including goodwill. Impairment assessments are performed using a variety of methodologies, including cash flow analysis and estimates of sales proceeds. Where applicable, an appropriate discount rate is used, based on the Company's cost of capital rate or location-specific economic factors. -- F-15 PARADIGM MEDICAL INDUSTRIES, INC. Notes to Financial Statements Continued -- 1. Organization Evaluation of Other Long-Lived Assets and Significant The Company evaluates the carrying value of the Accounting unamortized balances of other long-lived assets to Policies determine whether any impairment of these assets has Continued occurred or whether any revision to the related amortization periods should be made. This evaluation is based on management's projections of the undiscounted future cash flows associated with each asset. If management's evaluation were to indicate that the carrying values of these assets were impaired, such impairment would be recognized by a write down of the applicable asset. Income Taxes Deferred income taxes are provided in amounts sufficient to give effect to temporary differences between financial and tax reporting, principally related to net operating loss carryforwards, depreciation, impairment of intangible assets, stock compensation expense, and accrued liabilities. Stock - Based Compensation For stock options and warrants granted to employees the Company employs the footnote disclosure provisions of Statement of Financial Accounting Standards (SFAS) No. 123, Accounting for Stock-Based Compensation. SFAS No. 123 encourages entities to adopt a fair-value based method of accounting for stock options or similar equity instruments. However, it also allows an entity to continue measuring compensation cost for stock-based compensation using the intrinsic-value method of accounting prescribed by Accounting Principles Board (APB) Opinion No. 25, Accounting for Stock Issued to Employees (APB 25). The Company has elected to continue to apply the provisions of APB 25 and provide pro forma footnote disclosures required by SFAS No. 123. No stock-based employee compensation cost is reflected in net income, as all options granted under those plans had an exercise price equal to or greater than the market value of the underlying common stock on the date of grant. Stock options and warrants granted to non-employees for services are accounted for in accordance with SFAS No. 123, which requires expense recognition based on the fair value of the options/warrants granted. The Company calculates the fair value of options and warrants granted by use of the Black-Scholes pricing model. The following table illustrates the effect on net income and earnings per share if the company had applied the fair value recognition provisions of FASB Statement No. -- F-16 PARADIGM MEDICAL INDUSTRIES, INC. Notes to Financial Statements Continued -- 1. Organization Stock - Based Compensation - Continued and Significant 123, "Accounting for Stock-Based Compensation," to Accounting stock-based employee compensation. Policies Continued Years Ended December 31, -------------------------------- 2004 2003 -------------------------------- Net income (loss) applicable to common shareholders- as reported $ 10,000 $ (3,431,000) Deduct: total stock-based employee compen-sation determined under fair value based method for all awards, net of related (362,000) (595,000) tax effects -------------------------------- Net loss applicable to common shareholders - pro forma $ (352,000) $ (4,026,000) -------------------------------- Earnings per share: Basic and diluted - as reported $ - $ (.14) -------------------------------- Basic and diluted - pro forma $ (.01) $ (.17) -------------------------------- The fair value of each option grant is estimated at the date of grant using the Black-Scholes option pricing model with the following assumptions: December 31, -- 2004 2003 -- Expected dividend yield $ - $ - Expected stock price Volatility 112% - 173% 110%-117% Risk-free interest rate 4% 4% Expected life of options 2-7 years 2-7 years The weighted average fair value of options granted during 2004 and 2003 are $0.09 and $0.16, respectively. Earnings Per Share The computation of basic earnings per common share is based on the weighted average number of shares outstanding during each year. -- F-17 PARADIGM MEDICAL INDUSTRIES, INC. Notes to Financial Statements Continued -- 1. Organization Earnings Per Share- Continued and The computation of diluted earnings per common share is Significant based on the weighted average number of shares Accounting outstanding during the year plus the common stock Policies equivalents, which would arise from the conversion of Continued preferred stock to common stock and from the exercise of stock options and warrants outstanding using the treasury stock method and the average market price per share during the year. Options and warrants to purchase 6,036,469 shares of common stock at prices ranging from $0.16 to $12.98 per share were outstanding at December 31, 2003, but were not included in the diluted earnings per share calculation for 2003 because the effect would have been antidilutive. The following table is a reconciliation of basic and diluted weighted average shares for the years ended December 31, 2004 and 2003. Years Ended December 31, -------------------------------- 2004 2003 -------------------------------- Basic weighted average shares outstanding 25,405,000 24,058,000 Common stock equivalent-convertible preferred stock 2,047,000 - Diluted effect of stock options and warrants 217,000 - -------------------------------- Diluted weighted average shares outstanding 27,669,000 24,058,000 -------------------------------- Revenue Recognition Revenues for sales of products that require specific installation and acceptance by the customer are recognized upon such installation and acceptance by the customer. Revenues for sales of other surgical systems, ultrasound diagnostic devices, and disposable products are recognized when the product is shipped. A signed purchase agreement and a deposit or payment in full from customers is required before a product leaves the premises. Title passes at time of shipment (F.O.B. shipping point).

-- F-18 PARADIGM MEDICAL INDUSTRIES, INC. Notes to Financial Statements Continued -- 1. Organization Research and Development and Costs incurred in connection with research and Significant development activities are expensed as incurred. These Accounting costs consist of direct and indirect costs associated Policies with specific projects as well as fees paid to various Continued entities that perform certain research on behalf of the Company. Concentration of Risk The market for ophthalmic lasers is subject to rapid technological change, including advances in laser and other technologies and the potential development of alternative surgical techniques or new pharmaceutical products. Development by others of new or improved products, processes or technologies may make products developed by the Company obsolete or less competitive. The Company's high technology product line requires the Company to deal with suppliers and subcontractors supplying highly specialized parts, operating highly sophisticated and narrow tolerance equipment and performing highly technical calculations and tasks. Although there are a limited number of suppliers and manufacturers that meet the standards required of a regulated medical device, management believes that other suppliers and manufacturers could provide similar components and services. The nature of the Company's business exposes it to risk from product liability claims. The Company maintains product liability insurance providing coverage up to $1 million per claim with an aggregate policy limit of $2 million. Any losses that the Company may suffer from any product liability litigation could have a material adverse effect on the Company. A significant portion of the Company's product sales is in foreign countries. The economic and political instability of some foreign countries may affect the ability of medical personnel to purchase the Company's products and the ability of the customers to pay for the procedures for which the Company's products are used. Such circumstances could cause a possible loss of sales, which would affect operating results adversely. During the years ended December 31, 2004 and 2003, no single customer represented more than 10 percent of total net sales. -- F-19 PARADIGM MEDICAL INDUSTRIES, INC. Notes to Financial Statements Continued -- 1. Organization Concentration of Risk - Continued and Significant Accounts receivable are due from medical distributors, Accounting surgery centers, hospitals, optometrists and Policies ophthalmologists located throughout the U.S. and a Continued number of foreign countries. The receivables are generally due within thirty days for domestic customers with extended terms offered for some international customers. The Company maintains an allowance for estimated potentially uncollectible amounts. Warranty The Company provides product warranties on the sale of certain products that generally extend for one year from the date of sale. The Company maintains a reserve for estimated warranty costs based on historical experience and management's best estimates. Use of Estimates in the Preparation of Financial Statements The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Reclassifications Certain amounts in the 2003 financial statements have been reclassified to conform to the presentation of the current year financial statements. Series G Preferred Stock Dividends Under the terms of the private offering of Series G preferred shares, the Company is required to file a registration statement with the Securities and Exchange Commission to register the common shares issuable to the Series G preferred stockholders upon conversion of their Series G preferred shares and exercise of their warrants. If the registration statement has not been declared effective within 120 days of the initial closing of such offering on August 29, 2003, there is a penalty of 2% per month payable to the Series G preferred. Stockholders in common shares (or 39,631 common shares per month) until the registration statement is declared effective. As of December 31, 2004, the Company had recorded a liability of $54,000 related to the 356,682 common shares to be issued to the Series G preferred stockholders because a registration -- F-20 PARADIGM MEDICAL INDUSTRIES, INC. Notes to Financial Statements Continued -- 1. Organization Series G Preferred Stock Dividends - Continued and statement had not been declared effective as of that Significant date. Accounting Policies Continued 2. Going The accompanying financial statements have been prepared Concern on a going concern basis, which contemplates the realization of assets and the satisfaction of liabilities in the normal course of business. Historically, the Company has not demonstrated the ability to generate sufficient cash flows from operations to satisfy its liabilities and sustain operations, and the Company has incurred significant losses from operations. These factors raise substantial doubt about the Company's ability to continue as a going concern. The Company's continuation as a going concern is dependent on its ability to generate sufficient income and cash flow to meet its obligations on a timely basis and/or obtain additional financing as may be required. The Company is actively seeking to obtain additional capital and financing. In addition, the Company has taken significant steps to reduce costs and increase operating efficiencies, including the consolidation of several manufacturing, accounting and management responsibilities. Such consolidation resulted in significant headcount reductions as well as savings in other overhead costs. The Company has also significantly reduced the use of consultants, which has resulted in a large decrease in expenses, and reduced the direct sales force from six to five representatives, which has resulted in less payroll, travel and other selling expenses. Although these cost savings have significantly reduced the Company's losses and ongoing cash flow needs, if the Company is unable to obtain equity or debt financing, it may be unable to continue development of its products and may be required to substantially curtail or cease operations. -- F-21 PARADIGM MEDICAL INDUSTRIES, INC. Notes to Financial Statements Continued -- 3. Detail of Receivables Certain Trade receivables $ 758,000 Balance Allowance for doubtful accounts (101,000) Sheet ------------ Accounts $ 657,000 ------------ Inventories Finished goods $ 648,000 Raw materials 1,490,000 Reserve for obsolescence (1,418,000) ------------ $ 720,000 ------------ Accrued liabilities: Consulting and litigation reserve $ 492,000 Payroll and employment benefits 84,000 Sales tax payable 42,000 Customer deposits 10,000 Accrued royalties 13,000 Deferred revenue 7,000 Warranty and return allowance 149,000 Other accrued expenses 61,000 ------------ $ 858,000 ------------ 4. Intangible Intangible assets consist of the following at December Assets 31, 2004: Goodwill, net of accumulated amortization of $120,000 $ 679,000 ------------ Other intangible assets: Product and technology rights 769,000 Engineering and design costs 482,000 Patents 92,000 ------------ 1,343,000 Accumulated amortization (1,343,000) ------------ Total other intangible asstes - ------------ Net intangible assets $ 679,000 ------------ -- F-22 PARADIGM MEDICAL INDUSTRIES, INC. Notes to Financial Statements Continued -- 4. Intangible Amortization expense for the years ended December 31, Assets 2004 and 2003 was $3,000 and $79,000, respectively. Continued During the year ended December 31, 2003, the Company evaluated the carrying value of its unissued patent costs and product and technology rights for recoverability. This analysis, based on the estimated future cash flows associated with such assets, resulted in an impairment expense of $81,000 related to patents and product and technology rights. 