

MENTOR CORP /MN/  
Form 10-Q  
February 06, 2008

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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549  
FORM 10-Q**

(Mark One)

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

**For the quarterly period ended December 28, 2007**

**or**

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

**For the transition period from \_\_\_\_\_ to \_\_\_\_\_**

**Commission File No. 001-31744**

**MENTOR CORPORATION**

(Exact Name of Registrant as Specified in its Charter)

Minnesota

(State or other jurisdiction of  
incorporation or organization)

41-0950791

(IRS Employer Identification No.)

**201 Mentor Drive, Santa Barbara, California 93111**

(Address of principal executive offices) (Zip Code)

**(805) 879-6000**

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes  No

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

Large accelerated filer  Accelerated filer  Non-accelerated filer

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes  No

As of February 1, 2008 there were approximately 33,737,437 Common Shares, \$.10 par value per share, outstanding.

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**Table of Contents****PART I FINANCIAL INFORMATION****Item 1. Consolidated Financial Statements**Mentor Corporation  
Consolidated Balance Sheets  
(Unaudited)

(in thousands)	<b>December 31, 2007</b>	March 31, 2007
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 74,961	\$ 371,525
Marketable securities	31,686	116,215
Accounts receivable, net	72,385	65,419
Inventories	46,697	38,073
Deferred income taxes	26,353	25,892
Prepaid income taxes	9,789	13,495
Prepaid expenses and other	7,994	6,761
 Total current assets	 269,865	 637,380
 Property and equipment, net	 48,610	 34,683
Intangible assets, net	32,067	15,963
Goodwill, net	46,197	12,644
Other assets	6,681	9,098
 Total assets	 \$ 403,420	 \$ 709,768

See notes to consolidated financial statements.

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Mentor Corporation  
Consolidated Balance Sheets  
(Unaudited)

(in thousands, except share data)	<b>December 31, 2007</b>	March 31, 2007
<b>Liabilities and shareholders equity</b>		
Current liabilities:		
Accounts payable and accrued liabilities	\$ 38,709	\$ 32,147
Sales returns	14,881	18,590
Accrued compensation	17,917	14,022
Deferred revenue	12,443	11,863
Dividends payable	6,745	8,481
Product liability reserves	7,322	6,555
Short-term debt	1,076	
Warranty reserve	2,393	2,989
Interest payable	2,063	1,031
Accrued royalties	250	230
Other	14,108	16,823
<b>Total current liabilities</b>	<b>117,907</b>	112,731
Long-term accrued liabilities	15,606	12,169
Convertible subordinated notes	150,000	150,000
Other long-term debt	2,735	
Commitments and contingencies		
Shareholders equity:		
Common stock, \$.10 par value:		
Authorized - 150,000,000 shares; issued and outstanding 33,725,599 shares at December 31, 2007; 42,400,483 shares at March 31, 2007;	3,373	4,240
Preferred stock, \$.01 par value:		
Authorized - 25,000,000 shares; none issued and outstanding		
Accumulated other comprehensive income	22,630	11,342
Retained earnings	91,169	419,286
<b>Total shareholders equity</b>	<b>117,172</b>	434,868
<b>Total liabilities and shareholders equity</b>	<b>\$ 403,420</b>	\$ 709,768

See notes to consolidated financial statements.

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Mentor Corporation  
Consolidated Statements of Income  
Three Months Ended December 31, 2007 and 2006  
(Unaudited)

(in thousands, except per share data)	<b>2007</b>	2006
Net sales	<b>\$ 92,860</b>	\$ 75,309
Cost of sales	<b>26,138</b>	18,925
Gross profit	<b>66,722</b>	56,384
Selling, general, and administrative	<b>38,884</b>	32,356
Research and development	<b>9,690</b>	7,780
	<b>48,574</b>	40,136
Operating income from continuing operations	<b>18,148</b>	16,248
Interest expense	<b>(1,249)</b>	(1,426)
Interest income	<b>1,071</b>	6,346
Other income (expense), net	<b>(452)</b>	(281)
Income from continuing operations before income taxes	<b>17,518</b>	20,887
Income taxes	<b>5,406</b>	6,137
Income from continuing operations	<b>12,112</b>	14,750
Loss from discontinued operations, net of tax benefit of \$94 and \$596, respectively	<b>(170)</b>	(1,102)
Loss on sale of discontinued operations, net of tax benefit of \$13		(20)
Net income	<b>\$ 11,942</b>	\$ 13,628
Basic earnings (loss) per share		
Continuing operations	<b>\$ 0.36</b>	\$ 0.35
Discontinued operations	<b>(0.01)</b>	(0.03)
Basic earnings per share	<b>0.36</b>	0.33
Diluted earnings (loss) per share		
Continuing operations	<b>\$ 0.32</b>	\$ 0.32
Discontinued operations	<b>(0.01)</b>	(0.03)
Diluted earnings per share	<b>0.32</b>	0.29
Dividends per share	<b>\$ 0.20</b>	\$ 0.18

Weighted average shares outstanding		
Basic	<b>33,602</b>	41,916
Diluted	<b>39,848</b>	49,144
See notes to consolidated financial statements.		



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Mentor Corporation  
Consolidated Statements of Income  
Nine Months Ended December 31, 2007 and 2006  
(Unaudited)

(in thousands, except per share data)	<b>2007</b>	2006
Net sales	<b>\$ 273,814</b>	\$ 221,654
Cost of sales	<b>72,842</b>	59,491
Gross profit	<b>200,972</b>	162,163
Selling, general, and administrative	<b>108,326</b>	90,792
Research and development	<b>32,207</b>	24,654
	<b>140,533</b>	115,446
Operating income from continuing operations	<b>60,439</b>	46,717
Interest expense	<b>(4,160)</b>	(4,707)
Interest income	<b>7,218</b>	16,233
Other income (expense), net	<b>(1,421)</b>	494
Income from continuing operations before income taxes	<b>62,076</b>	58,737
Income taxes	<b>18,191</b>	17,490
Income from continuing operations	<b>43,885</b>	41,247
(Loss) income from discontinued operations, net of tax (benefit) expense of (\$152) and \$2,760, respectively	<b>(275)</b>	1,342
(Loss) gain on sale of discontinued operations, net of taxes of (\$5) and \$138,341, respectively	<b>(12)</b>	222,162
Net income	<b>\$ 43,598</b>	\$ 264,751
Basic earnings (loss) per share		
Continuing operations	<b>\$ 1.22</b>	\$ 0.98
Discontinued operations	<b>(0.01)</b>	5.33
Basic earnings per share	<b>1.21</b>	6.32
Diluted earnings (loss) per share		
Continuing operations	<b>\$ 1.09</b>	\$ 0.89
Discontinued operations	<b>(0.01)</b>	4.57
Diluted earnings per share	<b>1.08</b>	5.46

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Dividends per share	\$	<b>0.60</b>	\$	0.54
Weighted average shares outstanding				
Basic		<b>36,033</b>		41,898
Diluted		<b>42,499</b>		48,948
See notes to consolidated financial statements.				

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Mentor Corporation  
Consolidated Statements of Cash Flows  
Nine Months Ended December 31, 2007 and 2006  
(Unaudited)

(in thousands)	2007	2006
<b>Operating Activities:</b>		
Income from continuing operations	\$ 43,885	\$ 41,247
Adjustments to derive cash flows from continuing operating activities:		
Depreciation	6,024	5,640
Amortization	3,734	1,889
Deferred income taxes	(2,527)	3,477
Non-cash compensation	9,128	8,203
Tax benefit from exercise of stock options	2,054	8,465
Excess tax benefits from equity compensation	(2,256)	
Loss on sale of assets	29	162
Loss (gain) on long-term marketable securities, net	(28)	132
Cash provided by (used in) changes in operating assets and liabilities:		
Accounts receivable	(1,151)	(2,351)
Inventories	3,360	(725)
Other current assets	2,869	285
Accounts payable and accrued liabilities	4,503	3,933
Income taxes payable		(5,137)
Net cash provided by continuing operating activities	69,624	65,220
Net cash used for discontinued operating activities	(287)	(95,111)
Net cash provided by (used for) operating activities	69,337	(29,891)
<b>Investing Activities:</b>		
Purchases of property and equipment	(13,683)	(4,435)
Purchases of intangibles		(3,505)
Purchases of marketable securities	(44,150)	(65,609)
Sales of marketable securities	128,294	53,666
Acquisition, net of cash acquired	(53,437)	
Proceeds from the sale of the urology business		458,066
Other, net		5
Net cash provided by continuing investing activities	17,024	438,188
Net cash used for discontinued investing activities		(50)
Net cash provided by investing activities	17,024	438,138
<b>Financing Activities:</b>		
Repurchase of common stock	(367,701)	(88,198)
Proceeds from exercise of stock options and ESPP	4,982	22,194
Excess tax benefits from equity compensation	2,256	

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Dividends paid	<b>(22,780)</b>	(22,842)
Repayments under line of credit agreements	<b>(420)</b>	(14,000)
Net cash used for continuing financing activities	<b>(383,663)</b>	(102,846)
Net cash used for financing activities	<b>(383,663)</b>	(102,846)
Effect of currency exchange rates of continuing operations	<b>738</b>	413
Effect of currency exchange rates of discontinued operations		(120)
(Decrease) increase in cash and cash equivalents	<b>(296,564)</b>	305,694
Cash and cash equivalents at beginning of year	<b>371,525</b>	98,713
Cash and cash equivalents at end of period	<b>\$ 74,961</b>	\$ 404,407

See notes to consolidated financial statements.

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**MENTOR CORPORATION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**December 31, 2007**

**Note A Business Activity**

Mentor Corporation was incorporated in April 1969. Unless the context indicates otherwise, when we refer to Mentor, we, us, our, or the Company in these notes, we are referring to Mentor Corporation and its subsidiaries on a consolidated basis. Presently, the Company develops, manufactures, licenses and markets a range of products serving the aesthetic and general surgery markets, including plastic and reconstructive surgery.

Historically, the Company's products were categorized into three primary segments:

Aesthetic and General Surgery This segment includes surgically implantable breast implants for plastic and reconstructive surgery, capital equipment and consumables used for soft tissue aspiration or body contouring (liposuction), and facial rejuvenation products including various types of products for skin restoration.

Surgical Urology This segment includes surgically implantable prostheses for the treatment of impotence, surgically implantable incontinence products, urinary care products, and brachytherapy seeds for the treatment of prostate cancer.

Clinical and Consumer Healthcare This segment includes catheters and other products for the management of urinary incontinence and retention.

On June 2, 2006, the Company completed a transaction for the sale of the Surgical Urology and the Clinical and Consumer Healthcare segments (together referred to as the Urology Business) to Coloplast A/S (Coloplast). Please see Note P and Note R to the consolidated financial statements for further information.

**Note B Summary of Significant Accounting Policies**

The consolidated financial statements include the accounts of the Company and all of its subsidiaries in which a controlling interest is maintained. All intercompany accounts and transactions have been eliminated.

**Basis of Presentation**

The financial information for the three and nine months ended December 31, 2007 and 2006 is unaudited, but in the opinion of management includes all adjustments (consisting only of normally recurring accruals, unless otherwise indicated) that the Company considers necessary for a fair presentation of the results of operations for this period. Interim results are not necessarily indicative of results for the full fiscal year. The balance sheet at March 31, 2007 has been derived from the audited financial statements as of that date, but does not include all of the information and notes required by accounting principles generally accepted in the United States for complete financial statements.

**Use of Estimates**

Financial statements prepared in accordance with accounting principles generally accepted in the United States require management to make estimates and judgments that affect amounts and disclosures reported in the financial statements. Actual results could differ from those estimates.

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**Revenue Recognition**

The Company recognizes product revenue, net of discounts, returns, rebates, and taxes collected from customers in accordance with Statement of Financial Accounting Standards ( SFAS ) No. 48, Revenue Recognition When the Right of Return Exists, and Staff Accounting Bulletin ( SAB ) No. 104, Revenue Recognition. As required by these standards, revenue is recorded when persuasive evidence of a sales arrangement exists, delivery has occurred, the buyer's price is fixed or determinable, contractual obligations have been satisfied, and collectibility is reasonably assured. These requirements are met, and sales and related cost of sales are recognized upon the shipment of products, or in the case of consignment inventories, upon the notification of usage by the customer. The Company records estimated reductions to revenue for customer programs and other volume-based incentives. Should the actual level of customer participation in these programs differ from those estimated, additional adjustments to revenue may be required. The Company also allows credit for products returned within its policy terms. The Company records an allowance for estimated returns at the time of sale based on historical experience, recent gross sales levels, any notification of pending returns and other relevant information. Should the actual returns differ from those estimated, additional adjustments to revenue and cost of sales may be required.

The Company has current and long term deferred revenue, which include funds received in connection with purchases of the Company's Enhanced Advantage Limited Warranty program for breast implants. The fees received in connection with the Enhanced Advantage Limited Warranty are deferred and recognized evenly over the life of the warranty term.

**Warranty Reserves**

The Company offers limited warranty coverage on some of its products (see Note G for details). While the Company engages in extensive product quality programs and processes, including actively monitoring and evaluating the quality of our component and raw material suppliers, the limited warranty obligation is affected by reported rates of warranty claims and levels of financial assistance specified in the limited warranties. Should actual patient claim rates reported differ from the Company's estimates and/or changes in claim rates result in revised actuarial assumptions, additional adjustments to the estimated limited warranty liability may be required. These adjustments would be included in cost of sales. The Company's limited warranty programs may be modified in the future in response to the competitive market environment. Such changes may impact the amount and timing of the associated revenue and expense for these programs.