5. Property and Property and equipment consists of the following: Equipment Office equipment $ 750,000 Computer equipment 658,000 Furniture and fixtures 252,000 Leasehold improvements 166,000 ------------ 1,826,000 Accumulated depreciation and amortization (1,717,000) ------------ $ 109,000 ------------ 6. Lease During the years ended December 31, 2004 and 2003, the Obligations Company leased certain equipment under noncancellable capital leases. These leases provide the Company the option to purchase the leased assets at the end of the initial lease term. Assets under capital leases included in fixed assets and are as follows: Computer and other equipment $ 291,000 Less accumulated amortization (212,000) ------------ $ 79,000 ------------ Amortization expense on assets under capital leases during the years ended December 31, 2004 and 2003 was $39,000 and $56,000, respectively. -- F-23 PARADIGM MEDICAL INDUSTRIES, INC. Notes to Financial Statements Continued -- 6. Lease Capital lease obligations have imputed interest rates of Obligations approximately 7% to 22%. The leases are secured by Continued equipment. Future minimum payments on the capital lease obligations are as follows: 2005 $ 54,000 2006 14,000 ------------- 68,000 Less amount representing interest (7,200) ------------ Present value of future minimum lease payments 61,000 Less current portion (47,000) ------------ Long-term portion $ 14,000 ------------ The Company leases office and warehouse space under an operating lease agreement. Future minimum rental payments under the noncancellable operating lease as of December 31, 2004 are approximately as follows: Year Ending December 31, Amount ----------------------- ------ 2005 $ 140,000 ------------ Total future minimum rental payments $ 140,000 ------------ Rent expense related to noncancelable operating leases was approximately $137,000 and $159,000 for the years ended December 31, 2004 and 2003, respectively. -- F-24 PARADIGM MEDICAL INDUSTRIES, INC. Notes to Financial Statements Continued -- 7. Income The provision for income taxes is different than amounts Taxes which would be provided by applying the statutory federal income tax rate to loss before provision for income taxes for the following reasons: Years Ended December 31, ----------------------------------- 2004 2003 ----------------------------------- Income tax (provision) benefit at statutory rate $ (24,000) $ 1,170,000 Expiration of research and development tax credit carryforwards - - Meals and entertainment (3,000) (7,000) Other - 2,000 Change in valuation allowance 27,000 (1,165,000) ----------------------------------- $ - $ - ----------------------------------- Deferred tax assets (liabilities) are comprised of the following: Net operating loss carryforward $ 16,984,000 Depreciation, amortization, and impairment 853,000 Allowance and reserves 828,000 Research and development tax credit carryforwards 56,000 ---------------- 18,721,000 Valuation allowance (18,721,000) ---------------- $ - ---------------- A valuation allowance has been established for the net deferred tax asset due to the uncertainty of the Company's ability to realize such asset. -- F-25 PARADIGM MEDICAL INDUSTRIES, INC. Notes to Financial Statements Continued -- 7. Income At December 31, 2004, the Company had net operating loss Taxes carryforwards of approximately $48 million and research Continued and development tax credit carryforwards of approximately $56,000. These carryforwards are available to offset future taxable income and expire in 2004 through 2021. The utilization of the net operating loss carryforwards is dependent upon the tax laws in effect at the time the net operating loss carryforwards can be utilized. The Tax Reform Act of 1986 significantly limits the annual amount that can be utilized for certain of these carryforwards as a result of the change in ownership. 8. Capital The Company has established a series of preferred stock Stock with a total of 5,000,000 authorized shares and a par value of $.001, and one series of common stock with a par value of $.001 and a total of 80,000,000 authorized shares. Series A Preferred Stock On September 1, 1993, the Company established a series of non-voting preferred shares designated as the 6% Series A Preferred Stock, consisting of 500,000 shares with $.001 par value. The Series A Preferred Stock has the following rights and privileges: 1. The holders of the shares are entitled to dividends at the rate of twenty-four cents ($.24) per share per annum, payable in cash only from surplus earnings of the Company or in additional shares of Series A Preferred Stock. The dividends are non-cumulative and therefore deficiencies in dividend payments from one year are not carried forward to the next year. 2. Upon the liquidation of the Company, the holders of the Series A Preferred Stock are entitled to receive, prior to any distribution of any assets or surplus funds to the holders of shares of common stock or any other stock, an amount equal to $1.00 per share, plus any accrued and unpaid dividends related to the fiscal year in which such liquidation occurs. Total liquidation preference at December 31, 2004 was $6,000. 3. The shares are convertible at the option of the holder at any time into common shares, based on an initial conversion rate of one share of Series A Preferred Stock for 1.2 common shares. 4. The holders of the shares have no voting rights. -- F-26 PARADIGM MEDICAL INDUSTRIES, INC. Notes to Financial Statements Continued -- 8. Capital Series A Preferred Stock - Continued Stock 5. The Company may, at its option, redeem all of the Continued then outstanding shares of the Series A Preferred Stock at a price of $4.50 per share, plus accrued and unpaid dividends related to the fiscal year in which such redemption occurs. Series B Preferred Stock On May 9, 1994, the Company established a series of non-voting preferred shares designated as 12% Series B Preferred Stock, consisting of 500,000 shares with $.001 par value. The Series B Preferred Stock has the following rights and privileges: 1. The holders of the shares are entitled to dividends at the rate of forty-eight cents ($.48) per share per annum, payable in cash only from surplus earnings of the Company or in additional shares of Series B Preferred Stock. The dividends are non-cumulative and therefore deficiencies in dividend payments from one year are not carried forward to the next year. 2. Upon the liquidation of the Company, the holders of the Series B Preferred Stock are entitled to receive, prior to any distribution of any assets or surplus funds to the holders of shares of common stock or any other stock, an amount equal to $4.00 per share, plus any accrued and unpaid dividends related to the fiscal year in which such liquidation occurs. Such right, however, is subordinate to the rights of the holders of Series A Preferred Stock to receive a distribution of $1.00 per share plus accrued and unpaid dividends. Total liquidation preference at December 31, 2004 was $36,000. 3. The shares are convertible at the option of the holder at any time into common shares, based on an initial conversion rate of one share of Series B Preferred Stock for 1.2 common shares. 4. The holders of the shares have no voting rights. 5. The Company may, at its option, redeem all of the then outstanding share of the Series B Preferred Stock at a price of $4.50 per share, plus accrued and unpaid dividends related to the fiscal year in which such redemption occurs. -- F-27 PARADIGM MEDICAL INDUSTRIES, INC. Notes to Financial Statements Continued

-- 8. Capital Series C Preferred Stock Stock In January 1998, the Company authorized the issuance of Continued a total of 30,000 shares of Series C Preferred Stock, $.001 par value, $100 stated value. As of December 31, 2004 there were no Series C Preferred Stock issued and outstanding. The Series C Preferred Stock have the following rights and privileges: 1. The holders of the shares are entitled to dividends at the rate of 12% per share per annum of the aggregate stated value. The dividends are non-cumulative and, therefore, deficiencies in dividend payments from one year are not carried forward to the next year. 2. Upon the liquidation of the Company, the holders of the Series C Preferred Stock are entitled to receive an amount per share equal to the greater of (a) the amount they would have received if they had converted the shares into shares of Common Stock immediately prior to such liquidation plus declared but unpaid dividends; or (b) the stated value, subject to adjustment. 3. Each share was convertible, at the option of the holder at any time until January 1, 2002, into approximately 57.14 shares of common stock at an initial conversion price, subject to adjustments for stock splits, stock dividends and certain combination or recapitalization of the common stock, equal to $1.75 per share of common stock. 4. The holders of the shares have no voting rights. Series D Preferred Stock In January 1999, the Company's Board of Directors authorized the issuance of a total of 1,140,000 shares of Series D Preferred Stock $.001 par value, $1.75 stated value. The Series D Preferred Stock has the following rights and privileges: 1. The holders of the shares are entitled to dividends at the rate of 10% per share per annum of the aggregate stated value. The dividends are non-cumulative and, therefore, deficiencies in dividend payments from one year are not carried forward to the next year. 2. Upon the liquidation of the Company, the holders of the Series D Preferred Stock are entitled to receive -- F-28 PARADIGM MEDICAL INDUSTRIES, INC. Notes to Financial Statements Continued -- 8. Capital Series D Preferred Stock - Continued Stock an amount per share equal to the greater of (a) the Continued amount they would have received had they converted the shares into Common Stock immediately prior to such liquidation plus all declared but unpaid dividends; or (b) the stated value, subject to adjustment. Total liquidation preference at December 31, 2004 was $9,000. 3. Each share was convertible, at the option of the holder at any time until January 1, 2002, into one share of Common Stock at an initial conversion price, subject to adjustment. The Series D Preferred Stock shall be converted into one share of the Common Stock subject to adjustment (a) on January 1, 2002 or (b) upon 30 days written notice by the Company to the holders of the Shares, at any time after (i) the 30-day anniversary of the registration statement on which the shares of Common Stock issuable upon conversion of the Series D Preferred Stock were registered and (ii) the average closing price of the Common Stock for the 20-day period immediately prior to the date on which notice of redemption is given by the Company to the holders of the Series D Preferred Stock is at least $3.50 per share. The Company in 1999 recorded $872,000 as a beneficial conversion feature related to the differences in the conversion price of the preferred stock to common stock. 4. The holders of the shares have no voting rights. Series E Preferred Stock In May 2001, the Company authorized the issuance of a total of 50,000 shares of Series E Preferred Stock $.001 par value, $100 stated value. The Series E Preferred Stock has the following rights and privileges: 1. The holders of the shares are entitled to dividends at the rate of 8% per share per annum of the aggregate stated value. The dividends are non-cumulative and, therefore, deficiencies in dividend payments from one year are not carried forward to the next year. 2. Upon the liquidation of the Company, the holders of the Series E Preferred Stock are entitled to receive an amount per share equal to the greater of (a) the amount they would have received had they converted the shares into Common Stock immediately prior to such liquidation plus all declared but unpaid -- F-29 PARADIGM MEDICAL INDUSTRIES, INC. Notes to Financial Statements Continued -- 8. Capital Series E Preferred Stock - Continued Stock dividends; or (b) the stated value, subject to Continued adjustment. Total liquidation preference at December 31, 2004 was $100,000. 3. Each share is convertible, at the option of the holder at any time until January 1, 2005, into approximately 53.33 shares of Common Stock at an initial conversion price, subject to adjustment for stock splits, stock dividends and certain combination or recapitalization of the common stock, equal to $1.875 per share of common stock. The Series E Preferred Stock shall be converted into Common Stock subject to adjustment (a) on January 1, 2005 or (b) upon 30 days written notice by the Company to the holders of the Shares, at any time after (i) the 30-day anniversary of the registration statement on which the shares of Common Stock issuable upon conversion of the Series E Preferred Stock were registered and (ii) the average closing price of the Common Stock for the 20-day period immediately prior to the date on which notice of redemption is given by the Company to the holders of the

Series E Preferred Stock is at least $3.50 per share. The Company in 2001 recorded $1,482,000 as a beneficial conversion feature related to the differences in the conversion price of the preferred stock to common stock. 4. The holders of the shares have no voting rights. 5. The holders of the shares also were issued warrants to purchase shares of common stock equal to 1,000 warrants for every 200 shares purchased at an exercise price of $4.00 per share. Each warrant is exercisable until May 23, 2006. Series F Preferred Stock In August 2001, the Company authorized the issuance of a total of 50,000 shares of Series F Preferred Stock $.001 par value, $100 stated value. The Series F Preferred Stock has the following rights and privileges: 1. The holders of the shares are entitled to dividends at the rate of 8% per share per annum of the aggregate stated value. The dividends are non-cumulative and, therefore, deficiencies in dividend payments from one year are not carried forward to the next year. -- F-30 PARADIGM MEDICAL INDUSTRIES, INC. Notes to Financial Statements Continued -- 8. Capital Series F Preferred Stock - Continued Stock 2. Upon the liquidation of the Company, the holders of Continued the Series F Preferred Stock are entitled to receive an amount per share equal to the greater of (a) the amount they would have received had they converted the shares into Common Stock immediately prior to such liquidation plus all declared but unpaid dividends; or (b) the stated value, subject to adjustment. Total liquidation preference at December 31, 2004 was $245,000. 3. Each share is convertible, at the option of the holder at any time until January 1, 2005, into approximately 53.33 shares of Common Stock at an initial conversion price, subject to adjustment for stock splits, stock dividends and certain combination or recapitalization of the common stock, equal to $1.875 per share of common stock. The Series F Preferred Stock shall be converted into Common Stock subject to adjustment (a) on January 1, 2005 or (b) upon 30 days written notice by the Company to the holders of the Shares, at any time after (i) the 30-day anniversary of the registration statement on which the shares of Common Stock issuable upon conversion of the Series F Preferred Stock were registered and (ii) the average closing price of the Common Stock for the 20-day period immediately prior to the date on which notice of redemption is given by the Company to the holders of the Series F Preferred Stock is at least $3.50 per share. The Company in 2001 recorded $1,105,000 as a beneficial conversion feature related to the differences in the conversion price of the preferred stock to common stock. 4. The holders of the shares have no voting rights. Series G Preferred Stock In August 2003, the Company authorized the issuance of a total of 2,000,000 shares of Series G Preferred Stock $.001 par value, $1.00 stated value. The Series G Preferred Stock has the following rights and privileges: 1. The holders of the shares are entitled to dividends at the rate of 7% per share per annum of the aggregate stated value. The dividends are non-cumulative and, therefore, deficiencies in dividend payments from one year are not carried forward to the next year. -- F-31 PARADIGM MEDICAL INDUSTRIES, INC. Notes to Financial Statements Continued -- 8. Capital Stock Series G Preferred Stock - Continued Continued 2. Upon the liquidation of the Company, the holders of the Series G Preferred Stock are entitled to receive an amount per share equal to the greater of (a) the amount they would have received had they converted the shares into Common Stock immediately prior to such liquidation plus all declared but unpaid dividends; or (b) the stated value of $.25 per share plus declared but unpaid dividends. Total liquidation preference at December 31, 2004 was $432,000. 3. Each share is convertible, at the option of the holder at any time until August 1, 2005, into 1 share of common stock at an initial conversion price, subject to adjustment for dividends, equal to one share of common stock for each share of Series G Preferred Stock. The Series G Preferred Stock shall be converted into common stock subject to adjustment (a) on August 1, 2005 or (b) upon 30 days written notice by the Company to the holders of the shares, at any time after (i) the 30-day anniversary of the registration statement on which the shares of common stock issuable upon conversion of the Series G Preferred Stock were registered and (ii) the average closing price of the common stock for the 15-day period immediately prior to the date in which notice of redemption is given by the Company to the holders of the Series G Preferred Stock is at least $.50 per share. In 2003, the Company recorded a beneficial conversion feature of $217,000 related to the differences in the conversion price of the preferred stock to common stock. 4. The holders of the shares have no voting rights. -- F-32 PARADIGM MEDICAL INDUSTRIES, INC. Notes to Financial Statements Continued -- 8. Capital The following table summarizes preferred stock activity Stock during the years ended December 31, 2004 and 2003: Continued
-- Series

A Series B Series C Series D Series E Series F Series G Shares Amount Shares Amount Shares Amount Shares Amount Shares Amount Shares Amount Shares Amount Shares Amount Balance at January 1, 2003 5,627 $ - 8,986 $ - - $ - 5,000 $ - 1,500 $ - 6,272 $ - - $ - Issuance of Series G preferred stock for cash - - - - - - - - - - - - 1,764,706 $ 2,000 Issuance of Series G preferred stock for commissions - - - - - - - - - - - - 216,854 $ - Conversion of preferred stock - - - - - - - - (500) - (1,675) - - - -- Balance at December 31, 2003 5,627 - 8,986 - - - 5,000 - 1,000 - 4,597 - 1,981,560 2,000 Issuance of Series G preferred stock for cash - - - - - - - - - - - - - - Conversion of preferred stock - - - - - - - - - - - - (255,000) - -- Balance at December 31, 2004 5,627 $ - 8,986 $ - - $ - 5,000 $ - 1,000 $ - 4,597 $ - 1,726,560 $ 2,000 -- Authorized 500,000 500,000 30,000 1,140,000 50,000 50,000 2,000,000 -- Liquidation preference $ 6,000 $ 36,000 $ - $ 9,000 $ 100,000 $245,000 $432,000 -- -- F-33 PARADIGM MEDICAL INDUSTRIES, INC. Notes to Financial Statements Continued -- 9. Stock Option The Company has a Stock Option Plan (the Option Plan), Plan and which reserves shares of the Company's authorized but Warrants unissued common stock for the granting of stock options. Amendments to the Option Plan increased the number of shares of common stock reserved for issuance thereunder to an aggregate of 3,700,000 shares. The Option Plan provides for the grant of incentive stock options and non-qualified stock options to employees and directors of the Company. Incentive stock options may be granted only to employees. The Option Plan is administered by the Board of Directors or a Compensation Committee, which determines the terms of options granted including the exercise price, the number of shares subject to the option, and the exercisability of the option. The Company granted the following options and warrants during the year ended December 31, 2004: o Options to officers and the board of directors to purchase 1,775,000 shares of common stock at an exercise price ranging from $0.10 to $0.14. The Company granted the following options and warrants to non-employees during the year ended December 31, 2003: o Warrants to purchase 200,000 shares of common stock at an exercise price of $0.16 per share in return for consulting services. o Warrants to investors to purchase 422,633 shares of common stock at an exercise price of $0.75. o In connection with the Series G Preferred Stock offering, the Company issued warrants to purchase, in aggregate 382,353 shares of common stock at exercise prices ranging from $0.25 to $0.50. -- F-34 PARADIGM MEDICAL INDUSTRIES, INC. Notes to Financial Statements Continued -- 9. Stock Option A schedule of the options and warrants is as follows: Plan and Warrants Continued Number of Exercise ------------------------------ Price Per Options Warrants Share --- Outstanding at January 1, 2003 2,486,535 2,565,022 $ 2.00 - 12.98 Granted 2,150,000 1,404,986 0.16 - 0.25 Exercised - - - Expired - (1,162,025) 5.06 - 8.12 Forfeited (1,008,079) - 0.21 - 6.00 --- Outstanding at December 31, 2003 3,628,456 2,807,983 Granted 1,775,000 - 0.10 - 0.14 Exercised - - - Expired (187,500) (161,019) 2.38 - 4.00 Forfeited (1,369,750) (200,000) 0.16 - 5.00 --- Outstanding at December 31, 2004 3,846,206 2,446,964 $ 0.10 - 12.98 --- The following table summarizes information about stock options and warrants outstanding at December 31, 2004: Outstanding Exercisable ---------------------------------- ---------------------- Weighted Average Remaining Weighted Weighted Range of Contractual Average Average Exercise Number Life Exercise Number Exercise Prices Outstanding (Years) Price Exercisable Price -- ---------------------- $ 0.16 - 0.75 3,724,986 2.76 $ 0.20 2,236,653 $ 0.34 2.00 - 5.00 2,267,301 2.27 3.62 2,350,676 3.73 6.00 - 8.13 275,000 1.00 3.27 275,000 6.55 12.98 25,883 N/A 12.98 25,883 12.98 -- ---------------------- $ 0.16 - 12.98 6,293,170 2.50 $ 1.63 4,888,212 $ 2.39 -- ---------------------- -- F-35 PARADIGM MEDICAL INDUSTRIES, INC. Notes to Financial Statements Continued -- 10. Sale of In July 2004, the Company sold its investment in Investment International Bioimmune Systems, Inc. (IBS) for $532,000 cash. Because, for book purposes, the Company's investment in IBS had previously been reduced to $0, the net sales price was recorded as a gain as follows. Sale of IBS stock $532,000 Less commissions 27,000 -------- Net gain $505,000 -------- 11. Gain on Due to the Company's ongoing cash flow difficulties, Settlement of during 2003 and 2004 most vendors and suppliers were Liabilities contacted with attempts to negotiate reduce payments and settlements of settlements of outstanding accounts payable and accrued expenses. While some vendors refused to negotiate and demanded payment in full, some vendors were willing to settle for a reduced amount. The accounts payable forgiven by vendors and suppliers and accrued expenses settled resulted in a gain of $206,000 and $436,000 in 2004 and 2003, respectively. 12. Related Party A law firm, of which the chairman of the board of Transactions directors of the Company is a shareholder, has rendered legal services to the Company. The Company paid this firm $100,000 and $97,000, for the years ended December 31, 2004 and 2003, respectively. As of December 31, 2004, the Company owed this firm $197,000, which is included in accounts payable. During the year ended December 31, 2004, the Company increased accrued liabilities and increased accumulated deficit for $54,000 for accrued preferred stock dividends related to registration rights on the Series G preferred stock. 13. Supplemental During the year ended December 31, 2003, the Company: Cash Flow Information o Granted 200,000 warrants for consulting services, which is recorded as an increase to general and administrative expense and additional paid-in capital of $35,000. o Issued 1,562,000 shares of common stock, valued at $258,000 based on the trading prices on the date of issuance, as settlement of potential litigation. This amount is included in general and administrative expenses and additional paid-in capital. -- F-36 PARADIGM MEDICAL INDUSTRIES, INC. Notes to Financial Statements Continued -- 13. Supplemental o Incurred an obligation of approximately Cash Flow $46,000 for the settlement of accrued Information liabilities of approximately $83,000 and Continued recorded a corresponding gain of $37,000. o Reduced subscription receivable and additional paid-in capital for $294,000. Actual amounts paid for interest and income taxes are as follows: Years Ended December 31, ---------------------------------- 2004 2003 ---------------------------------- Interest $ 22,000 $ 24,000 ---------------------------------- Income taxes $ - $ - ---------------------------------- 14. Export Sales Total sales include export sales by major geographic area as follows: Years Ended December 31, ---------------------------------- Geographic Area 2004 2003 -------------- ---------------------------------- Far East $ 529,000 $ 272,000 South America 50,000 9,000 Middle East 233,000 228,000 Europe 684,000 363,000 Canada 68,000 62,000 Mexico - 9,000 Africa 9,000 - ---------------------------------- $ 1,573,000 $ 943,000 ---------------------------------- -- F-37 PARADIGM MEDICAL INDUSTRIES, INC. Notes to Financial Statements Continued -- 15. Savings Plan In November 1996, the Company established a 401(k) Retirement Savings Plan for the Company's officers and employees. The Plan provisions include eligibility after six months of service, a three year vesting provision and matching contributions at the Company's discretion. During the years ended December 31, 2004 and 2003, the Company contributed approximately zero and $1,000 to the Plan, respectively. 16. Commitments and Consulting Agreements Contingencies On April 3, 2003, the Company entered into a consulting agreement with Kinexsys Corporation ("Kinexsys"). Under the terms of the agreement, Kinexsys through its Senior Partner, Timothy R. Forstrom, is to prepare a capital markets plan and a corporate positioning and communications plan for the Company, for which Kinexsys is to receive warrants to purchase up to 200,000 shares of the Company's common stock at an exercise price of $.16 per share. The capital markets plan is to include a detailed analysis of the Company's capital market structure in relation to current investors, market trends and projected equity movements, and recommendations on capital management strategies. The corporate positioning and communications plan is to include a corporate positioning matrix for markets, analysts, customers and partners, and a communications plan. The agreement is for a one-year term but may be renewed at the option of both parties. The Agreement expired on April 3, 2004. During the year ended December 31, 1999 the Company entered a consulting agreement with a former officer of the Company, which expired in 2004 and requires annual payments of $25,000 through 2003 and a payment of $12,500 in 2004. During the year ended December 31, 2000, in connection with the acquisition of OBF, the Company entered a consulting agreement with the former owner of OBF, which required monthly payments of $6,000 through June 2003. As of December 31, 2003, this agreement was settled in conjunction with the royalty agreement for the Blood Flow Analyzer (see Royalty Agreements in Note 14). -- F-38 PARADIGM MEDICAL INDUSTRIES, INC. Notes to Financial Statements Continued -- 16. Commitments and Litigation Contingencies An action was brought against the Company in March 2000 Continued by

George Wiseman, a former employee, in the Third District Court of Salt Lake County, State of Utah. The complaint alleges that the Company owes Mr. Wiseman 6,370 shares of its common stock plus costs, attorney's fees and a wage penalty (equal to 1,960 additional shares of its common stock) pursuant to Utah law. The action is based upon an extension of a written employment agreement. The Company disputes the amount allegedly owed and intends to vigorously defend against the action. An action was brought against the Company on September 11, 2000 by PhotoMed International, Inc. and Daniel M. Eichenbaum, M.D. in the Third District Court of Salt Lake County, State of Utah. The action involves an amount of royalties that are allegedly due and owing to PhotoMed International, Inc. and Dr. Eichenbaum under a license agreement dated July 7, 1993, with respect to the sale of certain equipment, plus costs and attorneys' fees. Certain discovery has taken place and the Company has paid royalties of $16,000, which the Company believes brings all payments current as of the date of last payment on January 7, 2005. The Company has been working with PhotoMed and Dr. Eichenbaum to ensure that the calculations have been correctly made on the royalties paid as well as the proper method of calculation for the future. It is anticipated that once the parties can agree on the correct calculations on the royalties, the legal action will be dismissed. An issue in dispute concerning the method of calculating royalties is whether royalties should be paid on returned equipment. Since July 1, 2001, only one Photon(TM) laser system has been sold and no systems returned. However, if the parties are unable to agree on a method for calculating royalties, there is a risk that PhotoMed and Dr. Eichenbaum might amend their complaint to request termination of the license agreement and, if successful, the Company would lose its right to manufacture and sell the Photon(TM) laser system. On May 14, 2003, a complaint was filed in the United States District Court, District of Utah, captioned Richard Meyer, individually and on behalf of all others similarly suited v. Paradigm Medical Industries, Inc., Thomas Motter, Mark Miehle and John Hemmer, Case No. 2:03 CV00448TC. The complaint also indicates that it is a "Class Action Complaint for Violations of Federal -- F-39 PARADIGM MEDICAL INDUSTRIES, INC. Notes to Financial Statements Continued -- 16. Commitments and Litigation - Continued Contingencies Securities Law and Plaintiffs Demand a Trial by Jury." Continued The Company has retained legal counsel to review the complaint, which appears to be focused on alleged false and misleading statements pertaining to the Blood Flow Analyzer(TM) and concerning a purchase order from Valdespino Associates Enterprises and Westland Financial Corporation. More specifically, the complaint alleges that the Company falsely stated in its Securities and Exchange Commission filings and press releases that it had received authorization to use an insurance reimbursement CPT code from the CPT Code Research and Development Division of the American Medical 16. Commitments and Association for reimbursement to doctors in connection with the Blood Flow Contingencies Analyzer(TM), adding that the CPT code provides for a reimbursement to doctors Continued of $57.00 per patient for use of the Blood Flow Analyzer(TM). According to the complaint, the CPT code was critical. Without a reimbursement code, physicians would not purchase the Blood Flow Analyzer(TM) because they could not receive compensation for performance of medical procedures using the medical device. The complaint further contends that the Company never received the CPT code from the American Medical Association at any time. Nevertheless, it is alleged that the Company continued to misrepresent in its SEC filings and press releases that it had received the CPT code. It is also alleged that the Company has never made a full, corrective disclosure with respect to this alleged misstatement. The complaint also alleges that on July 11, 2002, the Company issued a press release falsely announcing that it had received a purchase order from Valdespino Associates Enterprises and Westland Financial Corporation for 200 sets of its entire portfolio of products, with $70 million in systems to be delivered over a two-year period, then another $35 million of orders to be completed in the third year. The complaint further alleges that the Company had never received a true purchase order for its products. As a result of these alleged misstatements, the complaint contends that the price of the Company's shares of common stock was artificially inflated during the period from April 25, 2001 through May 14, 2003, and the persons who purchased or retained the Company's common shares during that period suffered substantial damages. The complaint requests judgment for unspecified damages, together with interest and attorney's fees. -- F-40 