**Product Liability Reserves**

The Company has product liability reserves for product-related claims to the extent those claims may result in litigation expenses, settlements or judgments within the Company's self-insured retention limits. The Company has also established additional reserves, through its wholly-owned captive insurance company, for estimated liabilities for product-related claims based on actuarially determined estimated liabilities taking into account its excess insurance coverages. The actuarial valuations are based on historical information and certain assumptions about future events. Product liability costs are recorded in selling, general and administrative expenses as they are directly under the control of its General Counsel and other general and administrative staff and are directly impacted by the Company's overall risk management strategy; or in the case of products related to discontinued operations, including urology products or ophthalmic products, product liability costs are recorded in discontinued operations. Should actual product liability experience differ from the estimates and assumptions used to develop these reserves, subsequent changes in reserves will be recorded in selling, general and administrative expenses, and may affect the Company's operating results in future periods.

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**Employee Stock-Based Payments**

The Company has employee compensation plans under which various types of stock-based instruments have been granted. These instruments principally include stock options, restricted stock and performance units. As of December 31, 2007, these plans have instruments outstanding that might require the issuance of 4.9 million shares of common stock to its employees and directors. Stock-based awards under the Company's employee compensation plans are made with authorized, but unissued, shares reserved for this purpose.

Effective April 1, 2006, the Company adopted the fair value recognition provisions of SFAS No. 123(R), "Share-Based Payment". In addition to recognizing compensation expense related to restricted stock and performance units, SFAS No. 123(R) also requires the Company to recognize compensation expense related to the estimated fair value of stock options and other equity based compensation instruments. The Company adopted SFAS No. 123(R) using the modified-prospective-transition method. Under that transition method, compensation expense recognized subsequent to adoption includes: (a) compensation cost for all share-based payments granted prior to, but not yet vested, as of April 1, 2006, based on the values estimated in accordance with the original provisions of SFAS No. 123, and (b) compensation cost for all share-based payments granted subsequent to April 1, 2006 based on the grant-date fair values estimated in accordance with the provisions of SFAS No. 123(R).

**Effects of Recent Accounting Pronouncements**

In September 2006, the Financial Accounting Standards Board (FASB) issued SFAS No. 157, "Fair Value Measurements". This statement defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles (GAAP), and expands disclosure about fair value measurements. This statement applies under other accounting pronouncements that require or permit fair value measurements. Accordingly, this statement does not require any new fair value measurements. This statement is effective for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. The Company is currently evaluating the requirements of SFAS No. 157 and has not yet determined the impact on the Company's consolidated financial statements.

In July 2006, the FASB issued FASB Interpretation No. 48, "Accounting for Uncertainty in Income Taxes" an interpretation of FASB Statement No. 109 (FIN 48), which became effective for the Company as of April 1, 2007. FIN 48 clarifies the accounting for uncertainty in income taxes by prescribing rules for recognition, measurement and classification in the financial statements of tax positions taken or expected to be taken in a tax return.

For tax benefits to be recognized under FIN 48, a tax position must be more-likely-than-not to be sustained upon examination by taxing authorities. The amount recognized is measured as the largest amount of benefit that is greater than fifty percent likely of being realized upon ultimate settlement. As of April 1, 2007, the gross amount of the Company's liabilities for unrecognized tax benefits (UTBs) was approximately \$4.6 million and accrued interest related to these UTBs totaled approximately \$0.6 million. Virtually all of this balance of \$4.6 million of UTBs (net of the federal benefit on state taxes), if recognized, would affect the Company's annual effective tax rate. The cumulative effect of applying the recognition and measurement provisions upon adoption of FIN 48 was not material.

FIN 48 also provides guidance on the balance sheet classification of liabilities for UTBs as either current or non-current depending on the expected timing of payments. Upon adoption of FIN 48, the Company reclassified approximately \$1.4 million and \$3.8 million of UTBs and related accrued interest from prepaid income taxes payable to current and non-current liabilities, respectively.

As of adoption of FIN 48, the Company believed that it was reasonably possible that our liabilities for UTBs may decrease by \$0.6 million to \$1.6 million within the succeeding twelve months due to potential tax settlements and resolution of tax issues and examinations.

Interest and penalties related to UTBs are classified as a component of our provision for income taxes.

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In February 2007, FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Liabilities* including an amendment of FASB Statement No. 115 ( SFAS 159 ). SFAS 159 permits entities to choose to measure certain financial assets and liabilities at fair value. Unrealized gains and losses, arising subsequent to adoption, are reported in earnings. The Company is required to adopt SFAS 159 for the first fiscal year beginning after November 15, 2007. The Company is currently evaluating if it will elect the fair value option for any of its eligible financial instruments and other items.

In June 2007, FASB ratified Emerging Issues Task Force Issue No. 07-3, *Accounting for Nonrefundable Advance Payments for Goods or Services Received for Use in Future Research and Development Activities* ( EITF No. 07-3 ). EITF No. 07-3 requires that nonrefundable advance payments for goods and services that will be used or rendered in future research and development activities pursuant to executory contractual arrangements should be deferred and recognized as an expense in the period that the related goods are delivered or services are performed. The Company will adopt EITF No. 07-3 in the first quarter of fiscal 2009, and it is not expected to have a material impact on the Company's results of operations or financial position.

In December 2007, FASB ratified Emerging Issues Task Force Issue No. 07-1, *Accounting for Collaborative Arrangements* . EITF No. 07-1 requires a company in a collaborative arrangement to present the results of activities for which it acts as the principal on a gross basis and to report any payments received from (made to) other collaborators based on other applicable generally accepted accounting principles (GAAP) or, in the absence of other applicable GAAP, based on analogy to authoritative literature or a reasonable, rational, and consistently applied accounting policy election. The Company is required to adopt EITF No. 07-1 for annual periods beginning after December 15, 2008. The Company is currently evaluating the requirements of EITF No. 07-1 and has not yet determined the impact on the Company's consolidated financial statements.

**Note C Interim Reporting**

The Company's three quarterly interim reporting periods are each thirteen-week periods ending on the Friday nearest the end of the third calendar month of each calendar quarter. The fiscal year end remains March 31<sup>st</sup>. To facilitate ease of presentation, each interim period is shown as if it ended on the last day of the appropriate calendar month. The actual dates for each of the three interim quarter ends are shown below:

	Fiscal 2008	Fiscal 2007
First Quarter	June 29, 2007	June 30, 2006
Second Quarter	September 28, 2007	September 29, 2006
Third Quarter	December 28, 2007	December 29, 2006

The accompanying unaudited consolidated financial statements for the three and nine months ended December 31, 2007 and 2006 have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and with instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and notes required by accounting principles generally accepted in the United States for complete financial statements.

The consolidated financial statements should be read in conjunction with the Company's Annual Report on Form 10-K for the year ended March 31, 2007.

**Note D Cash Equivalents, Marketable Securities, and Long-Term Marketable Securities and Investments**

All highly liquid investments with maturities of three months or less at the date of purchase are considered to be cash equivalents.

The Company considers its marketable securities available-for-sale as defined in SFAS No. 115, *Accounting for Certain Investments in Debt and Equity Securities*. Available-for-sale securities are reported at fair market value. Realized gains and losses, and declines in value considered to be other than temporary, are included in income. The cost of securities sold is based on the specific identification method. Unrealized gains and losses are excluded from income, and are reported as a net amount in Accumulated Other Comprehensive Income in Shareholders' Equity. The Company's short-term marketable securities consist primarily of state and municipal government and government agency obligations, Federal Home Loan Bank and Mortgage Association bonds, and investment-grade corporate obligations, including commercial paper.





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Cash and available-for-sale investments at December 31, 2007 were as follows:

(in thousands)	Adjusted Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Cash balances	\$ 56,315	\$	\$	\$ 56,315
Money market funds	18,646			18,646
U.S. Government and agency obligations	16,799	6	(1)	16,804
State and Municipal agency obligations	14,596			14,596
Corporate debt securities	285	1		286
Total available-for-sale investments	\$ 106,641	\$ 7	\$ (1)	\$ 106,647
Included in cash and cash equivalents	\$ 74,961	\$	\$	\$ 74,961
Included in current marketable securities	31,680	7	(1)	31,686
Total available-for-sale investments	\$ 106,641	\$ 7	\$ (1)	\$ 106,647

Cash and available-for-sale investments at March 31, 2007 were as follows:

(in thousands)	Adjusted Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Cash balances	\$ 146,552	\$	\$	\$ 146,552
Money market funds	224,973			224,973
U.S. Government and agency obligations	23,923	34	(3)	23,954
State and Municipal agency obligations	92,261	1	(1)	92,261
Total available-for-sale investments	\$ 487,709	\$ 35	\$ (4)	\$ 487,740
Included in cash and cash equivalents	\$ 371,525	\$	\$	\$ 371,525
Included in current marketable securities	116,184	35	(4)	116,215
Total available-for-sale investments	\$ 487,709	\$ 35	\$ (4)	\$ 487,740

Our debt securities include U.S. Government and Agency obligations and Corporate debt with maturities within one year and highly liquid variable rate State and Municipal Agency obligations with maturities greater than ten years.

**Fair Values of Financial Instruments**

The fair value of available-for-sale investments is based on quoted market prices. The fair values of cash equivalents, accounts receivable and accounts payable approximate their carrying value due to the short-term nature of these financial instruments.

**Table of Contents****Note E Inventories**

Inventories are stated at the lower of cost or market, under which cost is determined by the first-in, first-out ( FIFO ) method. In the case of inventory acquired in an acquisition, inventory is valued at fair value. The Company writes down its inventory for estimated obsolescence or unmarketable inventory equal to the difference between the cost of inventory and the estimated market value based upon assumptions about future demand and market conditions.

Inventories at December 31, 2007 and March 31, 2007 consisted of:

(in thousands)	<b>December 31</b>	March 31
Raw materials	<b>\$ 8,075</b>	\$ 5,924
Work in process	<b>7,011</b>	4,961
Finished goods on consignment	<b>16,277</b>	13,402
Finished goods	<b>15,334</b>	13,786
	<b>\$ 46,697</b>	\$ 38,073

**Note F Property and Equipment**

Property and equipment is stated at cost. Depreciation is based on the useful lives of the properties and computed using the straight-line method. Buildings are depreciated over 30 years, furniture and equipment over 3 to 10 years and leasehold improvements over the shorter of their estimated remaining lives or lease terms. Significant improvements and betterments are capitalized, while maintenance and repairs are charged to operations as incurred. Property and equipment at December 31, 2007 and March 31, 2007 consisted of:

(in thousands)	<b>December 31</b>	March 31
Land	<b>\$ 190</b>	\$ 55
Buildings	<b>12,837</b>	10,853
Leasehold improvements	<b>23,904</b>	23,099
Furniture, fixtures and equipment	<b>65,291</b>	59,708
Construction in progress	<b>16,173</b>	4,217
	<b>118,395</b>	97,932
Less accumulated depreciation and amortization	<b>(69,785)</b>	(63,249)
	<b>\$ 48,610</b>	\$ 34,683

**Note G Product Warranties**

The Company offers two types of limited warranties relating to its breast implants in the United States and Canada: a standard limited warranty which is offered at no additional charge and an enhanced limited warranty, generally at an additional charge of \$100 in the U.S. (\$100 CAD in Canada), both of which provide limited financial assistance in the event of a deflation or rupture and free product replacement. The Company's standard limited warranty is also offered in certain European and other international countries for silicone gel-filled breast implants. During the fourth quarter of fiscal 2007, the Company began a limited-time offer of free enrollment in our Enhanced Advantage Limited Warranty for MemoryGel implants implanted after February 15, 2007 in the U.S. The Company provides an accrual for the estimated cost of the standard and/or free limited breast implant warranties at the time revenue is recognized. The cost of the enhanced limited warranty, when sold at an additional charge to the patient, is recognized as costs are incurred. Costs related to warranties are recorded in cost of sales. The accrual for the standard and/or free limited warranty is based on estimates, which are based on relevant factors such as unit sales, historical experience, the limited warranty period, estimated costs, and information developed using actuarial techniques. The accrual is analyzed periodically for adequacy. During the first quarter of fiscal 2008, the Company recorded an adjustment reducing its domestic warranty reserves as a result of this periodic analysis in the amount of \$2.9 million relating to

pre-existing warranties. In addition, the Company recorded an additional adjustment of \$0.3 million in the second quarter of fiscal 2008 relating to pre-existing warranties for our international warranty programs.

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Information on changes in the Company's accrued product warranty reserves is as follows:

(in thousands)	Nine Months Ended December 31,	
	2007	2006
Beginning warranty reserves	\$ 14,307	\$ 13,603
Costs of warranty claims	(2,005)	(2,579)
Accruals for product warranties	3,030	3,605
Adjustments made to accruals related to pre-existing warranties	(3,166)	
Ending warranty reserves	\$ 12,166	\$ 14,629

The total warranty reserve of \$12.2 million as of December 31, 2007 is made up of a current portion of \$2.4 million included in current liabilities and a long-term portion of \$9.8 million included in Long-term accrued liabilities on the Consolidated Balance Sheet.