PARADIGM MEDICAL INDUSTRIES, INC. Notes to Financial Statements Continued -- 16. Commitments and Litigation - Continued Contingencies The Company disputes having issued false and misleading Continued statements concerning the Blood Flow AnalyzerTM and a purchase order from Westland Financial Corporation and Valdespino Associates Enterprises. On April 25, 2001, the Company issued a press release that stated it had received authorization to use common procedure terminology or CPT code number 92120 for the Blood Flow AnalyzerTM. This press release was based on a letter the Company received from the CPT Editorial Research and Development Department of the American Medical Association stating that CPT code number 92120 was the appropriate common procedure terminology or CPT code number for doctors to use when reporting certain procedures performed with the Blood Flow AnalyzerTM. Currently, there is reimbursement by insurance payors to doctors using the Blood Flow Analyzer(TM) in 22 states and partial reimbursement in four other states. The amount of reimbursement to doctors using the Blood Flow Analyzer(TM) generally ranges from $56.00 to $76.00 per patient, depending upon the insurance payor. Insurance payors providing reimbursement for the Blood Flow Analyzer(TM) have the discretion to increase or reduce the amount of reimbursement. The Company is endeavoring to obtain reimbursement by insurance payors in other states where there is currently no reimbursement being made. The Company believes it has continued to correctly represent in its Securities and Exchange Commission filings that the CPT Editorial Research and Development Department of the American Medical Association has informed the Company that CPT code number 92120 is the appropriate code for doctors to use when reporting certain procedures performed with the Blood Flow Analyzer(TM). On July 11, 2002, the Company issued a press release that stated it received a purchase order from Valdespino Associates Enterprises and Westland Financial Corporation for 200 complete sets of the Company's entire product portfolio of diagnostic and surgical equipment for Mexican ophthalmic practitioners, to be followed by a second order of 100 sets of equipment. The press release was based on a purchase order dated July 10, 2002 that the Company entered into with Westland Financial Corporation for the sale of 200 complete sets of the Company's surgical and diagnostic equipment to Mexican ophthalmic practitioners. The press release also stated that the initial order was for $70 million of the -- F-41 PARADIGM MEDICAL INDUSTRIES, INC. Notes to Financial Statements Continued -- 16. Commitments and Litigation - Continued Contingencies Company's equipment to be filled over a two-year period Continued followed by the second order of $35 million in equipment to be completed in the third year. The press release further stated that delivery would be made in traunches of 25 complete sets of the Company's equipment, beginning in 30 days from the date of the purchase order. On September 13, 2002, the board of directors issued a press release updating the status of its product sales to the Mexican ophthalmic practitioners. In that press release the board stated that the Company had been in discussions for the prior nine months with Westland Financial Corporation, aimed at supplying its medical device products to the Mexican market. In the past, the Company has had a business relationship with Westland Financial. Upon investigation, the board of directors had determined that the purchase order referenced in the July 11, 2002 press release was not of such a nature as to be enforceable for the purpose of sales or revenue recognition. In addition, the Company had not sent any shipment of medical products to Mexican ophthalmic practitioners nor received payment for those products pursuant to those discussions. The September 13, 2002 press release also stated that discussions were continuing with Westland Financial Corporation regarding sales and marketing activities for the Company's medical device products in Mexico, but the Company could not, at the time, predict or provide any assurance that any transactions would result. On June 2, 2003, a complaint was filed in the United States District Court, captioned Michael Marrone v. Paradigm Medical Industries, Inc., Thomas Motter, Mark Miehle and John Hemmer, Case No. 2:03 CV00513 PGC. On July 11, 2003, a complaint was filed in the same United States District Court, captioned Lidia Milian v. Paradigm Medical Industries, Inc., Thomas Motter, Mark Miehle and John Hemmer, Case No. 2:03 CV00617PGC. Both complaints seek class action status. These cases are substantially similar in nature to the Meyer case, including the contention that as a result of allegedly false statements regarding the Blood Flow AnalyzerTM and the purchase order from Westland Financial Corporation and Valdespino Associates Enterprises, the price of the Company's common stock was artificially inflated and the persons who purchased the Company's common shares during the class period suffered substantial damages. In a press release dated July 11, 2003, captioned "Milberg -- F-42 PARADIGM MEDICAL INDUSTRIES, INC. Notes to Financial Statements Continued -- 16. Commitments and Litigation - Continued Contingencies Weiss announces the filing of a class action suit Continued against Paradigm Medical Industries, Inc. on behalf of investors," the law firm of Milberg Weiss Bershad Hynen & Levach LLP, which represents purchasers of the Company's securities in the class action suit filed on July 11, 2003, stated that the Company alleged misrepresentations caused the market price of the stock to be artificially inflated during the class period. As a result, it is alleged that investors suffered millions of dollars in damages from the

Company's alleged misstatements. The cases request judgment for unspecified damages, together with interest and attorney's fees. These cases have now been consolidated with the Meyer case into a single action, captioned In re: Paradigm Medical Industries Securities Litigation, Case No. 03-CV-448TC. The law firm of Milberg Weiss Bershad & Schulman LLP is representing purchasers of the Company's securities in the consolidated class action. On June 28, 2004, a consolidated amended class action complaint was filed on behalf of purchasers of the Company's securities. The consolidated complaint is similar to the three class action complaints and alleges that the Company made false representations regarding the CPT code for the Blood Flow Analyzer(TM), but it includes additional allegations that the Company failed to disclose in a timely manner that doctors were being denied reimbursement for procedures performed with the Blood Flow Analyzer(TM). The consolidated complaint also alleges that the Company made false statements regarding the purchase order from Westland Financial Corporation and Valdespino Associates Enterprises. The Company believes the consolidated complaint is without merit and intends to vigorously defend and protect its interests in the case. The Company was issued a Directors and Officers Liability and Company Reimbursement Policy by United States Fire Insurance Company for the period from July 10, 2002 to July 10, 2003 that contains a $5,000,000 limit of liability, which is excess of a $250,000 retention. The officers and directors named in the consolidated cases have requested coverage under the policy. U.S. Fire is currently investigating whether it may have a right to deny coverage for the consolidated cases based upon policy terms, conditions and exclusions or to rescind the policy based upon misrepresentations contained in its application for insurance. -- F-43 PARADIGM MEDICAL INDUSTRIES, INC. Notes to Financial Statements Continued -- 16. Commitments and Litigation - Continued Contingencies The Company has paid $30,000 to U.S. Fire toward Continued satisfaction of the $250,000 retention that is applicable to the consolidated cases. The Company has advised U.S. Fire that it cannot pay the $250,000 retention due to its current financial circumstances. As a consequence, on January 8, 2004, the Company entered into a non-waiver agreement with U.S. Fire in which U.S. Fire agreed to fund and advance the Company's retention obligation in consideration for which the Company has agreed to reimburse U.S. Fire the sum of $5,000 a month, for a period of six months, with the first of such payments due on February 15, 2004. Thereafter, commencing on August 15, 2004, the Company is currently required to reimburse U.S. Fire the sum of $10,000 per month until the entire amount of $250,000 has been reimbursed to U.S. Fire. The Company has made payments to U.S. Fire in the aggregate amount of $30,000 of which its last payment of $10,000 was made on October 11, 2004. These payments were for the $5,000 monthly payments due during the six month period from February 15 to July 15, 2004, leaving a remaining retention obligation to U.S. Fire of $220,000. In the event U.S. Fire determines that the Company or the former officers and directors named in the consolidated cases are not entitled to coverage under the policy, or that it is entitled to rescind the policy, or should the Company be declared in default under the non-waiver agreement on account of its failure to make the monthly payments owed to U.S. Fire for funding the Company's retention obligation, then the Company agrees to pay U.S. Fire, on demand, the full amount of all costs advanced by U.S. Fire, except for those amounts that the Company may have reimbursed to U.S. Fire pursuant to the monthly payments due under the non-waiver agreement. Moreover, if U.S. Fire denies coverage for the consolidated cases under the policy, the Company would owe its litigation counsel in the class action lawsuits, for any legal fees not paid by U.S. Fire. However, U.S. Fire has currently agreed to pay the legal fees relating to the class action lawsuits. The Company will be in default under the non-waiver agreement if it fails to make any payment due to U.S. Fire thereunder when such payment is due, or institute proceedings to be adjudicated as bankrupt or insolvent. U.S. Fire's obligation to advance defense costs under the agreement will terminate in the event that the $5,000,000 policy limit of liability is exhausted. If -- F-44 PARADIGM MEDICAL INDUSTRIES, INC. Notes to Financial Statements Continued -- 16. Commitments and Litigation - Continued Contingencies U.S. Fire denies coverage for the consolidated cases Continued under the policy and the Company is not successful in defending and protecting its interests in the cases, resulting in a judgment against the Company for substantial damages, the Company would not be able to pay such liability and, as a result, would be forced to seek bankruptcy protection. On July 10, 2003, an action was filed in the United States District Court, District of Utah, by Innovative Optics, Inc. and Barton Dietrich Investments, L.P. Defendants include us, Thomas Motter, Mark Miehle and John Hemmer, former officers of the company. The complaint claims that Innovative and Barton entered into an asset purchase agreement with the Company on January 31, 2002, in which the Company agreed to purchase all the

assets of Innovative in consideration for the issuance of 1,310,000 shares of the Company's common stock to Innovative. The complaint claims the Company breached the asset purchase agreement. The complaint also claims that the Company allegedly made false and misleading statements pertaining to the Blood Flow Analyzer(TM) and concerning a purchase order from Valdespino Associates Enterprises and Westland Financial Corporation. The purpose of these statements, according to the complaint, was to induce Innovative to sell its assets and purchase the shares of the Company's common stock at artificially inflated prices while simultaneously deceiving Innovative and Barton into believing that the Company's shares were worth more than they actually were. The complaint contends that had Innovative and Barton known the truth they would not have sold Innovative to us, would not have purchased the Company's stock for the assets of Innovative, or would not have purchased the stock at the inflated prices that were paid. The complaint further contends that as a result of the allegedly false statements, Innovative and Barton suffered substantial damages in an amount to be proven at trial. The complaint also claims that 491,250 of the shares to be issued to Innovative in the asset purchase transaction were not issued on a timely basis and the Company also did not file a registration statement with the Securities and Exchange Commission within five months of the closing date of the asset purchase transaction. As a result, the complaint alleges that the value of the shares of the Company's common stock issued to Innovative in the transaction declined, and
-- F-45 PARADIGM MEDICAL INDUSTRIES, INC. Notes to Financial Statements Continued -- 16. Commitments and Litigation - Continued Contingencies Innovative and Barton suffered damages in an amount to Continued be proven at trial. The Company filed an answer to the complaint and also filed counterclaims against Innovative and Barton for breach of contract. The Company believes the complaint is without merit and intends to vigorously defend and protect its interests in the action. If the Company is not successful in defending and protecting its interests in this action, resulting in a judgment against the Company for substantial damages, and U.S. Fire denies coverage in the litigation under the Directors and Officers Liability and Company Reimbursement Policy, the Company would not be able to pay such liability and, as a result, would be forced to seek bankruptcy protection. On October 14, 2003, an action was filed in the Third Judicial District Court, Salt Lake County, State of Utah, captioned Albert Kinzinger, Jr., individually and on behalf of all others similarly situated vs. Paradigm Medical Industries, Inc., Thomas Motter, Mark Miehle, Randall A. Mackey, and John Hemmer, Case No. 030922608. The complaint also indicates that it is a "Class Action Complaint for Violations of Utah Securities Laws and Plaintiffs Demand a Trial by Jury." The Company has retained legal counsel to review the complaint, which appears to be focused on alleged false or misleading statements pertaining to the Blood Flow Analyzer(TM). More specifically, the complaint alleges that the Company falsely stated in Securities and Exchange Commission filings and press releases that it had received authorization to use an insurance reimbursement CPT code from the CPT Code Research and Development Division of the American Medical Association in connection with the Blood Flow Analyzer(TM), adding that the CPT code provides for a reimbursement to doctors of $57.00 per patient for the Blood Flow Analyzer(TM). The purpose of these statements, according to the complaint, was to induce investors to purchase shares of the Company's Series E preferred stock in a private placement transaction at artificially inflated prices. The complaint contends that as a result of these statements, the investors that purchased shares of its Series E preferred stock in the private offering suffered substantial damages to be proven at trial. The complaint also alleges that the Company sold Series E preferred shares without registering the sale of such shares or obtaining an exemption from registration. The complaint requests rescission, compensatory damages and treble damages, including interest and attorneys' fees.