**Note H Comprehensive Income**

Comprehensive income is net income adjusted for changes in unrealized gains and losses on marketable securities and foreign currency translation.

Comprehensive income for the three and nine month periods ended December 31, 2007 and 2006 was:

(in thousands)	Three Months Ended December 31,		Nine Months Ended December 31,	
	2007	2006	2007	2006
Net income	\$ 11,942	\$ 13,628	\$ 43,598	\$ 264,751
Foreign currency translation adjustment	3,407	2,036	11,314	(6,110)
Unrealized (gains) losses on marketable securities and investment activities, net	(14)	(11)	(28)	89
Comprehensive income	\$ 15,335	\$ 15,653	\$ 54,884	\$ 258,730

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The provision for income taxes for the third quarter of fiscal 2008 and 2007 was computed in accordance with FASB Interpretation No. 18, Accounting for Income Taxes in Interim Periods, and was based on projections of total year pre-tax income in accordance with SFAS No. 109, Accounting for Income Taxes.

The effective income tax rate was 29.3% and 29.8% for the nine months ended December 31, 2007 and 2006, respectively. The effective rate for the nine months ended December 2007 was lower because of the lower rates on the Company's international operations which were partially offset by reductions in tax-exempt interest income and amounts provided for under FASB Interpretation No. 48 *Accounting for Uncertainty in Income Taxes - an interpretation of FASB Statement No. 109* (FIN 48). The Company adopted the provisions of FIN 48 on April 1, 2007. The cumulative effect of applying the recognition and measurement provisions upon the adoption of FIN 48 was not material.

During the nine months ended December 31, 2007, the gross amount of our UTBs increased approximately \$0.4 million as a result of tax positions taken during the current year, and increased approximately \$0.6 million related to tax positions taken in prior years. The majority of these changes impacted the April 1, 2007 balance of our UTBs that, if recognized, would affect our effective tax rate.

As of December 31, 2007, the Company believes that it is reasonably possible that its liabilities for unrecognized tax benefits recorded under FIN 48 may decrease by \$0.7 million to \$1.6 million within the succeeding twelve months due to potential tax settlements and resolution of tax issues and examinations.

The Company is no longer subject to U.S. federal income tax examinations for years ending on or before March 31, 2004 or to California state income tax examinations for years ending on or before March 31, 2003.

As permitted in Accounting Principles Board Opinion (APB) No. 23, Accounting for Income Taxes - Special Areas, the Company does not provide for U.S. income taxes on undistributed earnings of the Company's foreign operations that are intended to be permanently reinvested outside the United States.

**Note J Earnings per Share**

A reconciliation of weighted average shares outstanding, used to calculate basic earnings per share, to weighted average shares outstanding assuming dilution, used to calculate diluted earnings per share, follows:

(in thousands)	Three Months Ended December 31,		Nine Months Ended December 31,	
	2007	2006	2007	2006
Net income from continuing operations: as reported	\$ 12,112	\$ 14,750	\$ 43,885	\$ 41,247
Add back after tax interest expense on convertible notes	802	802	2,406	2,406
Net income from continuing operations for numerator of diluted earnings per share	\$ 12,914	\$ 15,552	\$ 46,291	\$ 43,653

(in thousands)	Three Months Ended December 31,		Nine Months Ended December 31,	
	2007	2006	2007	2006
Net income (loss) from discontinued operations	\$ (170)	\$ (1,122)	\$ (287)	\$ 223,504
Net income: as reported	11,942	13,628	43,598	264,751
Add back after tax interest expense on convertible notes	802	802	2,406	2,406

Net income for numerator of diluted earnings per share	\$	<b>12,744</b>	\$	14,430	\$	<b>46,004</b>	\$	267,157
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(in thousands, except per share data)	Three Months Ended December 31,		Nine Months Ended December 31,	
	2007	2006	2007	2006
Weighted average outstanding shares: basic	<b>33,602</b>	41,916	<b>36,033</b>	41,898
Restricted grants	<b>308</b>	185	<b>295</b>	112
Shares issuable through exercise of stock options	<b>502</b>	869	<b>613</b>	1,065
Shares issuable through convertible notes	<b>5,177</b>	5,153	<b>5,171</b>	5,150
Shares issuable through warrants	<b>259</b>	1,021	<b>387</b>	723
Weighted average outstanding shares: diluted	<b>39,848</b>	49,144	<b>42,499</b>	48,948
Basic earnings (loss) per share				
Continuing operations	\$ <b>0.36</b>	\$ 0.35	\$ <b>1.22</b>	\$ 0.98
Discontinued operations	\$ <b>(0.01)</b>	\$ (0.03)	\$ <b>(0.01)</b>	\$ 5.33
Basic earnings per share	\$ <b>0.36</b>	\$ 0.33	\$ <b>1.21</b>	\$ 6.32
Diluted earnings (loss) per share				
Continuing operations	\$ <b>0.32</b>	\$ 0.32	\$ <b>1.09</b>	\$ 0.89
Discontinued operations	\$ <b>(0.01)</b>	\$ (0.03)	\$ <b>(0.01)</b>	\$ 4.57
Diluted earnings per share	\$ <b>0.32</b>	\$ 0.29	\$ <b>1.08</b>	\$ 5.46

**Employee stock options, restricted shares and performance stock units**

Shares issuable under the Company's Long Term Incentive Plan, including employee stock options, restricted shares and performance stock units, may be included in the diluted earnings per share calculation using the treasury stock method. The Company would exclude the potential stock issuances in the diluted earnings per share calculation when the combined exercise price, average unamortized fair values and assumed tax benefits upon exercise are greater than the average market price for the Company's underlying common stock as the inclusion of these shares in the diluted shares outstanding would be anti-dilutive. The total number of shares excluded based on this policy for the three month period ended December 31, 2007 and December 31, 2006, was approximately 2.9 million and 0.4 million shares, respectively, and 3.1 million and 0.7 million shares for the nine month period ended December 31, 2007 and December 31, 2006, respectively. This calculation is performed on an instrument-by-instrument basis.

**Convertible subordinated notes and warrants**

The terms of the Company's convertible subordinated notes include restrictions which prevent the holder from converting the notes until the Company's share price exceeds the 120% conversion price on 20 trading days of the 30 consecutive trading day period ending on the first day of such fiscal quarter. However, EITF issue No. 04-8 requires that the Company use the if-converted method to determine the dilutive impact of the convertible subordinated notes described in Note M - Long Term Debt. Under the if-converted method, the numerator of the diluted earnings per share calculation is increased by the after-tax interest expense not recognized for the period upon conversion and the denominator of the calculation is increased by approximately 5.2 million shares potentially issued upon conversion for both that current reporting period and the corresponding year-to-date reporting period.

As described in Note M, the Company purchased a convertible note hedge and sold warrants which, in combination, have the effect of reducing the dilutive impact of the convertible subordinated notes by increasing the effective conversion price for the notes from the Company's perspective to \$39.00. SFAS 128, however, requires the Company to analyze the impact of the convertible note hedge and warrants on diluted earnings per share separately. As a result, the purchase of the convertible note hedge is excluded because its impact will always be anti-dilutive. SFAS 128 further requires that the impact of the sale of the warrants be computed using the treasury stock method.





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For example, using the treasury stock method, if the average price of the Company's stock during the period ended December 31, 2007 had been \$38.00, \$50.00 or \$60.00, the shares from the warrants to be included in diluted earnings per share would have been -0-, 1.1 million and 1.8 million shares, respectively. The total maximum number of shares that could potentially be included under the warrants is approximately 5.2 million. The average share price of our stock during the quarter ended December 31, 2007 exceeded the \$39.00 conversion price of the warrants. The impact of these warrants was that approximately 0.3 million shares were added to the diluted shares and diluted earnings per share calculation during the quarter ended December 31, 2007.

**Note K Stock Options, Restricted Stock and Employee Stock Purchase Plan****Employee Stock Purchase Plan**

In September 2005, the Company's Board of Directors approved an Employee Stock Purchase Plan ( ESPP ). The ESPP is intended to assist the Company in securing and retaining its U.S.-based employees by allowing them to participate in the ownership and growth of the Company through the grant of certain rights to purchase shares of the Company's common stock at an initial discount of 5% from the fair market value of its shares. The granting of such rights serves as partial consideration for employment and gives employees an additional inducement to remain in the service of the Company and its subsidiaries and provides them with an increased incentive to work toward the Company's success. Under the ESPP, each eligible employee is permitted to purchase shares of common stock through regular payroll deductions and/or cash payments in amounts ranging from 1% to 15% of the employee's compensation for each payroll period. The fair market value of the shares of common stock which may be purchased by any employee under this or any other plan of the Company is intended to comply with Section 423 of the Internal Revenue Code.

The ESPP provides for a series of consecutive offering periods that are three months long commencing on each Grant Date. Offering periods commence on January 1, April 1, July 1 and October 1 of each year. During each offering period, participating employees are able to purchase shares of common stock at a purchase price equal to 95% of the fair market value of the common stock at the end of each offering period. Under terms of the ESPP, 400,000 shares of common stock have been reserved for issuance to employees. As of December 31, 2007, approximately 4,000 shares have been sold under the plan.

**The Company's Long-Term Incentive Plans**

The Company has two plans under which equity awards have been issued, the 1991 Plan and the Amended 2000 Long-Term Incentive Plan. The latter was amended and restated by shareholder approval in September 2005 and is now referred to as the Mentor Corporation 2005 Long-Term Incentive Plan, and was further amended in November 2005, September 2006 and September 2007 (as amended, the 2005 Plan ). These amendments resulted in an increase in the number of shares of the Company's common stock available for award grants under the plan by 1.6 million shares with the new aggregate share limit for the 2005 Plan at 7.6 million shares.

The 2005 Plan reflects, among other things, amendments to the earlier plans to (i) provide the Company with flexibility to grant awards other than stock options, including but not limited to restricted stock, stock bonuses, stock units and dividend equivalents; (ii) allow the Company to grant awards intended to qualify as performance-based compensation within the meaning of Section 162(m) of the U.S. Internal Revenue Code; and (iii) extend the term of the plan to July 24, 2015.

Persons eligible to receive awards under the 2005 Plan include directors, officers or employees of the Company, and certain of its consultants and advisors. The types of awards that may be granted under the 2005 Plan include stock options, restricted stock, stock bonuses, stock units and dividend equivalents, and other forms of awards granted or denominated in the Company's common stock or units of the Company's common stock, as well as certain cash bonus awards.

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On August 9, 2007, the Board of Directors (the Board) of Mentor Corporation approved the 2007 Strategic Equity Incentive Plan (the Sub-Plan) under the 2005 Plan. The Board's objective in establishing the Sub-Plan was to create a long-term incentive plan for the Company's top 40 executives and senior managers, including the Company's executive officers, designed to reward the participants for achieving superior financial results for the Company over a period of approximately four fiscal years.

The Sub-Plan provides for the grants of nonqualified stock options to key employees of the Company. The exercise price for the shares subject to the options was set at a premium to the closing trading price of the Company's common stock as reported by the New York Stock Exchange on the date of grant. The shares subject to the options will vest subject to the attainment of specified earnings per share (EPS) targets over the second half of fiscal 2008 and the full fiscal years 2009, 2010 and 2011. The vesting percentages are disproportionately skewed to the achievement of the EPS targets in fiscal years 2010 and 2011, and the EPS targets represent compounded growth rates that are in excess of recent EPS growth rates for the Company.

**Restricted Stock**

In October 2005, the Compensation Committee of the Board of Directors of the Company granted awards in the aggregate amount of 288,856 restricted shares of Company common stock (the Restricted Stock) to the Company's executive and other officers, and to members of the Board of Directors. Similarly, 209,960 restricted shares were granted during the fiscal year ended March 31, 2007. During the three and nine months ended December 31, 2007, 37,500 and 47,500 restricted shares were granted, respectively. The Restricted Stock vests, and restrictions lapse, with respect to one-fifth of the total number of shares of Restricted Stock on each of the first, second, third, fourth and fifth anniversaries of the award date. The vesting schedule requires continued employment or service through each applicable vesting date as a condition to the vesting of the applicable installment of the Restricted Stock, and carries specific share holding requirements during such employment or service. Stock compensation expense is recognized over the five-year vesting period of the Restricted Stock grants.

The fair values of shares of restricted stock and performance units are determined based on the closing price of the Company's common stock on the grant dates. Information regarding our restricted stock during the nine months ended December 31, 2007 is as follows:

Nonvested shares (in thousands, except per share amounts)	Shares	Weighted-average grant date fair value
Nonvested at March 31, 2007	346	\$ 47.71
Granted	48	40.73
Restrictions lapsed	(71)	48.05
Forfeited	(29)	41.64
<b>Nonvested at December 31, 2007</b>	<b>294</b>	<b>\$ 46.24</b>

**Options**

The Company has granted options to purchase shares of the Company's common stock to key employees and non-employee directors under its 2005 Plan and 1991 Plan. With the exception of options issued under the Sub-Plan described above, options granted under both plans are generally exercisable in four equal annual installments beginning one year from the date of grant, and expire ten years from the date of grant. Options are granted with an exercise price equal to the fair market value on the date of grant.

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Options issued under the Sub-Plan are exercisable, subject to the attainment of EPS targets, which are disproportionately skewed to the achievement of the EPS targets in fiscal 2010 and 2011 over a forty-two month period and expire seven years from the date of grant. They were issued with an exercise price at a premium to the fair market value on the date of grant.

Activity in the stock option plans during the nine months ended December 31, 2007 was as follows:

(in thousands, except per share amounts and years)	<b>Options</b>	<b>Weighted- average exercise price</b>	<b>Weighted- average remaining contractual life (Yrs)</b>	<b>Aggregate intrinsic value</b>
Balance outstanding at March 31, 2007	2,261	\$ 28.13		
Granted	2,719	48.26		
Exercised	(316)	19.56		
Forfeited/expired	(77)	37.75		
<b>Balance outstanding at December 31, 2007</b>	<b>4,587</b>	<b>\$ 40.51</b>	<b>6.87</b>	<b>\$ 21,157</b>
Exercisable at December 31, 2007	1,264	\$ 23.96	5.30	\$ 19,564

At December 31, 2007, the 2005 Plan had options for 4.3 million shares granted and outstanding, and 0.3 million shares available for grant. The 1991 Plan had options for 0.3 million shares granted and outstanding at December 31, 2007. No additional options can be granted under the 1991 Plan.

The weighted-average fair value of stock options granted was \$12.18 and \$12.64 per share for the nine months ended December 31, 2007 and 2006, respectively. There were 2.7 million and 0.2 million stock options granted during the nine months ended December 31, 2007 and 2006, respectively. These values were estimated at the date of grant using the Black-Scholes option valuation model and the following assumptions:

	December 31, 2007	December 31, 2006
Risk-free interest rate	4.3%	4.6%
Expected life (in years)	5.0	5.1
Expected volatility	33.9%	30.0%
Expected dividend yield	1.9%	1.4%

**Performance Award Program**

In June and July 2006, certain management-level employees received grants of Performance Stock Units ( PSUs ). A PSU gives the recipient the right to receive common stock that is contingent upon achievement of specified pre-established performance goals over a performance period ending March 31, 2009. The performance goals are based upon the Company's total shareholder return compared to the average total shareholder return reported by the Russell 2500 Growth Index over the performance period.

PSUs are assigned a unit value based on the fair market value of the Company's common stock on the grant date. The ultimate level of attainment of performance goals is determined at the end of the performance period and expressed as a percentage (within a range of 0% to 200%). This percentage is multiplied by the number of PSUs initially granted to determine the number of shares of common stock payable to the recipient. In addition, dividends that would have accrued over the performance period attributable to the final share grant under the program will be payable to the recipients.



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Vesting of the PSUs occurs entirely on March 31, 2009. Consequently, no PSUs have yet vested, no common stock has been issued and no dividends have been accrued or paid to any recipient as of December 31, 2007. The fair value of the PSUs at the date of grant is being amortized as compensation expense over the performance period. The Fair Value of the PSUs at the date of grant was determined using a Monte Carlo Simulation Model.

Information regarding our Performance Stock Units during the nine months ended December 31, 2007 is as follows, assuming the maximum distribution under the plan:

	Shares	Fair market value at date of grant
Nonvested performance stock units (in thousands)		
Nonvested at March 31, 2007	307	\$ 6,520
Forfeited	(5)	(109)
<b>Nonvested at December 31, 2007</b>	<b>302</b>	<b>\$ 6,411</b>

The following table reflects the components of stock-based compensation expense recognized in the Company's Consolidated Statements of Income for the three and nine months ended December 31, 2007 and 2006, respectively:

(in thousands)	Three Months Ended December 31		Nine months Ended December 31,	
	2007	2006	2007	2006
Stock options	\$ 2,516	\$ 1,297	\$ 4,252	\$ 4,068
Restricted stock	275	1,069	3,279	2,787
Performance units	459	655	1,597	1,348
Total stock-based compensation expense, pre-tax	3,250	3,021	9,128	8,203
Tax benefit from stock-based compensation expense	958	900	2,937	2,289
Total stock-based compensation expense, net of tax	\$ 2,292	\$ 2,121	\$ 6,191	\$ 5,914

The employee stock-based compensation cost reflected above that would be properly capitalized as part of inventory and included in research and development expense for the three and nine months ended December 31, 2007 was minor.

As of December 31, 2007, there was \$40.0 million of total unrecognized compensation cost related to non-vested awards of stock options, shares of restricted stock and performance stock units. That cost is expected to be recognized over a weighted-average period of 3.1 years. The Company will recognize the total compensation cost on a straight-line basis over the service period of each vesting tranche, assuming EPS targets are met, for the options issued under the Sub-Plan.

**Note L Share Repurchase Program**

The Company has a stock repurchase program, primarily to reduce the overall number of shares outstanding and to offset the dilutive effects of our employee equity compensation programs and dilution related to our convertible notes from the inclusion of contingently convertible debt in fully diluted earnings per share calculations in accordance with EITF Issue No. 04-8, The Effect of Contingently Convertible Instruments on Diluted Earnings Per Share.

On June 16, 2006, the Company entered into a stock purchase plan with Citigroup Global Markets Inc. for the purpose of repurchasing up to 5.0 million shares of the Company's common stock, up to a cumulative purchase price of \$166 million, under a Rule 10b5-1 Plan (the "10b5 Plan") compliant with Rule 10b-18. In connection with the entry into the 10b5 Plan, the Company's Board of Directors increased the authorized number of shares available for repurchase pursuant to the stock repurchase program from 3.3 million to 5.0 million shares. The Company repurchased

4.1 million shares of its common stock for a total purchase price of \$166 million under the 10b5 Plan, and this 10b5 Plan terminated on June 15, 2007.

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On June 18, 2007, the Company entered into a second stock purchase plan (the 2007 10b5 Plan ) with Citigroup Global Markets Inc. for the purpose of repurchasing its common stock, up to a cumulative purchase price of \$200 million, under another Rule 10b5 Plan compliant with Rule 10b-18. In connection with the entry into the 2007 10b5 Plan, the Company's Board of Directors increased the authorized number of shares available for repurchase pursuant to our stock repurchase program by 5.0 million shares. The Company repurchased 4.8 million shares of its common stock under the 2007 10b5 Plan for a total purchase price of \$200 million. Although 0.8 million shares remained authorized as of December 31, 2007, authorized funding for the 2007 10b5 Plan has been exhausted. The 2007 10b5 Plan terminates on June 17, 2008.

During the three months ended December 31, 2007, the Company repurchased 0.3 million shares of its common stock for a total purchase price of \$9.9 million. These purchases were not made under the 2007 10b5 Plan. For the nine months ended December 31, 2007, the Company repurchased 9.0 million shares of its common stock for a total purchase price of \$367.7 million, of which 8.7 million shares were purchased for \$357.8 million under the 10b5 plans. In addition to the shares repurchased mentioned above, the Company acquired an additional 8,042 and 13,628 shares for the payment of withholding taxes related to the lapsing of restrictions on certain outstanding restricted stock grants during the three and nine month period ending December 31, 2007, respectively.

As of December 31, 2007, approximately 0.8 million shares remained authorized by the Company's Board of Directors for future repurchase under the Company's stock repurchase program. All shares previously repurchased under the program have been retired and are no longer deemed to be outstanding. The timing of repurchases is subject to market conditions, cash availability and to the terms of any 10b5 Plan in place at that time. There is no guarantee that the remaining shares authorized for repurchase by the Board will ultimately be repurchased. The additional shares available for repurchase are subject to limitations set forth in the Company's Credit Agreement previously entered into on May 26, 2005, amended on May 31, 2006 and further amended on March 30, 2007.

The amended Credit Agreement now permits the repurchase of up to \$400 million of equity securities, a portion of which was utilized in the repurchases described above, leaving a remaining amount of \$31.5 million as of December 31, 2007. In addition, after the \$400 million is utilized for such repurchases, the Company may repurchase during any four consecutive quarters additional equity securities in an amount limited to the Company's consolidated net income, less dividends paid, for the preceding four quarters. See Note N Short Term Bank Borrowings for additional information on the Credit Agreement.

**Note M Long-Term Debt**

On December 22, 2003, the Company completed an offering of \$150 million of convertible subordinated notes due January 1, 2024 pursuant to Rule 144A under the Securities Act of 1933. The notes bear interest at 2<sup>3</sup>/<sub>4</sub>% per annum and are convertible into shares of the Company's common stock at an adjusted conversion price of \$29.289 per share and are subordinated to all existing and future senior debt.

Holders of the notes may convert their notes only if any of the following conditions is satisfied:

during any fiscal quarter prior to January 1, 2019, if the closing price of the Company's common stock for at least 20 trading days in the 30 consecutive trading day period ending on the first trading day of such fiscal quarter is more than 120% of the conversion price per share of the Company's common stock on such trading day;



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any business day on or after January 1, 2019, if the closing price of the Company's common stock on the immediately preceding trading day is more than 120% of the conversion price per share of the Company's common stock on such trading day;

during the five business day period after any five consecutive trading day period if the average of the trading prices of the notes for such five consecutive trading day period is less than 98% of the average of the conversion values of the notes during such period, subject to certain limitations;

if the Company has called the notes for redemption; or

if the Company makes certain significant distributions to holders of its common stock or the Company enters into specified corporate transactions.

At an initial conversion price of \$29.289, each \$1,000 principal amount of notes was convertible into 34.1425 shares of common stock. As a result of the Company's decision to increase its per share dividend to an amount greater than \$0.15 per share per quarter, the conversion price has been adjusted to \$28.9736, and each \$1,000 principal amount was convertible into 34.51 shares of common stock as of December 31, 2007.

During the quarter, the market price condition was satisfied, giving holders of the notes the option to convert the notes into common shares at the aforementioned adjusted conversion price per share. Concurrent with the issuance of the convertible subordinated notes, the Company purchased a convertible note hedge from Credit Suisse First Boston LLC. The note hedge expires on January 1, 2009 and gives the Company the ability to purchase shares of its common stock equal to the number of shares we are obligated to issue under any convertible notes converted by the holder prior to the hedge expiration date at a purchase price equal to the conversion price of the convertible notes.

Concurrent with the issuance of the notes, the Company also issued warrants to Credit Suisse First Boston LLC. The warrants are European-style call warrants, which also expire on January 1, 2009. The holder of the warrants is entitled to purchase 5.2 million shares of the Company's common stock at \$39.0030. The number of shares and exercise price of the warrants are subject to adjustment from time to time in a similar manner to the convertible notes.

Both the note hedge and the warrants may be settled either in cash or shares at the Company's option. The Company is not obligated under either the warrants or the note hedge, to settle its obligations in cash. The warrants do require the Company to settle its obligations thereunder in cash or shares, do permit the Company to settle its obligation in unregistered shares and contain no provision obligating the Company to settle its obligations in freely-tradable shares, and the Company is not required to make any cash payments under the warrants for failure to have a registration statement declared effective. There are no required cash payments to the holder of the warrants if the shares initially delivered upon settlement are subsequently sold by the holder and the sales proceeds are insufficient to provide the holder with an expected return. The Company has sufficient authorized shares to settle the warrants and the convertible notes in shares, considering all of its obligations under the instruments for their full terms. The warrants, note hedge, and convertible notes each contain an express limit on the number of shares issuable thereunder. The warrants and note hedge expressly indicate that the holder of the warrants has no rank higher than those of a shareholder of the stock underlying the warrants. Under certain circumstances in a change of control of the Company it may be required to issue additional shares under a make-whole provision under the warrant. The Company has no obligation to post collateral under the warrants, convertible notes or note hedge.

The cost of the note hedge and the proceeds from the sale of warrants have been included in shareholders' equity in accordance with the guidance in EITF No. 00-19, Accounting for Derivative Financial Instruments Indexed to and Potentially Settled in a Company's Own Stock. Any proceeds received or payments made upon termination of these instruments will be recorded in shareholders' equity.

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On July 2, 2007, the Company acquired all of the outstanding shares of Perouse Plastique, SAS, including the assumption of approximately 3.0 million in net debt. The debt consists primarily of installment loans with an average term of 6 years and a weighted average interest rate of 3.0%. Approximately 0.4 million was repaid in the nine months ended December 31, 2007, leaving 2.6 million or approximately \$3.8 million, of which \$2.7 million is considered long term. The loans may be repaid at any time, subject to certain notice requirements of the lenders. See Note S for discussion of this acquisition.

**Note N Short Term Bank Borrowings****Credit Agreement**

On May 26, 2005, the Company entered into a Credit Agreement (the Credit Agreement) that provides a \$200 million senior revolving credit facility, subject to a \$20 million sublimit for the issuance of standby and commercial letters of credit, a \$10 million sublimit for swing line loans and a \$50 million alternative currency sublimit. The Credit Agreement expires on September 30, 2008. At the election of the Company, and subject to lender approval, the amount available for borrowings under the Credit Agreement may be increased by an additional \$50 million. Funds under the Credit Agreement are available to the Company to finance permitted acquisitions, for stock repurchases up to certain dollar limitations, and for other general corporate purposes.

During the quarter ended June 28, 2006, the Company entered into an amendment to the Credit Agreement (First Amendment) to permit the Company to consummate the sale of its surgical urology and clinical and consumer health care segments. Additionally, the First Amendment releases urology subsidiaries as guarantors, releases the pledges of the capital stock of urology subsidiaries, modified the minimum EBITDA, modifies certain covenants restricting the Company to enter into certain investments, incur indebtedness and increased the amount of its equity securities the Company is allowed to repurchase.