-- F-46 PARADIGM MEDICAL INDUSTRIES, INC. Notes to Financial Statements Continued -- 16. Commitments and Litigation - Continued Contingencies The Company filed an answer to the complaint. The Continued Company believes the complaint is without merit and intends to vigorously defend its interests in the action. If the Company is not successful in defending and protecting its interests in the action, resulting in a judgment against it for substantial damages, and U.S. Fire denies coverage in the litigation under the Directors and Officers Liability and Company Reimbursement Policy, the Company would not be able to pay such liability and, as a result, would be forced to seek bankruptcy protection. On January 26, 2005, the Company completed a written settlement agreement to settle the lawsuit that Innovative Optics, Inc. and Barton Dietrich Investments, L.P. brought against the Company and its former executive officers. Under the terms of the settlement, U.S. Fire agreed to pay Innovative Optics, Inc. and Barton Dietrich Investments, L.P. the sum of $367,500 in cash. Payment of this amount is contingent,

however, upon the courts in the federal and state class action lawsuits granting final approval of the settlements reached in those respective actions, and such orders becoming final and non-appealable. On February 23, 2005, the Company executed written settlement agreements to settle the federal and state court class action lawsuits that were filed against the Company and its former executive officers. Under the terms of settlement of the federal court class action lawsuit, U.S. Fire agreed to pay the sum of $1,507,500 in cash to the class members that purchased the Company's securities during the period between April 17, 2002 and November 4, 2002. Under the terms of settlement of the state court class action lawsuit, U.S. Fire agreed to pay the sum of $625,000 in cash to the class members that purchased shares of Series E Convertible preferred stock on or about July 11, 2001. As a condition to the settlement agreements to settle the federal and state court class action lawsuits, the courts in such lawsuits must have entered orders granting final approval of the settlements reached in those respective actions, and such orders must have become final and non-appealable. On March 3, 2005, the federal court entered an order granting preliminary approval of the settlement in the federal court class action lawsuit and providing for notice to be sent to potential class members. On April 18, 2005, a hearing was held in the state court and the court entered a -- F-47 PARADIGM MEDICAL INDUSTRIES, INC. Notes to Financial Statements Continued -- 16. Commitments and Litigation - Continued Contingencies minute entry granting preliminary approval of the Continued settlement in the state court class action lawsuit. As a further condition to the settlement agreements to settle the federal and state court class action lawsuits, both settlement agreements provide that U.S. Fire must not have exercised its option to terminate the settlement agreements. U.S. Fire has the option to terminate the settlement agreements if the cumulative dollar value of the claims held by individuals or entities that "opt out" of the federal and state class action lawsuits exceeds $250,000. If such "opt outs" exceed $250,000, however, plaintiffs in the federal and state court class action lawsuits will have five days to cure by reducing the amount of "opt outs" to less than $250,000. If U.S. Fire exercises its option to terminate the settlement agreements, then all parties to the settlement agreements will be restored to their respective positions in the various actions as of the date of the settlement agreements. In addition, the terms and provisions of the settlement agreements will have no further force and effect on the various parties and will be deemed null and void in their entirety. Under the terms of the settlement agreements regarding the federal and state court class action lawsuits and the lawsuit that Innovative Optics, Inc. and Barton Dietrich Investors, L.P. brought against the Company and its former executive officers, U.S. Fire has agreed to pay a total of $2,500,000 in cash to the classes in the class action lawsuits and to Innovative Optics, Inc. and Barton Dietrich Investments, L.P. in settlement of these lawsuits. Under the terms of settlement, Paradigm Medical is to pay U.S. Fire the sum of $220,000 representing the remaining amount owing under the $250,000 retention obligation in the insurance policy, and to execute a policy release in favor of U.S. Fire as to coverage under the insurance policy. An action was filed on June 20, 2003, in the Third Judicial District Court, Salt Lake County, State of Utah (Civil No. 030914195) by CitiCorp Vendor Finance, Inc., formerly known as Copelco Capital, Inc. The complaint claims that $50,000 plus interest is due for the leasing of three copy machines that were delivered to the Company's Salt Lake City facilities on or about April of -- F-48 PARADIGM MEDICAL INDUSTRIES, INC. Notes to Financial Statements Continued -- 16. Commitments and Litigation - Continued Contingencies 2000. The action also seeks an award of attorney's fees Continued and costs incurred in the collection. The Company disputes the amounts allegedly owed, asserting that two of the machines were returned to the leasing company because they did not work properly. A responsive pleading has been filed. The Company was engaged in settlement discussions with CitiCorp until counsel for CitiCorp withdrew from the case. New counsel for CitiCorp has been appointed and it is anticipated that settlement discussions will resume. An action was filed in June, 2003 in the Third Judicial District Court, Salt Lake County, State of Utah (Civil No. 030914719) by Franklin Funding, Inc. in which it alleges that the Company had entered into a lease agreement for the lease of certain equipment for which payment is due. It is claimed that there is due and owing approximately $89,988 after accruing late fees, interest, repossession costs, collection costs and attorneys' fees. On August 28, 2003, the Company agreed to a settlement of the case with Franklin Funding by agreeing to make 24 monthly payments of $2,000 to Franklin Funding, with the first monthly payment due on August 29, 2003. As of March 31, 2005, the Company has made 19 monthly payments of $2,000 each to Franklin Funding. The Company received demand letters dated July 18, 2003, September 26, 2003 and November 10, 2003 from counsel for Douglas A. MacLeod, M.D., a shareholder of the company. In the July 18, 2003 letter, Dr. MacLeod demands that he and certain entities with which he is involved or controls, namely the Douglas A. MacLeod, M.D. Profit Sharing Trust, St. Marks' Eye Institute and Milan Holdings, Ltd., be issued a total of 2,296,667 shares of the Company's common stock and warrants to purchase 1,192,500 shares of its common stock at an exercise price of $.25 per share. Dr. MacLeod claims that these common shares and warrants are owing to him and the related entities under the terms of a mutual release dated January 16, 2003, which he and the related entities entered into with us. Dr. MacLeod renewed his request for these additional common shares and warrants in the September 26, 2003 and November 10, 2003 demand letters. The Company believes that Dr. MacLeod's claims and assertions are without merit and that neither he nor the related entities are entitled to any additional shares of its common stock or any additional warrants under the terms of the mutual release. The Company -- F-49 PARADIGM MEDICAL INDUSTRIES, INC. Notes to Financial Statements Continued -- 16. Commitments and Litigation - Continued Contingencies intends to vigorously defend against any legal action Continued that Dr. MacLeod may bring. On August 3, 2003, a complaint was filed against the Company by Corinne Powell, a former employee, in the Third Judicial District Court, Salt Lake County, State of Utah (Civil No. 030918364). Defendants consist of the Company and Randall A. Mackey, Dr. David M. Silver and Keith D. Ignotz, directors of the Company. The complaint alleges that at the time the Company laid off Ms. Powell on March 25, 2003, she was owed $2,000 for business expenses, $11,000 for accrued vacation days, $13,000 for unpaid commissions, the fair market value of 50,000 stock options exercisable at $5.00 per share that she claims she was prevented from exercising, attorney's fees and a continuing wage penalty under Utah law. On March 29, 2005, the Company agreed to a settlement with Ms. Powell of her claims for unpaid business expenses, accrued vacation days, and unpaid commissions by agreeing to pay her $13,000. The Company has not yet made payment to Ms. Powell for the agreed upon settlement amount. On September 10, 2003, an action was filed against the Company by Larry Hicks in the Third Judicial District Court, Salt Lake County, State of Utah, (Civil No. 030922220), for payments due under a consulting agreement with us. The complaint claims that monthly payments of $3,083 are due for the months of October 2002 to October 2003 under a consulting agreement and, if the agreement is terminated, for the sum of $110,000 minus whatever the Company has paid Mr. Hicks prior to such termination, plus costs, attorney's fees and a wage penalty pursuant to Utah law. The Company has filed an answer in which it denies any liability to Mr. Hicks. Formal discovery in the matter has commenced. The Company disputes the amount allegedly owed and intends to vigorously defend against such action. On November 7, 2003, a complaint was filed against the Company by Todd Smith, a former employee, in the Third Judicial District Court, Salt Lake County, State of Utah (Civil No. 030924951 CN). Defendants consist of the Company and Randall Mackey, a director of the Company. The complaint alleges that while an employee of the Company, Mr. Smith was granted stock options to purchase 16,800 shares of common stock exercisable at $5.00 per share. Mr. Smith claims unpaid wages in the amount of -- F-50 PARADIGM MEDICAL INDUSTRIES, INC. Notes to Financial Statements Continued -- 16. Commitments and Litigation - Continued Contingencies the fair market value of the stock options he claims he Continued was prevented from exercising, attorney's fees, and a continuing wage penalty under Utah law. The Company believes the claims are without merit and intends to vigorously defend against such action. On May 25, 2004, an action was brought against the Company by Jeffrey F. Poore, former President and Chief Executive Officer of the Company, in the Third Judicial District Court of Salt Lake County, State of Utah (Civil No. 040910875). The complaint alleges that the Company unlawfully terminated the written employment agreement between Mr. Poore and the Company. As a result, Mr. Poore demands judgment against the Company for $350,000, representing his annual salary for the two remaining years under the employment agreement, for money judgment based on the value of his benefits for the two remaining years under the employment agreement, including profit sharing plans, 401(k) and cafeteria plans, health, hospitalization, dental, disability and other insurance plans canceled by the Company, and for money judgment equal to the value of the stock options granted to him under the employment agreement. The Company disputes the amounts allegedly owed in the complaint and believes that there was a sufficient basis to terminate Mr. Poore's employment for cause under the terms of the employment agreement. Accordingly, the Company intends to vigorously defend against the action. On August 9, 2004, a third party complaint was brought against the Company by Wakefield Eye Center and Dr. Kenneth C. Westfield (collectively "Westfield"). The original action was brought by American Express Business Finance Corporation against Westfield on May 27, 2004 in the

District Court, Clark County, State of Nevada (Civil No. A486307, Dept. No. XXI) concerning the financing of the purchase of a Blood Flow Analyzer(TM) involving Westfield Eye Center. The transaction took place during the latter half of 2001. Westfield takes the position that if there is liability of Westfield to American Express this liability is ultimately ours and the other third-party defendants. The amount being sought against Westfield by American Express in the original action includes the sum of $30,000, together with interest and attorney's fees. Westfield's alleged claims against the Company include fraud, breach of contract, promissory estoppel, declaratory relief, negligence, negligent supervision, damages for injuries resulting from actions -- F-51 PARADIGM MEDICAL INDUSTRIES, INC. Notes to Financial Statements Continued -- 16. Commitments and Litigation - Continued Contingencies of employee/contractor, wilful and wanton misconduct, Continued conspiracy, and breach of fiduciary duty as well as costs and attorney's fees. Westfield also seeks punitive damages. The Company has filed an answer to the third party complaint in which the Company denies liability. Formal discovery in the matter involving us has commenced. The case has been referred to arbitration. The Company intends to vigorously defend the action. On March 31, 2005, an action was filed against the Company by Joseph W. Spadafora in the United States District Court, District of Utah (Civil No. 2:05CV00278 TS). The complaint alleges that Dr. Spadafora was a clinical investigator in the study for the FDA involving the Company's Photon(TM) laser system where he performed numerous surgeries using the Photon(TM). Dr. Spadafora contends that in meetings with Company personnel he suggested ways in which the handpiece on the Photon(TM) could be improved. Dr. Spadafora further contends that on August 5, 1999, the Company filed a patent application for an improved handpiece with the United States Patent and Trademark Office but he was not named as one of the inventors or a co-inventor on the patent application. On September 24, 2004, the Company was issued a patent entitled, "Laser Surgival Handpiece