On March 30, 2007, the Company amended the Credit Agreement a second time. The amendment permits the Company to declare or pay annual dividends up to \$0.90 per share and repurchase up to an aggregate of \$400 million worth of its common stock after March 30, 2007. The Company has one standby letter of credit totaling \$0.8 million outstanding which is secured by the Credit Agreement. Accordingly, although there were no borrowings outstanding under the Credit Agreement at December 31, 2007, only \$199 million was available for borrowings.

Interest on borrowings (other than swing line loans) under the Credit Agreement is at a variable rate that is calculated, at the Company's option, at either prime rate or LIBOR, plus an additional percentage that varies depending on the Company's senior leverage ratio (as defined in the Credit Agreement) at the time of the borrowing. Swing line loans bear interest at the prime rate plus additional basis points, depending on the Company's senior leverage ratio at the time of the loan. In addition, the Company paid certain fees to the lenders to initiate the Credit Agreement and pays an unused commitment fee based on the Company's senior leverage ratio and unborrowed lender commitments.

Borrowings under the Credit Agreement are guaranteed by certain of the Company's domestic subsidiaries and are also secured by a pledge of 100% of the outstanding capital stock of certain other domestic subsidiaries. In addition, if the ratio of total funded debt to adjusted EBITDA exceeds 2.50 to 1.00, the Company is obligated to grant to the lenders a first priority perfected security interest in essentially all of its domestic assets.

The Credit Agreement imposes certain financial and operational restrictions on the Company and its subsidiaries, including financial covenants that require the Company to maintain a maximum consolidated funded debt leverage ratio of not greater than 4.00 to 1.00, a senior funded debt ratio of not greater than 2.50 to 1.00, minimum quarterly EBITDA, and a minimum fixed charge ratio of greater than 1.25 to 1.00. The covenants also restrict the Company's ability, among other things, to make certain investments, incur certain types of indebtedness or liens, make acquisitions in excess of \$20 million except in compliance with certain criteria, and repurchase shares of common stock, pay dividends or dispose of assets above specified thresholds. The Credit Agreement also contains customary events of default, including payment defaults, material inaccuracies in its representations and warranties, covenant defaults, bankruptcy and involuntary proceedings, monetary judgment defaults in excess of specified amounts, cross-defaults to certain other agreements, change of control, and ERISA defaults. If an event of default occurs and is continuing, the commitments under the Credit Agreement may be terminated and the principal amount and all accrued but unpaid interest and other amounts owed thereunder may be declared immediately due and payable. As of December 31, 2007, all covenants and restrictions had been satisfied, and there were no borrowings outstanding under

the Credit Agreement.

**Table of Contents****Other Financing**

On October 4, 2005, Mentor Medical Systems B.V., ( Mentor BV ), a wholly-owned subsidiary of Mentor Corporation, entered into a Loan and Overdraft Facility (the Facility ) with Cooperative RaboBank Leiden, Leiderdorp en Oestgstgeest U.A. ( RaboBank ).

The Facility provides Mentor BV with an initial 15 million loan and overdraft facility, which began decreasing by 375,000 quarterly in September 2006. Under the Facility, Mentor BV may borrow up to 12.5 million in fixed amount advances, with terms of three to six months, and a further sublimit of up to 5 million of loans in fixed amount advances with a term of up to 5 years. Up to 10 million of the Facility may be drawn in the form of U.S. Dollars. Funds under the Facility are available to Mentor BV to finance certain dividend payments to Mentor Corporation and for other normal business purposes. As of December 31, 2007, there was no outstanding balance under this credit facility, and accordingly, \$18.6 million was available for borrowing.

Interest on borrowings under the Facility is at a rate equal to 0.55% over the RaboBank base lending rate, Euribor, or LIBOR depending upon the currency and term of each borrowing. Interest rates on borrowings other than overdrafts are fixed for the term of the advance. Borrowings by Mentor BV under the Facility are guaranteed by Mentor s wholly-owned subsidiary, Mentor Medical Systems CV through a Joint and Several Debtorship agreement. In addition, borrowings under the Facility are secured by certain real estate owned by Mentor BV.

The Facility imposes certain financial and operational restrictions on Mentor BV, including financial covenants that require Mentor BV and Mentor Medical Systems CV to maintain a minimum combined defined solvency ratio, a maximum combined debt leverage ratio of not greater than 4 to 1, a senior funded debt ratio of not greater than 2.5 to 1, minimum quarterly operational results, and a minimum interest coverage ratio of greater than 5 to 1. The Facility also contains customary events of default, including cross default and material or adverse change provisions. If an event of default occurs, the commitments under the Facility may be terminated and the principal amount and all accrued but unpaid interest and other amounts owed thereunder may be declared immediately due and payable. As of December 31, 2007, all covenants and restrictions were satisfied.

Mentor BV paid 15,000 in certain fees to the RaboBank upon entry into the Facility, and Mentor BV is obligated to pay, over the 10-year term of the Facility, a commitment fee of 0.25% of the committed and unborrowed balances. Fees are payable quarterly in arrears.

At December 31, 2007, there was approximately \$1.1 million in short term borrowings outstanding. A total of \$217.9 million was available under all lines of credit at December 31, 2007, and approximately \$216.5 million was available under all lines of credit at March 31, 2007.

**Note O Related Party Transactions**

On June 5, 2006, the Company repurchased 2.0 million shares of its common stock from an investment partnership managed by ValueAct Capital at \$42.00 per share, a discount to the \$42.21 closing market price on the NYSE on that date. ValueAct Capital s managing director, Mr. Jeff Ubben, was a member of the Company s Board of Directors at the time of this share repurchase. Mr. Ubben is no longer on the Company s Board of Directors. The 2.0 million shares were repurchased for a total of \$84 million pursuant to the Company s continuing stock repurchase program. The repurchase of these shares was pre-approved by the Audit Committee and the Board of Directors with interested parties abstaining or not in attendance.

**Table of Contents****Note P Discontinued Operations**

In October 2005, the Company announced that it was evaluating strategic alternatives for its urology business that would both enhance shareholder value and enable the Company to focus more fully on its aesthetics business. On May 17, 2006, the Company executed a definitive agreement for the sale of the Company's surgical urology and clinical and consumer healthcare business segments to Coloplast for \$463 million, of which \$456 million was in cash and \$7 million in non-cash consideration consisting of an indemnification by Coloplast to Mentor related to certain foreign tax credits that the Company expects to realize. The sale was completed on June 2, 2006. In accordance with SFAS No. 144 Accounting for the Impairment or Disposal of Long Lived Assets, the assets and liabilities related to this transaction were segregated from continuing operations and were reported as assets and liabilities of discontinued operations in the consolidated balance sheets. In addition, operations associated with these segments and other former businesses have been classified as income from discontinued operations in the accompanying consolidated statements of income, and cash flows associated with these segments are included in cash flows from discontinued operations in the consolidated statements of cash flows. Net cash used in discontinued operations for the nine months ended December 31, 2007 and 2006, was \$0.3 million and \$95.3 million, respectively.

Net sales from discontinued operations were \$38.4 million for the two month period ending June 2, 2006, which represents the period prior to the sale. For the three and nine months ending December 31, 2007, income (loss) before income taxes from discontinued operations was (\$0.3) million and (\$0.4) million, respectively. In comparison, for the three and nine months ending December 31, 2006, (loss) income before income taxes from discontinued operations was (\$1.7) million and \$364.6 million, respectively (including a pre-tax gain of \$360.5 million on the sale of our Urology Business).

**Note Q Postretirement Benefit Plan**

The Company's Savings and Investment Plan is a qualified salary-reduction plan under Section 401(k) of the Internal Revenue Code in which substantially all of our U.S. employees may participate by contributing a portion of their compensation. The Company matches contributions up to a specified percentage of each employee's compensation. Charges against income for the matching contributions were \$1.0 million and \$0.8 million for the nine month periods ending December 31, 2007 and 2006, respectively.

**Note R Contingencies**

Limited warranty and product liability claims are a regular and ongoing aspect of the medical device and biologics industries. At any one time, the Company may be subject to claims against it and may be involved in litigation. These actions can be brought by an individual or by a group of patients purporting to be a class action. The Company is currently involved in a number of product liability legal actions, the outcomes of which are not within its control and may not be known for prolonged periods of time. No individual product liability case or group of cases, in which the Company is currently involved, is considered material and there are no certified class actions currently pending against the Company. In accordance with SFAS No. 5 Accounting for Contingencies, a liability is recorded in the consolidated financial statements when a loss is known or considered probable and the amount can be reasonably estimated. If the reasonable estimate of a known or probable loss is a range, and no amount within the range is a better estimate, the minimum amount of the range is accrued. If a loss is not probable or cannot be reasonably estimated, no liability is recorded in the consolidated financial statements.

The Company carries product liability insurance on all its products. This insurance is subject to certain self-insured retention and other limits of the policy, exclusions and deductibles that the Company believes to be appropriate. The Company had established reserves of \$2.9 million and \$2.7 million at December 31, 2007 and March 31, 2007, respectively, for product-related claims to the extent that those claims may result in settlements or judgments within its self-insured retention limits. In addition, the Company had established additional reserves of \$4.4 million and \$3.8 million at December 31, 2007 and March 31, 2007, respectively, through its wholly-owned captive insurance company based on actuarially determined estimates and taking the Company's excess insurance coverage into account. Those reserves were actuarially determined based on historical information, trends and certain assumptions about future claims and are primarily for claims that have been asserted. Should actual product liability experience differ from the estimates and assumptions used to develop these reserves, subsequent changes in these reserves will be recorded in selling, general and administrative expenses and may affect the Company's operating results in future

periods.

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In addition, the Company also offers limited warranty coverage on some of its products (see Note G for details). While the Company engages in extensive product quality programs and processes, including actively monitoring and evaluating the quality of its component and raw material suppliers, the limited warranty obligation is affected by reported rates of product problems as well as the costs incurred in correcting product problems. Should actual warranty experience differ from the estimates and assumptions used to develop the warranty reserves, subsequent changes in the reserves will be recorded in cost of sales and may affect our operating results in future periods. In addition, in the ordinary course of its business, the Company experiences various types of claims that sometimes result in litigation or other legal proceedings. The Company does not anticipate that any of these current proceedings will have a material adverse effect on the Company.

The Company has also agreed to indemnify Coloplast against specified losses in connection with the June 2006 sale of the Company's Urology Business. Generally, the Company has retained responsibility for various legal, including product, liabilities prior to closing. The Company also made representations and warranties to Coloplast about the condition of the Urology Business, including matters relating to intellectual property, regulatory compliance and environmental laws.

**Note S Business Combinations**

*Perouse Acquisition*

On July 2, 2007 the Company purchased all of the outstanding shares of Perouse Plastic SAS (Perouse). Perouse is an international breast implant manufacturer based in France that currently supplies a complete range of products for the European and Latin America markets. The Company paid \$53.4 million in cash (net of cash acquired). In addition, the Company incurred approximately \$0.5 million in acquisition costs, bringing the total purchase price to \$53.9 million. The acquisition was accounted for using the purchase method of accounting and, accordingly, the purchase price was allocated to the tangible and intangible net assets acquired on the basis of their respective values on the acquisition date. The fair value of intangible assets acquired was determined based upon an external valuation and for tangible assets the Company used a combination of methods including replacement cost. The results of Perouse operations are included in our consolidated results since acquisition date. Pro forma results of operations for the three and nine months ended December 31, 2007 and 2006, as though the acquisition had taken place at the beginning of each of the periods presented, would not differ significantly from the actual results for those periods.

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The following table summarizes the Company's current estimates of the fair values of the assets acquired and liabilities assumed at July 2, 2007. This allocation is preliminary and subject to adjustments as the Company completes its review and evaluation of the acquired assets and assumed liabilities, including obtaining evidence supporting assumed fair values of land and property.

(In thousands)

Cash	\$ 436
Accounts receivable	3,508
Inventory	8,953
Prepaid expenses and other current assets	798
Total current assets	13,695
Property, plant and equipment	4,544
Intangible assets	18,423
Goodwill	31,064
Other assets	39
Total assets acquired	\$ 67,765
Liabilities associated with acquisition:	
Accounts payable and accrued liabilities	\$ 7,416
Other long-term liabilities	6,476
Total liabilities assumed	\$ 13,892
Net assets acquired	\$ 53,873

Of the \$18.4 million of acquired intangible assets, \$8.7 million was assigned to developed technology with a useful life of seven years, \$5.4 million was assigned to customer relationships with a four year life for distributors and an eight year life for physicians and hospitals, \$0.3 million was assigned to covenant not to compete with a useful life of three years, and \$4.0 million was assigned to trade names which have an indefinite life and is therefore not subject to amortization.

Of the \$6.5 million in other long-term liabilities, \$3.6 million is the long-term portion of deferred taxes related to the intangibles acquired. The remaining \$2.9 million is the long-term portion of outstanding bank loans assumed.

## **Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations**

### *Cautionary Statement:*

*The following discussion and analysis should be read in conjunction with our Unaudited Consolidated Financial Statements and related Notes thereto contained elsewhere in this Report. The information contained in this Quarterly Report on Form 10-Q is not a complete description of our business or the risks associated with an investment in our securities. We urge you to carefully review and consider the various disclosures made by us in this Report and in our other reports filed with the Securities and Exchange Commission ( SEC ), including our Annual Report on Form 10-K for the year ended March 31, 2007, and subsequent reports on Form 8-K, both of which discuss our business in greater detail.*

*The section entitled Risk Factors set forth in Item 1A under Part II Other Information, and similar discussions in our other SEC filings, discuss some of the important risk factors that may affect our business, results of operations and financial condition. These risks, in addition to the other information in this Report and in our other filings with*



*the SEC, should be carefully considered before deciding to purchase, hold or sell our securities.*

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*Various statements in this Report, in future filings by us with the SEC, in our press releases and in our oral statements made by or with the approval of authorized personnel, constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Forward-looking statements are based on current expectations and are indicated by words or phrases such as anticipate, estimate, expect, intend, project, plan, believe, will, seek, and similar words or phrases and involve known and unknown risks, uncertainties and other factors which may cause actual results, performance or achievements to be materially different from any future results, performance or achievements expressed or implied by such forward-looking statements. Some of the factors that could affect our financial performance or cause actual results to differ from our estimates in, or underlying, such forward-looking statements are set forth in Part II under Item 1A -Risk Factors or elsewhere in this Report.*

*Forward-looking statements include statements regarding, among other things:*

*our anticipated operating results for fiscal year 2008;*

*our expectations regarding future developments in the markets in which we compete and intend to compete;*

*our anticipated growth strategies;*

*our intention to introduce or seek approval for new products;*

*our ability to continue to meet United States Food and Drug Administration ( FDA ) and other regulatory requirements;*

*our anticipated outcomes of regulatory reviews;*

*our anticipated outcomes of litigation; and*

*our ability to replace sources of supply without disruption and regulatory delay.*

*These forward-looking statements are based on our expectations and are subject to a number of risks and uncertainties, many of which are beyond our control. Actual results could differ materially from these forward-looking statements as a result of the facts described in Part II under Item 1A - Risk Factors or elsewhere including, among others, problems with suppliers, changes in the competitive marketplace, significant product liability or other claims, product recalls, difficulties with new product development, the introduction of new products by our competitors, changes in the economy, FDA or other regulatory delay in approval or rejection of new or existing products, changes in Medicare, Medicaid or third-party reimbursement policies, changes in government regulations, use of hazardous or environmentally sensitive materials, inability to implement new information technology systems, inability to integrate new acquisitions, and other events. We undertake no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise. In light of these risks and uncertainties, we cannot assure you that the forward-looking information contained in this Form 10-Q will, in fact, transpire.*

### **Company Overview**

We develop, manufacture, license and market a range of products serving the aesthetic medical market, including plastic and reconstructive surgery. Our products include breast implants for plastic and reconstructive surgery, capital equipment and consumables used for soft tissue aspiration for body contouring (liposuction), and facial rejuvenation products including various types of products for skin restoration. Historically, we operated in three reportable segments: aesthetic and general surgery, surgical urology, and clinical and consumer healthcare. In June 2006, we sold the surgical urology and clinical and consumer healthcare businesses (collectively, the Urology Business. ) We are headquartered in Santa Barbara, California, with manufacturing and research operations primarily in the United States, The Netherlands and France and employ approximately 1,175 people around the world as of December 31 2007. We also purchase finished products and certain raw material components from third party manufacturers and suppliers. Our cost of goods sold represents raw materials, labor and overhead, the cost of third

party finished products, amortization of certain intangibles, freight expense and the cost associated with our product warranty programs. Gross margins may fluctuate from period to period due to a variety of factors, including changes in the selling prices of our products, the mix of products sold, changes in the cost of third party finished products, raw materials, labor and overhead, fluctuations in foreign currency exchange rates, changes in warranty costs and warranty reserves, the purchase accounting treatment of acquired inventory, amortization and changes in manufacturing processes and yields.

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In addition to our U.S. sales, we also sell most of our product lines outside the U.S., principally in Canada, Europe, Central and South America, and the Pacific Rim. Products are sold through our direct international sales offices in Canada, United Kingdom, Germany, Spain, Italy, Australia and France, as well as through independent distributors in other countries. Our manufactured products are mainly supplied by our plants in the U.S. and The Netherlands. Our Netherlands plant serves our international branches and distributors. Our U.S. plant also serves these markets in addition to the U.S. market.

We employ a direct sales force domestically for our aesthetic surgery and facial product lines, and specialists to support our body contouring business. The sales force provides product information, training and data support and related services to physicians, nurses and other health care professionals. We promote our products through participation in and sponsorship of medical conferences and educational seminars, specialized websites, journal advertising, direct mail programs, and a variety of marketing support programs. In addition, we contribute to organizations that provide counseling and education for persons suffering from certain conditions, and we provide patient education materials for most of our products to physicians for use with their patients.

Our selling, general and administrative expenses incorporate the expenses of our sales and marketing organization and the general and administrative expenses necessary to support the global organization. Our selling expenses consist primarily of salaries, commissions, and marketing program costs. General and administrative expenses generally incorporate the costs of accounting, human resources, information services, equity compensation expense, certain intangible amortization, business development, legal and insurance costs.

Our research and development expenses are comprised of the following types of costs incurred in performing clinical development and research and development activities: salaries and benefits, allocated overhead, clinical trial and related clinical manufacturing costs, regulatory submission costs, intellectual property procurement, contract services, other outside costs, and costs related to our post-approval study conditions. We also conduct research on materials technology, manufacturing processes, product design and product improvement options.

Our quarterly results reflect seasonality, as the second fiscal quarter ending September 30 tends to historically have the lowest revenue and profitability of all of the quarters. This is primarily due to lower levels of sales of breast implants for augmentation, an elective procedure, as many surgeons and patients take vacations during this quarter.

### **Urology Summary**

On May 17, 2006, we entered into a definitive purchase agreement to sell our Urology Business to Coloplast A/S (Coloplast) for total consideration of \$463 million (\$456 million in cash and the remainder consisting of an indemnification by Coloplast to Mentor related to certain foreign tax credits that arose from the transaction). On June 2, 2006, the sale of the Urology Business was completed.

As a result of the sale to Coloplast, operations associated with the Urology Business have been classified as income from discontinued operations in the accompanying consolidated statements of income. As a result of this sale, we are focused on the aesthetic medical market. We intend to leverage our traditional strengths in plastic surgery and grow our market presence in cosmetic dermatology. For further information regarding this divestiture, see Note P and Note R of the consolidated financial statements.

### **Recent Events**

During the third quarter of fiscal 2008, we began enrollment of our botulinum toxin type A Phase IIIb study for the treatment of rhytides. Enrollment was completed on January 17, 2008.

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**APPLICATION OF CRITICAL ACCOUNTING POLICIES**

Management's Discussion and Analysis of Financial Condition and Results of Operations addresses our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities, the 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. On an on-going basis, we evaluate our estimates and judgments. We base our estimates and judgments on historical experience and on various other factors that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

We believe the following critical accounting policies, among others, affect our more significant judgments and estimates used in the preparation of our consolidated financial statements.

**Revenue Recognition**

We recognize product revenue, net of discounts, returns, rebates and taxes collected from customers in accordance with Statement of Financial Accounting Standards ( SFAS ) No. 48, Revenue Recognition When the Right of Return Exists, and Staff Accounting Bulletin ( SAB ) No. 104, Revenue Recognition. As required by these standards, revenue is recorded when persuasive evidence of a sales arrangement exists, delivery has occurred, the buyer's price is fixed or determinable, contractual obligations have been satisfied, and collectibility is reasonably assured. These requirements are met, and sales and related cost of sales are recognized, upon the shipment of products, or in the case of consignment inventories, upon the notification of usage by the customer. We record estimated reductions to revenue for customer programs and other volume-based incentives. Should the actual level of customer participation in these programs differ from those estimated, additional adjustments to revenue may be required. We also allow credit for products returned within our policy terms. We record an allowance for estimated returns at the time of sale based on historical experience, recent gross sales levels and any notification of pending returns. Should the actual returns differ from those estimated, additional adjustments to revenue and cost of sales may be required.

Our deferred revenue consists of both current and long term and includes funds received in connection with sales of our Enhanced Advantage Limited Warranty program for breast implants. The fees received in connection with a sale of such a warranty are deferred and recognized as revenue evenly over the life of the warranty term.

**Accounts Receivable**

We market our products to a diverse customer base, principally throughout the United States, Canada, Europe, Central and South America, and the Pacific Rim. We grant credit terms in the normal course of business to our customers, primarily hospitals, doctors and distributors. We perform ongoing credit evaluations of our customers and adjust credit limits based upon payment history and the customer's current credit worthiness, as determined through review of their current credit information. We continuously monitor collections and payments from customers and maintain allowances for doubtful accounts for estimated losses resulting from the inability of some of our customers to make required payments. Estimated losses are based on historical experience and any specifically identified customer collection issues. If the financial condition of our customers, or the economy as a whole, were to deteriorate resulting in an impairment of our customers' ability to make payments, additional allowances may be required. These additional allowances for estimated losses would be included in selling, general and administrative expenses.

**Table of Contents****Inventories**

We value our inventories at the lower of cost, based on the first-in first-out ( FIFO ) cost method, or the current estimated market value of the inventory. In the case of inventory acquired in an acquisition, inventory is valued at fair value. We write down our inventory for estimated obsolescence or unmarketable inventory equal to the difference between the cost of inventory and the estimated market value based upon assumptions about future demand and market conditions. If actual future demand or market conditions differ from those projected by us, additional inventory valuation adjustments may be required. These additional valuation adjustments would be included in cost of sales.

**Warranty Reserves**

We offer two types of limited warranties relating to our breast implants in the United States and Canada: a standard limited warranty which is offered at no additional charge and an enhanced limited warranty, generally sold for an additional charge of \$100 in the U.S. (\$100 CAD in Canada), both of which provide limited financial assistance in the event of a deflation or rupture and free product replacement. Our standard limited warranty is also offered in certain European and other international countries for silicone gel-filled breast implants. As a competitive market response to offers made by our primary competitor as a result of the silicone gel breast implant post approval environment in the U.S., during the fourth quarter of fiscal 2007, we began a limited-time offer of free enrollment in our Enhanced Advantage Limited Warranty for MemoryGel implants implanted after February 15, 2007. We provide an accrual for the estimated cost of the standard and/or free limited breast implant warranties at the time revenue is recognized. The cost of the enhanced limited warranty, when sold at an additional charge to the patient, is recognized as costs are incurred. Costs related to warranties are recorded in cost of sales. The accrual for the standard and/or free limited warranty is based on estimates, which are based on relevant factors such as unit sales, historical experience, the limited warranty period, estimated costs, and information developed using actuarial techniques. The accrual is analyzed periodically for adequacy. During the first nine months of fiscal 2008, we recorded adjustments reducing our warranty reserves as a result of this periodic analysis in the amount of \$3.2 million relating to pre-existing warranties. While we engage in extensive product quality programs and processes, including actively monitoring and evaluating the quality of our component and raw material suppliers, the warranty obligation is affected by reported rates of warranty claims and levels of financial assistance specified in the limited warranties. Should actual patient claim rates reported differ from our estimates and/or changes in claim rates result in revised actuarial assumptions, adjustments to the estimated warranty liability may be required. These adjustments would be included in cost of sales. Our warranty programs may be modified in the future in response to the competitive market environment. Such changes may impact the amount and timing of the associated revenue and expense for these programs.

**Product Liability Reserves**

We have product liability reserves for product-related claims to the extent those claims may result in litigation expenses, settlements or judgments within our self-insured retention limits. We have also established additional reserves, through our wholly-owned captive insurance company, for estimated liabilities for product-related claims based on actuarially determined estimated liabilities, taking also into account our excess insurance coverages and retention levels. The actuarial valuations are based on historical information and certain assumptions about future events. Product liability costs are recorded in selling, general and administrative expenses as they are generally under the control of our General Counsel and other general and administrative staff and are directly impacted by our overall corporate risk management strategy; or in the case of products related to discontinued operations, including urology products or ophthalmic products, costs are recorded in discontinued operations. Should actual product liability experience differ from the estimates and assumptions used to develop these reserves, subsequent changes in reserves will be recorded in selling, general and administrative expenses or discontinued operations, and may affect our results in future periods.

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**Goodwill and Intangible Asset Impairment**

We evaluate long-lived assets, including goodwill and other intangibles, for impairment whenever events or changes in circumstances indicate that the carrying value of an asset may not be recoverable. In addition, we evaluate goodwill and other intangibles annually in the fourth quarter of each fiscal year. In assessing the recoverability of goodwill and other intangibles, we must make assumptions regarding estimated future cash flows and other factors to determine the fair value of the respective assets.

**Stock-Based Compensation Expense**

Effective April 1, 2006 we adopted SFAS No. 123 (revised 2004), Share-Based Payment, or SFAS 123(R). SFAS 123(R) requires all share-based payments, including grants of stock options, restricted stock units and performance stock units to be recognized in our financial statements based on their respective grant date fair values. Under this standard, the fair value of each equity grant to an employee is estimated on the date of grant using an option pricing model that meets certain requirements. We currently use the Black-Scholes option pricing model to estimate the fair value of our share-based payments related to Stock Option Grants. The fair value of our restricted stock units is based on the fair market value of our common stock on the date of grant and the fair value of our Performance Stock Units ( PSUs ) is estimated using a Monte Carlo simulation model.