with Photon Trap." Because the Company did not list Dr. Spadafora as one of the inventors or a co-inventor on the patent, Dr. Spadafora is requesting in his complaint that a court order be entered declaring that he is the inventor or co-inventor of the patent and, as a result, is entitled to all or part of the royalties and profits that the Company earned or will earn from the sale of any product incorporating or using the improved handpiece, plus interest and attorney's fees. The Company disputes the claims made by Dr. Spadafora and intends to vigorously defend against such action. The Company is not a party to any other material legal proceedings outside the ordinary course of its business or to any other legal proceedings, which, if adversely determined, would have a material adverse effect on its financial condition or results of operations. Royalty Agreements The Company had a royalty agreement with the president of OBF. The agreement provided for the payment of 10% royalty of the net sales related to the Blood Flow Analyzer. -- F-52 PARADIGM MEDICAL INDUSTRIES, INC. Notes to Financial Statements Continued -- 16. Commitments and Royalty Agreements - Continued Contingencies During 2003, a settlement was reached with the president Continued of OBF whereby the royalty payments were forfeited and no longer are an obligation of the Company. The over-accrued amount of $147,000 was reversed during 2003 to reflect the settlement agreement. The Company has an amended exclusive patent license agreement with a company which owns the patent for the laser-probe used on the Photon machine. The agreement provides for the payment of a 1% royalty on all sales proceeds related directly or indirectly, to the Photon machine. The agreement expires when the United States patent rights expire in September 2004. Through December 31, 2003, no significant royalties have been paid under this agreement. The Company has a royalty agreement with another company that developed a promotional CD for the Company. Through the promotion of the CD, the Company hopes to increase sales in the Autoperimiter and assist doctors currently using the unit with the interpretation of visual fields. The royalty base is 50% each until the Company's share equals the production costs related to development of the disk. Thereafter, the developer will receive 70% and the Company will receive 30% of the royalty base. Royalties paid during the year relating to this agreement were not significant. 17. Fair Value The Company's financial instruments consist of cash, of Financial receivables, payables, and notes payable. The carrying Instruments amount of cash, receivables and payables approximates fair value because of the short-term nature of these items. The carrying amount of the notes payable approximates fair value as the individual borrowings bear interest at market interest rates. 18. Recent In December 2003, the FASB issued Interpretation No. 46 Accounting ("FIN 46R") (revised December 2003), Consolidation of Pronounce- Variable Interest Entities, an Interpretation of ments Accounting Research Bulletin No. 51 ("ARB 51"), which addresses how a business enterprise should evaluate whether it has a controlling interest in an entity though means other than voting rights and accordingly should consolidate the entity. FIN 46R replaces FASB Interpretation No. 46 (FIN 46), which was issued in January 2003. Before concluding that it is appropriate to apply ARB 51 voting interest consolidation model to an entity, an enterprise must first determine that the entity is not a variable interest entity (VIE). As of the effective date of FIN 46R, an enterprise must -- F-53 PARADIGM MEDICAL INDUSTRIES, INC. Notes to Financial Statements Continued -- 18. Recent evaluate its involvement with all entities or legal Accounting structures created before February 1, 2003, to determine Pronounce- whether consolidation requirements of FIN 46R apply to ments those entities. There is no grandfathering of existing entities. Public companies must apply either FIN 46 or FIN 46R immediately to entities Continued created after January 31, 2003 and no later than the end of the first reporting period that ends after December 15, 2004. The adoption of FIN 46 had no effect on the Company's consolidated financial position, results of operations or cash flows. In December 2004, FASB issued SFAS 153 "Exchanges of Nonmonetary Assets--an amendment of APB Opinion No. 29". The guidance in APB Opinion No. 29, Accounting for Nonmonetary Transactions, is based on the principle that exchanges of nonmonetary assets should be measured based on the fair value of the assets exchanged. The guidance in that Opinion, however, included certain exceptions to that principle. This Statement amends Opinion 29 to eliminate the exception for nonmonetary exchanges of similar productive assets and replaces it with a general exception for exchanges of nonmonetary assets that do not have commercial substance. A nonmonetary exchange has commercial substance if the future cash flows of the entity are expected to change significantly as a result of the exchange. The Company does not believe adoption of SFAS 153 will have any impact on the Company's consolidated financial statements. In November 2004, the FASB issued SFAS 151 "Inventory Costs--an amendment of ARB No. 43". This Statement amends the guidance in ARB No. 43, Chapter 4, "Inventory Pricing," to clarify the accounting for abnormal amounts of idle facility expense, freight, handling costs, and wasted material (spoilage). Paragraph 5 of ARB 43, Chapter 4, previously stated that ". . . under some circumstances, items such as idle facility expense, excessive spoilage, double freight, and re-handling costs may be so abnormal as to require treatment as current period charges. . . ." This Statement requires that those items be recognized as current-period charges regardless of whether they meet the criterion of "so abnormal." In addition, this Statement requires that allocation of fixed production overheads to the costs of conversion be based on the normal capacity of the production facilities. The provisions of this Statement shall be effective for inventory costs incurred during fiscal years beginning after June 15, 2005. The Company does not believe adoption of SFAS 151 will have any impact on the Company's consolidated financial statements. -- F-54 PARADIGM MEDICAL INDUSTRIES, INC. Notes to Financial Statements Continued -- 18. Recent In December 2004, the FASB issued FASB Statement No. 123 Accounting (revised 2004), "Shared-Based Payment." Statement 123(R) Pronounce- addresses the accounting for share-based payment ments transactions in which an enterprise receives employee Continued services in exchange for (a) equity instruments of the enterprise or (b) liabilities that are based on the fair value of the enterprise's equity instruments or that may be settled by the issuance of such equity instruments. Statement 123(R) requires an entity to recognize the grant-date fair-value of stock options and other equity-based compensation issued to employees in the income statement. The revised Statement generally requires that an entity account for those transactions using the fair-value-based method, and eliminates the intrinsic value method of accounting in APB Opinion No. 25, "Accounting for Stock Issued to Employees", which was permitted under Statement 123, as originally issued. The revised Statement requires entities to disclose information about the nature of the share-based payment transactions and the effects of those transactions on the financial statements. Statement 123(R) is effective for public companies that do not file as small business issuers as of the beginning of the first interim or annual reporting period that begins after June 15, 2005. For public companies that file as small business issuers, Statement 123(R) is effective as of the beginning of the first interim or annual reporting period that begins after December 15, 2005 (i.e., first quarter 2006 for the Company). All public companies must use either the modified prospective or the modified retrospective transition method. Early adoption of this Statement for interim or annual periods for which financial statements or interim reports have not been issued is encouraged. The Company believes that the adoption of this pronouncement may have a material impact on the Company's financial statements. -- F-55 No dealer, salesperson or other person is authorized to give any information or to represent anything not contained in this prospectus. This prospectus is an offer to sell only the shares offered 183,201,059 Common Stock hereby, but only under circumstances and in jurisdictions where it is lawful to do so. The information contained in this prospectus is current only as of its date. -------------------- PARADIGM MEDICAL INDUSTRIES, INC. TABLE OF CONTENTS ---------------- Page Prospectus Summary.................... PROSPECTUS Risk Factors .... ---------------- Use of Proceeds....................... Dividend Policy....................... Capitalization........................ Market for Common Equity and Related Shareholder Matters........ Selected Financial Data............... Management's Discussion and Analysis or Plan of Operation.............. July __, 2005 Business .... Management .... Security Ownership of Certain Beneficial Owners and Management .. Certain Transactions................. Selling Stockholders................. Description of Securities............ Plan of Distribution................. Experts.............................. Legal Matters........................ Where You Can Find More Information... PART II INFORMATION NOT REQUIRED IN PROSPECTUS Item 24. Indemnification of Directors and Officers Section 145 of the General Corporation Law of the State of Delaware (the "Delaware Law") empowers a Delaware corporation to indemnify any person who is, or is threatened to be made, a party to any threatened, pending or completed legal action, suit or proceedings, whether civil, criminal, administrative or investigative (other than action by or in the right of such corporation), by reason of the fact that such person was an officer or director of such corporation, or is or was serving at the request of such corporation as a director, officer, employee or agent of another corporation or enterprise. The indemnity may include expenses (including attorneys' fees), judgments, fines and amounts paid in settlement actually and reasonably incurred by such person in connection with such action, suit or proceeding, provided that such officer or director acted in good faith and in a manner he or she reasonably believed to be in or not opposed to the corporation's best interests, and, for criminal proceedings, had no reasonable cause to believe his or her conduct was illegal. A Delaware corporation may indemnify officers and directors in an action by or in the right of the corporation under the same conditions, except that no indemnification is permitted without judicial approval if the officer or director is adjudged to be liable to the corporation in the performance of his or her duty. Where an officer or director is successful on the merits or otherwise in the defense of any action referred to above, the corporation must indemnify him or her against the expenses which such officer or director actually and reasonably incurred. In accordance with the Delaware Law, the Certificate of Incorporation of the Company contains a provision to limit the personal liability of the directors of the Company for violations of their fiduciary duty. This provision eliminates each director's liability to the Registrant or its stockholders for monetary damages except (i) for any breach of the director's duty of loyalty to the Company or its stockholders, (ii) for acts or omissions not in good faith or which involve intentional misconduct or a knowing violation of law, (iii) under Section 174 of the Delaware Law providing for liability of directors for unlawful payment of dividends or unlawful stock purchases or redemptions, or (iv) for any transaction from which a director derived an improper personal benefit. The effect of this provision is to eliminate the personal liability of directors for monetary damages for actions involving a breach of their fiduciary duty of care, including any such actions involving gross negligence. The Company may not indemnify an individual unless authorized and a determination is made in the specific case that indemnification of the individual is permissible in the circumstances because his or her conduct was in good faith, he or she reasonably believed that his or her conduct was in, or not opposed to, the Company's best interests and, in the case of any criminal proceeding, he or she had no reasonable cause to believe his or her conduct was unlawful. The Company may not advance expenses to an individual to whom the Company may ultimately be responsible for indemnification unless authorized in the specific case after the individual furnishes the following to the Company: a written affirmation of his or her good faith belief that his or her conduct was in good faith, that he or she reasonably believed that his or her conduct was in, or not opposed to, the Company's best interests and, in the case of any criminal proceeding, he or she had no reasonable cause to believe his or her conduct was unlawful and (2) the individual furnishes to the Company a written undertaking, executed personally or on his or her behalf, to repay the advance if it is ultimately determined that he or she did not meet the standard of conduct referenced in part (1) of this sentence. In addition to the individual furnishing the aforementioned written affirmation and undertaking, in order for the Company to advance expenses, a determination must also be made that the facts then- known to those making the determination would not preclude indemnification. All determinations relative to indemnification must be made as follows: (1) by the Board of Directors of the Company by a majority vote of those present at a meeting at which a quorum is present, and only those