The Black-Scholes model used to value our stock option grants meets the requirements of SFAS 123(R), but the fair values generated by the model may not be indicative of the actual fair values of our stock-based awards as it does not consider certain factors important to stock-based awards, such as continued employment, periodic vesting requirements and limited transferability. The determination of the fair value of stock option grants utilizing the Black-Scholes model is affected by our stock price and a number of assumptions, including expected volatility, expected life, risk-free interest rate and expected dividends. We use the historical volatility for our stock as the expected volatility assumption required in the Black-Scholes model. We believe that our historical volatility is the best estimate of our future volatility. The expected life of the stock options is based on historical data. The risk-free interest rate assumption is based on observed interest rates appropriate for the terms of our stock options and stock purchase rights. The dividend yield assumption is based on our history and expectation of dividend payouts.

Stock-based compensation expense recognized in our financial statements is based on awards that are ultimately expected to vest. The amount of stock-based compensation expense has been reduced for estimated forfeitures based on historical experience. Forfeitures are required to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. We evaluate the assumptions used to value stock awards on a quarterly basis. If factors change and we employ different assumptions, stock-based compensation expense may differ significantly from what we have recorded in the past. If there are any modifications or cancellations of the underlying unvested securities, we may be required to accelerate, increase or cancel any remaining unearned stock-based compensation expense. To the extent that we grant additional equity securities to employees or we assume unvested securities in connection with any acquisitions, our stock-based compensation expense will be increased by the additional unearned compensation resulting from those additional grants or acquisitions.

**Table of Contents****RESULTS OF OPERATIONS**

The following table sets forth certain data from the Consolidated Statements of Income expressed as a percentage of net sales for the periods indicated:

	Three Months Ended		Nine Months Ended	
	December 31,		December 31,	
	2007	2006	2007	2006
Net sales	<b>100.0%</b>	100.0%	<b>100.0%</b>	100.0%
Cost of sales	<b>28.1</b>	25.1	<b>26.6</b>	26.8
Gross profit	<b>71.9</b>	74.9	<b>73.4</b>	73.2
Selling, general and administrative expense	<b>41.9</b>	43.0	<b>39.6</b>	41.0
Research and development expense	<b>10.4</b>	10.3	<b>11.8</b>	11.1
Operating income	<b>19.6</b>	21.6	<b>22.0</b>	21.1
Interest expense	<b>(1.3)</b>	(1.9)	<b>(1.5)</b>	(2.1)
Interest income	<b>1.2</b>	8.4	<b>2.6</b>	7.3
Other income (expense), net	<b>(0.5)</b>	(0.3)	<b>(0.5)</b>	0.2
Income from continuing operations before income taxes	<b>19.0</b>	27.8	<b>22.6</b>	26.5
Income taxes	<b>5.8</b>	8.2	<b>6.6</b>	7.9
Net income from continuing operations	<b>13.2</b>	19.6	<b>16.0</b>	18.6
Net income (loss) from discontinued operations	<b>(0.2)</b>	(1.5)	<b>(0.1)</b>	0.6
Gain (loss) on sale of discontinued operations				100.2
Net income	<b>13.0%</b>	18.1%	<b>15.9%</b>	119.4%

**For the three month period ended December 31, 2007 compared to the three month period ended December 31, 2006**

**Net Sales**

Net sales for the three month period ended December 31, 2007 increased 23.3% to \$92.9 million, compared to \$75.3 million for the same period in the prior year. Foreign exchange rate movements, primarily the stronger Euro and Canadian Dollar over the same quarter in the prior year had a favorable year-to-year impact on sales of \$1.6 million. The increase in net sales was primarily the result of a 23.6% increase in total sales of breast aesthetic products to \$81.0 million for the quarter from \$65.6 million for the same period in the prior year. Increased breast aesthetic sales were driven by growth in MemoryGel silicone-gel breast implants across all markets. These increases were due primarily to regulatory approval of these products in the United States and Canada during fiscal 2007. Because of this regulatory approval, during fiscal 2008, our U.S. augmentation market experienced a shift from saline-filled breast implants to MemoryGel breast implants, which carry a higher average selling price than saline-filled breast implants. Increased breast aesthetics sales were also due in part to \$4.1 million in incremental sales in the current period from our Perouse Plastic (Perouse) operations. The increase in net sales of breast implants was moderated in the quarter by a slight decrease in unit volume in the U.S. Also contributing to sales growth were the successful domestic launch of NeoForm dermis and strong global sales of tissue expanders, both of which are primarily used for breast reconstruction. We anticipate that our breast aesthetic sales in the remainder of fiscal 2008 will be driven by existing products, particularly sales of our MemoryGel<sup>®</sup> products, in all markets, and incremental sales related to our



acquisition of Perouse which was completed early in the second quarter of fiscal 2008. Net sales of body contouring products were \$3.9 million for the current quarter which is equal to the same period in the prior year. Other aesthetic products sales increased 35.9% to \$8.0 million for the quarter, from \$5.9 million for the same period in the prior year due in part to increased revenue from our facial aesthetics products, including international sales of our dermal fillers, increased sales of Niadyne's NIA 24 line of science-based cosmeceutical products which was launched domestically in May 2006, and \$0.6 million related to Perouse.

**Table of Contents****Cost of Sales and Gross Profit**

Gross profit increased \$10.3 million to \$66.7 million for the quarter from \$56.4 million in the same period last year. The gross profit percentage decreased to 71.9% of net sales for the quarter compared to 74.9% for the same period in the prior year. The decrease in gross profit percentage was primarily the result of lower margins related to Perouse products, including \$1.0 million of additional cost of goods sold as a result of inventory fair value adjustments associated with the Perouse acquisition. Our gross profit percentage benefited from favorable manufacturing variances and lower warranty costs, offset by higher amortization expense and higher international distributor sales and facial sales, which tend to carry lower margins.

**Selling, General and Administrative**

Selling, general and administrative expenses increased to \$38.9 million, or 41.9% of net sales, for the three months ended December 31, 2007, compared to \$32.4 million, or 43.0% of net sales, in the same period in the prior year. The increase was primarily due to Perouse costs in fiscal 2008 of \$2.0 million, severance of \$1.8 million and \$1.7 million of higher compensation expense, including salaries and related costs. Higher marketing expenses in the current year were offset by lower samples expense in the prior year related to the MemoryGel breast implant post-approval launch in the third quarter of fiscal 2007.

**Research and Development**

Research and development expense was \$9.7 million, or 10.4% of net sales, for the three months ended December 31, 2007, compared to the \$7.8 million or 10.3% of net sales reported in the same period last year. This change was primarily due to increases in development costs related to our botulinum toxin project and higher costs related to the requirements of the FDA post-approval conditions. These costs were partly offset by a decrease in clinical study costs related to our silicone gel-filled breast implant regulatory submissions in the United States and Canada for which we received approval in the third quarter of fiscal 2007, and lower spending for our dermal filler development program with Genzyme.

**Interest and Other Income and Expense**

Interest expense was \$1.2 million and \$1.4 million for the three months ended December 31, 2007 and 2006, respectively. These costs included interest on our \$150 million convertible subordinated notes at 2<sup>3</sup>/<sub>4</sub>% issued in December 2003, interest expense on balances outstanding under our lines of credit in the prior year, commitment fees on our credit facilities and amortization of debt issuance costs.

Interest income decreased \$5.3 million to \$1.1 million for the three months ended December 31, 2007, compared to \$6.3 million in the same period of the prior year, as a result of lower cash and marketable securities balances in the current period, due mainly to our stock buyback program in fiscal 2008 and the acquisition of Perouse.

Other income (expense) primarily includes foreign currency gains or losses related to our foreign operations. Other income (expense) for the three month period ending December 31, 2007 was (\$0.5) million as compared to (\$0.3) million for the same period in the prior year.

**Income Taxes**

Our effective tax rate for continuing operations for the three months ended December 31, 2007 was 30.9% compared to 29.4% for the same period in the prior year. The effective tax rate for the three months ended December 31, 2006 is lower than the tax rate for the three months ended December 31, 2007 because of the reinstatement of the federal research and experimentation (R&E) credit in the third quarter of fiscal year 2007.

**Table of Contents****Income, Net of Income Taxes and Earnings per Share from Continuing Operations**

Income from continuing operations was \$12.1 million and \$14.8 million for the three months ended December 31, 2007 and 2006, respectively. Basic earnings per share was \$0.36 and \$0.35 for these same respective periods. Diluted earnings per share was \$0.32 for both of these same respective periods.

**Income from Discontinued Operations, Net of Income Taxes**

Income from discontinued operations, net of income taxes, includes the results of our former surgical urology and clinical and consumer healthcare business segments, which were sold to Coloplast on June 2, 2006. For the three months ended December 31, 2007, we had a loss from discontinued operations, net of income taxes, of \$0.2 million compared to a loss from discontinued operations, net of income taxes, of \$1.1 million for the three months ended December 31, 2006. For further details regarding discontinued operations, see Note P of the Notes to Consolidated Financial Statements.

**For the nine month period ended December 31, 2007, compared to the nine month period ended December 31, 2006****Net Sales**

Net sales for the nine month period ended December 31, 2007 increased 23.5% to \$273.8 million, compared to \$221.7 million for the same period in the prior year. Foreign exchange rate movements, primarily the stronger Euro, Canadian Dollar and British Pound, over the same period in the prior year had a favorable year-to-year impact on sales of \$3.2 million. The increase in net sales was primarily the result of a 24.5% increase in total sales of breast aesthetic products to \$240.6 million for the nine month period ended December 31, 2007 from \$193.2 million for the same period in the prior year. Increased breast aesthetic sales were driven by growth in MemoryGel silicone-gel breast implants across all markets. These increases were due primarily to regulatory approval of these products in the United States and Canada during the third quarter of fiscal 2007. Because of this regulatory approval, during the first nine months of fiscal 2008, our U.S. augmentation market experienced a shift from saline-filled breast implants to our MemoryGel breast implants, which carry a higher average selling price than saline-filled breast implants. Increased breast aesthetics sales were also due in part to \$8.6 million in incremental sales in the current year from our Perouse operations. We anticipate that our breast aesthetic sales in the remainder of fiscal 2008 will be driven by existing products, particularly sales of our MemoryGel<sup>®</sup> products, in all markets, and incremental sales related to our acquisition of Perouse which was completed early in the second quarter of fiscal 2008. Net sales of body contouring products decreased 9.8% to \$11.6 million for the first nine months of the current year, from \$12.8 million for the same period in the prior year, due in part to our decision in the first quarter of fiscal 2007 to discontinue sale of a number of low margin products within the body contouring product line. Other aesthetic products sales increased 39.0% to \$21.7 million for the first nine months of the current year, from \$15.6 million for the same period in the prior year due in part to increased revenue from our facial aesthetics products, including international sales of dermal fillers and Niadyne's NIA 24 line of science-based cosmeceutical products which was launched domestically in May 2006. In addition, other aesthetic product sales include \$1.0 million related to Perouse. We expect net sales in the range of \$365 million to \$370 million for the full fiscal year 2008.

**Cost of Sales and Gross Profit**

Gross profit increased \$38.8 million to \$201.0 million for the first nine months of the current year from \$162.2 million in the same period last year. The gross profit percentage increased to 73.4% of net sales for the first nine months of the current year compared to 73.2% for the same period in the prior year. During fiscal 2008, we obtained updated actuarial data which resulted in adjustments to our estimated warranty reserves of \$2.9 million and \$0.3 million, in the first and second quarters of fiscal 2008, respectively. Gross profit was further benefited by favorable manufacturing variances. In addition, fiscal 2007 included additional inventory reserves for the discontinuation of certain low margin product lines in our body contouring business of \$1.2 million. The current year includes a decrease in gross profit percentage related to Perouse products, including \$2.3 million of additional cost of goods sold as a result of inventory fair value adjustments. The gross profit percentage also decreased due to inventory adjustments in our foreign offices and higher distributor sales, which tend to carry lower margins. We believe that our gross profit as a percentage of net sales will be in the range of 73% to 75% for the full fiscal year 2008.



**Table of Contents****Selling, General and Administrative**

Selling, general and administrative expenses increased to \$108.3 million, or 39.6% of net sales, for the nine months ended December 31, 2007, compared to \$90.8 million, or 41.0% of net sales, in the same period in the prior year. The increase was primarily due to Perouse costs in fiscal 2008 of \$3.4 million and \$6.5 million of higher compensation expense, including salaries, commissions and recruiting costs. Other increases included \$2.0 million related to higher consulting, \$1.2 million related to foreign currency fluctuations and \$1.9 million in higher promotional and other marketing expenses. We expect selling, general and administrative expenses to be in the range of 39% to 41% of net sales for the full fiscal year 2008.

**Research and Development**

Research and development expense was \$32.2 million, or 11.8% of net sales, for the nine months ended December 31, 2007, compared to the \$24.7 million or 11.1% of net sales reported in the same period in the prior year. This change was primarily due to increases in development costs, including \$6.8 million in combined expense related to our botulinum toxin project and our dermal filler development program with Genzyme. Higher costs related to the requirements of the FDA post-approval conditions of \$5.2 million in the current year were partly offset by a \$1.1 million decrease in clinical study costs. These decreases were partly due to the completion of certain prior year studies and a decrease in expenses related to our silicone gel-filled breast implant regulatory submissions in the United States and Canada for which we received approval in the third quarter of fiscal 2007. In addition, the first nine months of fiscal 2007 includes \$1.4 million in severance-related costs. We expect research and development expense to be in the range of 12% to 14% of net sales for the full fiscal year 2008.