directors not parties to the proceeding shall be counted in satisfying the quorum requirement; or (2) if a quorum cannot be obtained as contemplated in part (1) of this sentence, by a majority vote of a committee of the Board of Directors designated by the Board of Directors of the Company, which committee shall consist of two or more directors not parties to the proceeding, except that directors who are parties to the proceeding may participate in the designation of directors for the committee; or (3) by special legal counsel selected by the Board of Directors or its committee in the manner prescribed in part (1) or part (2) of this sentence (however, if a quorum of the Board of Directors cannot be obtained under part (1) of this sentence and a committee cannot be designated under part (2) of this sentence, then a special legal counsel shall be selected by a majority vote of the full board of directors, in which selection directors who are parties to the proceeding may participate); or (4) by the shareholders, by a majority of the votes entitled to be cast by holders of qualified shares present in person or by proxy at a meeting. The Company has also entered into Indemnification Agreements with its executive officers and directors. These Indemnification Agreements are substantially similar in effect to the Bylaws and the provisions of our Certificate of Incorporation relative to providing indemnification to the maximum extent and in the manner permitted by the Delaware General Corporation Law. Additionally, such Indemnification Agreements contractually bind the Company with respect to indemnification and contain certain exceptions to indemnification, but do not limit the indemnification available pursuant to our Bylaws, our Certificate of Incorporation or the Delaware General Corporation Law. II-1 Item 25. Other Expenses of Issuance and Distribution The following table sets forth the expenses payable by the Company in connection with the issuance and distribution of the securities being registered (all amounts except the Securities and Exchange Commission filing fee are estimated): Filing fee -- Securities and Exchange Commission.................. $ 0 Printing and engraving expenses................................... 250 Legal fees and disbursements...................................... 20,000 Accounting fees and disbursements .... 5,000 Blue Sky fees and expenses (including legal fees)................. 1,000 Transfer agent and registrar fees and expenses.................... 250 Miscellaneous... 500 ------- Total expenses.. $27,000 Item 26. Recent Sales of Unregistered Securities The following information is furnished with regard to all issuances of unregistered shares of our common stock during the past three years. These shares were issued, unless otherwise indicated, without registration in reliance upon the exemption provided by Section 4(2) of the Securities Act of 1933, as amended or, in the case of the exercise of warrants, the shares were registered pursuant to a registration statement in effect at the time of the warrant exercise. I. Common Stock On January 31, 2002, the Company issued 1,272,825 shares of common stock and warrants to purchase 250,000 shares of the Company's Common Stock at $5.00 per share to Innovative Optics, Inc. as consideration pursuant to the completion of a transaction involving the purchase of all of the assets of Innovative Optics, Inc. One-half of these common shares, or 636,412 shares, were delivered to Innovative Optics at closing, and the other half were held in escrow pending completion of the blade cost reduction project. On August 2, 2002, 477,309 of the shares held in escrow were delivered to Innovative Optics. The remainder of the shares, or 159,103 shares, remains in escrow because phase 2 of the blade cost reduction project has not been completed. The assets purchased from Innovative Optics included raw materials, work in process, finished goods inventories, equipment, patents, rights, trade name and goodwill, which were recorded as $2,209,000 on the financial statements of the Company. On January 31, 2002, the Company issued 50,000 shares of common stock to Dr. Scott S. Bair as consideration pursuant to the completion of a transaction involving the purchase of all the assets of Innovative Optics, Inc. On June 19, 2002, the Company issued 17,007 shares of common stock to John Charles Casebeer, M.D. for services rendered to the Company under a consulting agreement. The shares represent the payment of $50,000 in common stock in consideration for assisting the Company to develop and promote its Innovatome(TM) microkeratome during the period from April 1, 2002 to June 30, 2002. On July 9, 2002, the Company issued 35,000 shares of common stock to Michael W. Stelzer pursuant to the Severance Agreement and General Release, which the Company entered into with Mr. Stelzer on January 21, 2000. On July 29, 2002, the Company issued 26,677 shares of common stock to John Charles Casebeer, M.D. for services rendered to the Company under a consulting agreement. The shares represent the payment of $50,000 in common stock in consideration for assisting the Company to develop and promote the Innovatome(TM) microkeratome during the period from July 1, 2002 to September 30, 2002. On July 30, 2002, the Company issued 50,000 shares of common stock to each of Peter Kristensen and F. Briton McConkie for services rendered to the Company under a Major Account Facilitator Contract in which Messrs. McConkie and Kristensen served as intermediaries between the Company and an international agent in an effort to sell 150 Photon(TM) laser systems in Asia. II-2 On August 2, 2002, the Company issued 48,000 shares of common stock to Michael B. Lindberg, M.D. for services rendered under a consulting agreement (24,000 shares for services rendered in 2001 and 24,000 shares for services rendered in 2002). The shares issued to Dr. Lindberg represent the payment for assisting the Company in evaluating new technologies and instruments during the period from December 1, 2000 to November 30, 2002. On September 26, 2002, the Company issued a total of 736,945 shares of its on stock to 34 shareholders of International Bio-Immune Systems, Inc. or IBS in connection with a transaction with IBS to acquire 19.9% of the outstanding shares of IBS common stock through the exchange and issuance of the 736,945 shares of its common stock for 2,663,254 shares of common stock of IBS. In addition, as part of the transaction, the Company lent 300,000 shares of its common stock to IBS and, as consideration for the payment of certain expenses of IBS in the transaction, issued 44,000 shares of its common stock to IBS and 50,000 shares of its common stock to Joseph S. Anile, II. These shares were issued without registration in reliance upon Section 4(2) of the Securities Act of 1933 and Rule 506 of Regulation D thereunder. On September 30, 2002, the Company issued 40,000 shares of common stock to Michael W. Stelzer pursuant to a Severance Agreement and General Release, which the Company entered into with Mr. Stelzer on September 27, 2002. On January 22, 2003, the Company issued a total of 2,524,000 shares of common stock to six accredited investors, as defined in Section 2(15) of the Securities Act of 1933 and Rule 501 of Regulation D thereunder, through a private placement under Section 4(2) of the Securities Act of 1933 and Rule 506 of Regulation D thereunder at a price of $.25 per share. The Company received a total of $631,000 in cash in the private placement transaction and paid $69,410 in commissions and expenses. In addition, the Company issued warrants to purchase 157,750 shares of common stock at an exercise price of $.25 per share for commissions and expenses. The accredited investors also received warrants to purchase a total of 631,000 shares of common stock at an exercise price of $.25 per share. On March 26, 2003, the Company issued 695,991 shares of common stock to Triton West Group, Inc., an accredited investor, as defined in Section 2(15) of the Securities Act of 1933 and Rule 501 of Regulation D thereunder, for a cash investment in the amount of $85,746, or at a purchase price of $.12 per share. These shares were issued without registration in reliance upon Section 4(2) of the Securities Act of 1933 and Rule 506 of Regulation D thereunder. On June 13, 2003, the Company issued 50,000 shares of common stock to Frank G. Mauro for a cash investment of $12,500 pursuant to the exercise of warrants at an exercise price of $.25 per share. On June 13, 2003, the Company issued 7,888 shares of common stock to Delbert G. Reichardt for a cash investment in the amount of $1,972 pursuant to the exercise of warrants at an exercise price of $.25 per share. On June 13, 2003, the Company issued 7,887 shares of common stock to John H. Banzhaf for a cash investment in the amount of $1,971.25 pursuant to the exercise of warrants at an exercise price of $.25 per share. On June 26, 2003, the Company issued 51,000 shares of common stock to Paul L. Archambeau, M.D. for a cash investment in the amount of $12,750 pursuant to the exercise of warrants at an exercise price of $.25 per share. On June 30, 2003, the Company completed the sale of 845,266 shares of common stock to 14 accredited investors, as defined in Section 2(15) of the Securities Act of 1933 and Rule 501 of Regulation D thereunder, through a private placement under Section 4(2) of the Securities Act of 1933 and Rule 506 of Regulation D thereunder at a price of $.375 per share. The Company received a total of $316,975 in cash in the private placement transaction and issued 82,526 shares of common stock in commissions and expenses. The accredited investors also received warrants to purchase 422,634 shares of common stock at an exercise price of $.75 per share. On October 9, 2003, the Company issued 300,000 shares of common stock to John Charles Casebeer, M.D. in settlement of a lawsuit that Dr. Casebeer brought against the Company for services performed under a personal services contract. On January 14, 2005, the Company issued 2,000,000 shares of common stock to Dr. Endre Bodnar, an accredited investor, as defined in Section 2(15) of the Securities Act of 1933 and Rule 501 of Regulation D thereunder, through a private placement under Section 4(2) of the Securities Act of 1933 and Rule 506 of Regulation D thereunder at a price of $.075 per share. The Company received a total of $150,000 in cash from the private placement transaction and issued as a commission warrants to purchase 200,000 shares of the Company's common stock at $.15 per share. On February 1, 2005, the Company issued a total of 515,206 shares of common stock to Crescent International, Ltd. and Otape Investments, Ltd. that had purchased a total of 1,981,560 shares of the Company's Series G convertible preferred stock in a private placement transaction, which was initially closed on September 29, 2003. Under the terms of the private offering, the Company was required to file a registration statement with the Securities and Exchange II-3 Commission to register the common shares issuable to the Series G preferred stockholders upon conversion of their Series G preferred shares and exercise of their warrants. The 515,206 shares represented a penalty for the Company not having a registration statement declared effective within 120 days of the initial closing of the offering. On April 7, 2005, the Company issued 250,000 shares of common stock to the law firm of Mackey Price Thompson & Ostler for legal services rendered in the amount of $22,500 pursuant to the terms of a stock purchase agreement dated April 7, 2005, between Mackey Price Thompson & Ostler and the Company. Randall A. Mackey, Chairman of the Company, is President and a shareholder of Mackey Price Thompson & Ostler. II. Series G Preferred Stock During the period from August 24, 2003 to September 15, 2003, the Company sold a total of

1,981,560 shares of Series G convertible preferred stock to two accredited investors, as defined in Section 2(15) of the Securities Act of 1933 and Rule 501 of Regulation D thereunder, through a private placement under Regulation D promulgated under the Securities Act of 1933 at a price of $.17 per share. The Company received $300,000 in cash as a result of the private placement transaction and paid $30,000 in commissions and expenses. In addition, the Company issued warrants to purchase 88,236 shares of common stock at an exercise price of $.50 per share for commissions and expenses. The Series G convertible preferred stock is convertible into shares of common stock at a conversion price equal to one share of common stock for each share of Series G preferred stock. The accredited investors also received warrants to purchase a total of 382,353 shares of common stock at an exercise price of $.50 per share. These shares of Series G. convertible preferred stock were issued without registration in reliance upon Section 4(2) of the Securities Act of 1933 and Rule 506 of Regulation D promulgated thereunder. Moreover, the Company issued an additional 515,206 shares of common stock to the investors. Under the terms of the private offering, the Company is required to file a registration statement with the Securities and Exchange Commission to register the common shares issuable to the Series G preferred stockholders upon conversion of their Series G preferred shares and exercise of their warrants. If the registration statement was not declared effective within 120 days of the initial closing of the offering on August 29, 2003, there was a penalty of 2% per month payable to the investors in common shares (or 39,631 common shares per month) until the registration statement is declared effective. The registration Statement was declared effective on February 10, 2005. III. Callable Secured Convertible Notes During the period from April 27, 2005 to June 30, 2005, the Company sold a total of $1,650,000 in callable secured convertible notes to four accredited investors, as defined in Section 2(15) of the Securities Act of 1933 and Rule 501 of Regulation D thereunder, through a private placement under Regulation D promulgated under the Securities Act of 1933. In addition, the Company issued warrants to purchase 10,912,699 shares of its common stock at an exercise price of $.20 per share, of which 5,621,684 warrants are exercisable through April 27, 2010 and 5,291, 005 warrants are exercisable through June 23, 2010. The callable secured convertible notes bear interest at 8% per annum, payable quarterly in cash, with six months of interest payable up front. The interest rate resets to zero percent for any month in which the stock price is greater than 125% of the initial market price, or $.0945, for each trading date during that month. The callable secured convertible notes mature in three years from the date of issuance, and are convertible into common stock, at the noteholder's option, at the lower of (i) $.09 or (ii) 60% of the average of the three lowest intraday trading prices for the common stock on the OTC Bulletin Board for the 20 days before but not including the conversion date. The callable secured convertible notes are secured by the Company's assets, including its inventory, accounts receivable and intellectual property. Moreover, the Company has a call option under the terms of the notes. The call option provides the Company with the right to repay all of the outstanding callable secured convertible notes at any time, provided there is no event of default by the Company and the common stock is trading at or below $.09 per share. Prepayment of the callable secured convertible notes is to be made in cash equal to either (i) 125% of the outstanding principal and accrued interest for prepayments occurring within 30 days following the issue date of the notes; (ii) 130% of the outstanding principal and accrued interest for prepayments occurring between 31 and 60 days following the issue date of the notes; and (iii) 145% of the outstanding principal and accrued interest for prepayments occurring after the 60th day following the issue date of the notes. Item 27. Exhibits (a) Exhibits -------- The following Exhibits are filed herewith pursuant to Rule 601 of Regulation S-B or are incorporated by reference to previous filings. Exhibit No. Document Description ------- -------------------- 2.1 Amended Agreement and Plan of Merger between Paradigm Medical Industries, Inc., a California corporation and Paradigm Medical Industries, Inc., a Delaware corporation(1) 3.1 Certificate of Incorporation(1) 3.2 Amended Certificate of Incorporation(10) 3.3 Bylaws(1) 4.1 Warrant Agency Agreement with Continental Stock Transfer & Trust Company(3) 4.2 Specimen Common Stock Certificate(2) 4.3 Specimen Class A Warrant Certificate(2) 4.4 Form of Class A Warrant Agreement(2) 4.5 Underwriter's Warrant with Kenneth Jerome & Co., Inc.(3) 4.6 Warrant to Purchase Common Stock with Note Holders re bridge financing (1) 4.7 Specimen Series C Convertible Preferred Stock Certificate(4) 4.8 Certificate of the Designations, Powers, Preferences and Rights of the Series C Convertible Preferred Stock(4) 4.9 Specimen Series D Convertible Preferred Stock Certificate (6) 4.10 Certificate of the Designations, Powers, Preferences and Rights of the Series D Convertible Preferred Stock (7) 4.11 Warrant to Purchase Common Stock with Cyndel & Co. (6) 4.12 Warrant to Purchase Common Stock with R.F. Lafferty & Co., Inc. (6) 4.13 Warrant to Purchase Common Stock with Dr. Michael B. Limberg (7) 4.14 Warrant to Purchase Common Stock with John W. Hemmer (7) 4.15 Stock Purchase Warrant with Triton West Group, Inc.(9) 4.16 Warrant to Purchase Common Stock with KSH Investment Group, Inc.(9) 4.17

Warrant to Purchase Common Stock with Consulting for Strategic Growth, Ltd.(9) II-4 4.18 Certificate of Designations, Powers, Preferences and Rights of the Series G Convertible Preferred Stock (14) 5.1 Opinion of Mackey Price Thompson & Ostler 10.1 Exclusive Patent License Agreement with PhotoMed(1) 10.2 Consulting Agreement with Dr. Daniel M. Eichenbaum(1) 10.3 1995 Stock Option Plan (1) 10.4 Employment Agreement with Thomas F. Motter (5) 10.5 Stock Purchase Agreement with Ocular Blood Flow, Ltd. and Malcolm Redman (7) 10.6 Consulting Agreement with Malcolm Redman (7) 10.7 Royalty Agreement with Malcolm Redman (7) 10.8 Registration Rights with Malcolm Redman (7) 10.9 Employment Agreement with Mark R. Miehle (8) 10.10 Agreements with Steven J. Bayern and Patrick M. Kolenik (8) 10.11 Private Equity Line of Credit Agreement with Triton West Group, Inc. (9) 10.12 Asset Purchase Agreement with Innovative Optics, Inc. and Barton Dietrich Investments, L.P.(10) 10.13 Escrow Agreement with Innovative Optics, Inc., Barton Dietrich Investments, L.P. (10) 10.14 Assignment and Assumption Agreement with Innovative Optics, Inc.(10) 10.15 General Assignment and Bill of Sale with Innovative Optics, Inc.(10) 10.16 Non-Competition and Confidentiality Agreement with Mario F. Barton(10) 10.17 Termination of Employment Agreement with Mark R. Miehle(12) 10.18 Consulting Agreement with Mark R. Miehle(12) 10.19 Employment Agreement with Jeffrey F. Poore (13) 10.20 License Agreement with Sunnybrook Health Science Center(15) 10.21 Major Account Facilitator Contract(15) 10.22 Mutual Release with Douglas A. MacLeod, M.D. and others(15) 10.23 Purchase Agreement with American Optisurgical, Inc.(15) 10.24 Purchase Order with Westland Financial Corporation(16) 10.25 Non-Waiver Agreement with United States Fire Insurance Company(16) 10.26 Employment Agreement with John Y. Yoon(17) 10.27 Consulting Agreement with Dr. John Charles Casebeer (18) 10.28 Stock Purchase and Sale Agreement with William Ungar (19) 10.29 Employment Agreement with Aziz A. Mohabbat (20) 10.30 Investment Banking Agreement with Alpha Advisory Services, Inc. (21) 10.31 Manufacturing and Distribution Agreement with E-Technologies, Inc. (21) 10.32 Settlement Agreement with Innovative Optics, Inc., Barton Dietrich Investments, L.P. and United States Fire Insurance Company(22) 10.33 Securities Purchase Agreement with AJW Partners, LLC, AJW Offshore, Ltd., AJW Qualified Partners, LLC and New Millennium Capital Partners II, LLP (the "Purchasers")(23) 10.34 Form of Callable Secured Convertible Note with each purchaser(23) 10.35 Form of Stock Purchase Warrant with each purchaser(23) 10.36 Security Agreement with Purchasers(23) 10.37 Intellectual Property Security Agreement with Purchasers(23) 10.38 Registration Statement with the Purchasers(23) 10.39 Stock Purchase Agreement with Mackey Price Thompson & Ostler(24) 23.1 Consent of Mackey Price Thompson & Ostler 23.2 Consent of Tanner LC 23.3 Consent of Chisholm, Bierwolf & Nilson, LLC ---------------- (1) Incorporated by reference from Registration Statement on Form SB-2, as filed on March 19, 1996. (2) Incorporated by reference from Amendment No. 1 to Registration Statement on Form SB-2, as filed on May 14, 1996. (3) Incorporated by reference from Amendment No. 2 to Registration Statement on Form SB-2, as filed on June 13, 1996. (4) Incorporated by reference from Annual Report on Form 10-KSB, as filed on April 16, 1998. (5) Incorporated by reference from Quarterly Report on Form 10-QSB, as filed on November 12, 1998. (6) Incorporated by reference from Registration Statement on Form SB-2, as filed on April 29, 1999. (7) Incorporated by reference from Quarterly Report on Form 10-QSB, as filed on August 16, 2000. (8) Incorporated by reference from Quarterly Report on Form 10-QSB, as filed on November 1, 2000. (9) Incorporated by reference from Quarterly Report on Form 10-KSB, as filed on April 16, 2001. II-5 (10) Incorporated by reference from Current Report on Form 8-K, as filed on March 5, 2002. (11) Incorporated by reference from Amendment No. 1 to Registration Statement on Form S-3, as filed on March 20, 2002. (12) Incorporated by reference from Quarterly Report on Form 10-QSB, as filed on November 18, 2002. (13) Incorporated by reference from Registration Statement on Form SB-2, as filed on July 7, 2003. (14) Incorporated by reference from Quarterly Report on Form 10-QSB, as filed on November 14, 2003. (15) Incorporated by reference from Amendment No. 2 to Registration Statement on Form SB-2, as filed on December 15, 2003. (16) Incorporated by reference from Amendment No. 3 to Registration Statement on Form SB-2, as filed on February 27, 2004. (17) Incorporated by reference from Current Report on Form 8-K, as filed on March 23, 2004. (18) Incorporated by reference from Annual Report on Form 10-KSB, as filed on April 14, 2004. (19) Incorporated by reference from Quarterly Report on Form 10-QSB, as filed on August 16, 2004. (20) Incorporated by reference from Amendment No. 6 to Registration Statement on Form SB-2, as filed on October 20, 2004. (21) Incorporated by reference from Report on Form 10-QSB, as filed on November 15, 2004. (22) Incorporated by reference from Current Report on Form 8-K, as filed on January 26, 2005. (23) Incorporated by reference from Current Report on Form 8-K, as filed on May 18, 2005. (24) Incorporated by reference from Registration Statement on Form SB-2, as filed on June 22, 2005. (b) Reports on Form 8-K ------------------ Current Report on Form 8-K, as filed on January 27, 2005.

Current Report on Form 8-K, as filed on February 24, 2005. Current Report on Form 8-K, as filed on May 18, 2005. Item 28. Undertakings (a) The undersigned registrant hereby undertakes: (1) To file, during any period in which it offers or sells securities, a post -effective amendment to this registration statement: (i) To include any prospectus required by Section 10(a)(3) of the Securities Act of 1933 (the "Securities Act"); (ii) To reflect in the prospectus any facts or events which, individually or together, represent a fundamental change in the information in the registration statement. Notwithstanding the foregoing, any increase or decrease in volume of securities offered (if the total dollar value of securities offered would not exceed that which was registered) and any deviation from the low or high end of the estimated maximum offering range may be reflected in the form of prospectus filed with the Commission pursuant to Rule 424(b) if, in the aggregate, the changes in volume and price represent no more than 20% change in the maximum aggregate offering price set forth in the "Calculation of Registration Fee" table in the effective registration statement; and (iii) To include any additional or changed material information on the plan of distribution. (2) That, for determining liability under the Securities Act, treat each post-effective amendment as a new registration statement of the securities offered, and the offering of the securities at that time to be the initial bona fide offering. (3) To file a post-effective amendment to remove from registration any of the securities that remain unsold at the end of the offering. (b) Insofar as indemnification for liabilities arising under the Securities Act may be permitted to directors, officers and controlling persons of the registrant pursuant to the foregoing provisions, or otherwise, the registrant has been advised that in the opinion of the Securities and Exchange Commission such indemnification is against public policy as expressed in the Securities Act and is, therefore, unenforceable. In the event that a claim for indemnification against such liabilities (other than the payment by the registrant of expenses incurred or paid by a director, officer or controlling person of the registrant in the successful defense of any action, suit or preceding) is asserted by such director, officer or controlling person in connection with the securities being registered, the registrant will, unless in the opinion of its counsel the matter has been settled by controlling precedent, submit to a court of appropriate jurisdiction the question whether such indemnification by it is against policy as expressed in the Securities Act and will be governed by the final adjudication of such issue. The undersigned registrant also undertakes that: II-6 (1) For purposes of determining any liability under the Securities Act, treat the information omitted from the form of prospectus filed as part of this registration statement in reliance upon Rule 430A and contained in a form of prospectus filed by the registrant pursuant to Rule 424(b)(1), or (4) or Rule 497(h) under the Securities Act shall be deemed to be part of this registration statement as of the time it was declared effective. (2) For the purposes of determining any liability under the Securities Act, treat each post-effective amendment that contains a form of prospectus as a new registration statement for the securities offered in the registration statement, and the offering of the securities at that time as the initial bona fide offering of those securities. II-7 SIGNATURES In accordance with the requirements of the Securities Act of 1933, the Registrant certifies that it has reasonable grounds to believe that it meets all of the requirements of filing on Form SB-2 and has duly caused this registration statement to be signed on its behalf by the undersigned, in Salt Lake City, State of Utah, this 24th day of June, 2005. PARADIGM MEDICAL INDUSTRIES, INC. By:/s/ John Y. Yoon ------------------- John Y. Yoon Its: President and Chief Executive Officer POWER OF ATTORNEY Pursuant to the requirements of the Securities Act of 1933, this registration statement has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated: Signature Title Date /s/ John Y. Yoon President and Chief Executive Officer June 24, 2005 ----------------- (Principal Executive Officer) John Y. Yoon /s/ Randall A. Mackey Chairman of the Board and Secretary June 24, 2005 --------------------- Randall A. Mackey /s/ David M. Silver* Director June 24, 2005 -------------------- David M. Silver /s/ Keith D. Ignotz* Director June 24, 2005 -------------------- Keith D. Ignotz /s/ John C. Pingree* Director June 24, 2005 -------------------- John C. Pingree /s/ Luis A. Mostacero Controller, Treasurer and Secretary June 24, 2005 --------------------- (Principal Financial and Accounting Luis A. Mostacero Officer) *By: /s/John Y. Yoon ----------------- John Y. Yoon as Attorney-in-Fact II-8