**Interest and Other Income and Expense**

Interest expense was \$4.2 million and \$4.7 million for the nine months ended December 31, 2007, and 2006, respectively. These costs include interest on our \$150 million convertible subordinated notes at 2<sup>3</sup>/<sub>4</sub>% issued in December 2003, interest expense on balances outstanding under our lines of credit in the prior year, commitment fees on our credit facilities and amortization of debt issuance costs.

Interest income decreased \$9.0 million to \$7.2 million for the nine months ended December 31, 2007, compared to \$16.2 million in the same period of the prior year, as a result of lower cash and marketable securities balances in fiscal 2008 due mainly to our stock buyback program and the acquisition of Perouse.

Other income (expense) primarily includes foreign currency gains or losses related to our foreign operations. Other income (expense) for the nine month period ending December 31, 2007 was (\$1.4) million as compared to \$0.5 million for the same period in the prior year.

**Income Taxes**

Our effective tax rate for continuing operations for the nine months ended December 31, 2007 was 29.3% compared to 29.8% for the same period in the prior year. The effective rate for the nine months ended December 2007 was lower because of the lower rates on the Company's international operations which were partially offset by reductions in tax-exempt interest income and amounts provided for under FASB Interpretation No. 48 Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109 ( FIN 48 ).

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**Income, Net of Income Taxes, and Earnings per Share from Continuing Operations**

Income from continuing operations was \$43.9 million and \$41.2 million for the nine months ended December 31, 2007 and 2006, respectively. This equates to \$1.22 and \$0.98 basic earnings per share and \$1.09 and \$0.89 diluted earnings per share for these same respective periods. We expect diluted earnings per share from continuing operations to be in the range of \$1.36 to \$1.40 for the full fiscal year 2008.

**Income from Discontinued Operations, Net of Income Taxes**

Income from discontinued operations, net of income taxes, includes the results of our former surgical urology and clinical and consumer healthcare business segments, which were sold to Coloplast on June 2, 2006. For the nine month period ended December 31, 2007, we had a loss from discontinued operations, net of income taxes, of \$0.3 million compared to income from discontinued operations, net of income taxes, of \$1.3 million for the nine months ended December 31, 2006. For further details regarding discontinued operations, see Note P of the Notes to Consolidated Financial Statements.

**Gain on Sale of Discontinued Operations, Net of Income Taxes**

For the nine months ended December 31, 2006, we recorded a net gain of \$222.2 million after taxes and expenses related to the sale of our Urology Business.

**FINANCIAL CONDITION, LIQUIDITY AND CAPITAL RESOURCES**

Cash provided by operating activities and from the exercise of employee stock options have been our primary recurring sources of funds. As of December 31, 2007, we had cash, cash equivalents and short-term marketable securities of \$106.6 million, a decrease of \$381.1 million from \$487.7 million as of March 31, 2007. The principal components of the decrease in cash, cash equivalents and marketable securities were cash outflows of \$367.7 million for common shares repurchased under our share repurchase program, \$53.4 million related to the purchase of Perouse, \$22.8 million in dividends paid and \$13.7 million used for capital expenditures of continuing operations, offset by cash generated from operating activities of continuing operations of \$69.6 million, proceeds of \$5.0 million from the exercise of employee stock options and stock purchases under our Employee Stock Purchase Plan and \$84.1 million in net sales of marketable securities.

During the first quarter of fiscal 2007 we completed the sale of our Urology Business to Coloplast for total consideration of \$463 million, which was subject to customary post-closing adjustments and included non-cash consideration consisting of the value of the indemnification by Coloplast to us related to certain foreign tax credits. On the closing date of June 2, 2006, we received \$446 million in cash from Coloplast, an additional \$10 million that was held under an escrow agreement in connection with the transaction and an additional \$2 million was received from an unrelated third party.

We invest excess cash in interest bearing bank deposits and marketable securities that are highly liquid, of high-quality investment grade, and which have varying maturities. Our short-term marketable securities consist primarily of money market funds, state and municipal government and government agency obligations, Federal Home Loan Bank and Mortgage Association bonds, and investment-grade corporate obligations, including commercial paper.

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The following table summarizes our cash, cash equivalents and marketable securities for the periods noted:

(in thousands)	December 31, 2007	March 31, 2007
Cash and cash equivalents	\$ 74,961	\$ 371,525
Marketable securities	31,686	116,215
Total cash, cash equivalents and marketable securities	\$ 106,647	\$ 487,740
Percentage of total assets	26%	69%

**Cash Flow Changes**

The following table summarizes our cash flow activity:

(in thousands)	Nine Months Ended December 31,	
	2007	2006
Net cash provided by continuing operating activities	\$ 69,624	\$ 65,220
Net cash provided by continuing investing activities	17,024	438,188
Net cash used for continuing financing activities	(383,663)	(102,846)
Net cash used for discontinued operations	(287)	(95,281)
Effect of currency exchange rates on cash and cash equivalents	738	413
Increase (decrease) in cash and cash equivalents	\$ (296,564)	\$ 305,694

**Cash Provided by Operating Activities of Continuing Operations**

Cash provided by operating activities of continuing operations of \$69.6 million and \$65.2 million for the nine months ended December 31, 2007 and 2006, respectively, was due in part to the net impact of non-cash adjustments to income from continuing operations. Non-cash adjustments primarily included tax benefits from the exercise of employee stock options, non-cash compensation, depreciation, amortization and deferred income taxes. For the nine month periods ended December 31, 2007 and 2006, operating cash flows were positively impacted in the amount of \$9.6 million and \$4.0 million, respectively, by changes in working capital balances. Our working capital was \$152.0 million at December 31, 2007, and \$524.6 million at March 31, 2007.

**Cash Provided by (Used for) Investing Activities of Continuing Operations**

Historically, cash provided by (used in) investing activities of continuing operations has been primarily attributable to purchases and sales of marketable debt and equity securities, as well as capital expenditures on property and equipment and intangibles. For the nine months ended December 31, 2007, total cash provided by investing activities of continuing operations was \$17.0 million, primarily related to capital expenditures of \$13.7 million and the purchase of Perouse of \$53.4 million, offset by net sales of marketable securities of \$84.1 million. For the nine months ended December 31, 2006, total cash provided by investing activities of continuing operations was \$438.2 million, which includes the proceeds from the sale of the urology business of \$458.1 million. For the nine months ended December 31, 2006, our net purchases of marketable securities totaled \$11.9 million and our capital expenditures totaled \$7.9 million. We anticipate our capital expenditures to total approximately \$20 million to \$25 million in fiscal 2008, as we will continue to invest in our new botulinum toxin manufacturing plant, facility improvements, software to support our manufacturing processes, and production equipment.

**Table of Contents***Perouse Acquisition*

On July 2, 2007 we purchased all of the outstanding shares of Perouse Plastique SAS (Perouse). Perouse is an international breast implant manufacturer based in France that currently supplies a complete range of products for the European and Latin America markets. We paid \$53.4 million in cash (net of cash acquired). In addition, we incurred approximately \$0.5 million in acquisition costs, bringing the total purchase price to \$53.9 million.

The acquisition was accounted for using the purchase method of accounting and, accordingly, the purchase price was allocated to the tangible and intangible net assets acquired on the basis of their respective values on the acquisition date. The fair value of intangible assets acquired was determined based upon an external valuation and for tangible assets the Company used a combination of methods including replacement cost. The results of Perouse operations are included in our consolidated results since acquisition date. For further information regarding this acquisition, see Note S of the Notes to Consolidated Financial Statements.

*Cash (Used) Provided by Discontinued Operations*

Cash used by discontinued operations was approximately \$0.3 million for the nine months ended December 31, 2007 and \$95.3 million for the nine months ended December 31, 2006.

*Cash Used for Financing Activities of Continuing Operations*

Net cash used for financing activities is primarily a result of our stock repurchase program, cash used in payments of dividends, and the net impact of our debt financing activities offset by cash provided by employee stock option exercises.

We have a share repurchase program, primarily to reduce the overall number of shares outstanding and to offset the dilutive effect of our employee equity compensation and dilution related to our convertible notes from the inclusion of contingently convertible debt in fully diluted earnings per share calculations. All shares repurchased under the program are retired and are no longer deemed to be outstanding. The timing of our repurchases is subject to market conditions, cash availability and terms of our 10b5-1 stock purchase plans, if any. There is no guarantee that shares authorized for repurchase by the Board will ultimately be repurchased.

On June 16, 2006, we entered into a stock purchase plan with Citigroup Global Markets Inc. for the purpose of repurchasing up to 5 million shares of our common stock, up to a cumulative purchase price of \$166 million, under a Rule 10b5-1 Plan (the "10b5 Plan") compliant with Rule 10b-18. In connection with the entry into such 10b5 Plan, our Board of Directors increased the authorized number of shares available for repurchase pursuant to our stock repurchase program from 3.3 million to 5.0 million shares. We repurchased 4.1 million shares of our common stock under this 10b5 Plan for a total purchase price of \$166 million, and this 10b5 Plan terminated on June 15, 2007.

On June 18, 2007, we entered into a second stock purchase plan (the "2007 10b5 Plan") with Citigroup Global Markets Inc. for the purpose of repurchasing our common stock, up to a cumulative purchase price of \$200 million, under another Rule 10b5 Plan compliant with Rule 10b-18. In connection with the entry into the 2007 10b5 Plan, our Board of Directors increased the authorized number of shares available for repurchase pursuant to our stock repurchase program by 5.0 million shares. As of December 31, 2007, we have repurchased 4.8 million shares of our common stock under the 2007 10b5 Plan for a total purchase price of \$200 million. Although 0.8 million shares remain authorized as of February 1, 2008, authorized funding for the 2007 10b5 Plan has been exhausted. The repurchase program may be suspended or discontinued at any time.

In addition to the shares we repurchased under the two 10b5 Plans mentioned above, we acquired 0.3 million shares during the third quarter of fiscal 2008 and an additional 13,628 shares for the payment of withholding taxes related to the lapsing of restrictions on certain outstanding restricted stock grants during the nine month period ending December 31, 2007.



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Since April 1, 2007 we have repurchased a total of 9.0 million shares for total consideration of \$367.7 million. On December 14, 2007, the Board of Directors declared a quarterly cash dividend payable on our common stock of \$0.20 per share. It is our intent to continue to pay dividends for the foreseeable future subject to, among other things, Board approval, cash availability, debt and line of credit restrictions and alternative cash needs. At the current annual dividend rate of \$0.80 per share, the aggregate annual dividend, based on 33.7 million shares outstanding, would be approximately \$27.0 million.

We receive cash from the exercise of employee stock options and the employee stock purchase plan ( ESPP ). Employee stock option exercises and ESPP purchases provided \$5.0 million and \$22.2 million of cash in the nine months ended December 31, 2007 and 2006, respectively. Proceeds from the exercise of employee stock options will vary from period to period based upon, among other factors, fluctuations in the market value of our common stock relative to the exercise price of such options.

**Financing Arrangements***Senior Credit Facility*

On May 26, 2005, we entered into a three-year Credit Agreement ( Credit Agreement ) that provides us with a \$200 million senior revolving credit facility, subject to a \$20 million sublimit for the issuance of standby and commercial letters of credit, a \$10 million sublimit for swing line loans, and a \$50 million alternative currency sublimit. At our election and subject to lender approval, the amount available for borrowings under the Credit Agreement may be increased by an additional \$50 million. Funds are available under the Credit Agreement to finance permitted acquisitions, stock repurchases up to certain dollar limitations, and for other general corporate purposes. We have one standby letter of credit for \$750,000 outstanding under the Credit Agreement. Accordingly, although there were no borrowings outstanding under the Credit Agreement at December 31, 2007, only \$199 million was available for borrowings.

On May 31, 2006, we amended the Credit Agreement to permit the consummation of the sale of our Urology Business. Additionally, the amendment modified the minimum Adjusted Consolidated EBITDA covenant that we are required to comply with under the terms of the Credit Agreement. The amendment also amended certain negative covenants contained in the Credit Agreement, including amendments to the covenants restricting our ability to make investments and incur indebtedness and an amendment increasing the amount of our equity securities that we are permitted to repurchase. On March 30, 2007, we entered into a second amendment to the credit agreement to set the maximum amount of cash dividends per share that we can declare or pay in any four consecutive quarters. The second amendment also increased the amount of our common shares and other equity interests we could repurchase. As of February 1, 2008, there were no borrowings outstanding under the Credit Agreement.

Interest on borrowings (other than swing line loans and alternative currency loans) under the Credit Agreement is at a variable rate that is calculated, at our option, at the prime rate, or a Eurocurrency rate for deposits denominated in U.S. dollars plus an additional percentage that varies between 1.00% and 1.65%, depending on our senior leverage ratio at the time of the borrowing. Swing line loans bear interest at the prime rate. Alternative currency loans bear interest at the Eurocurrency rate for deposits denominated in the applicable currency plus the same additional percentage. In addition, we paid certain fees to the lenders to initiate the Credit Agreement and pay an unused commitment fee based on our senior leverage ratio and unborrowed lender commitments.

Borrowings under the Credit Agreement are guaranteed by certain of our domestic subsidiaries and are also secured by a pledge of 100% of the outstanding capital stock of certain of our other domestic subsidiaries. In addition, if the ratio of total funded debt to adjusted earnings before interest, taxes, depreciation and amortization (or adjusted EBITDA ), exceeds 2.50 to 1.00, then we are obligated to grant to the lenders a first priority perfected security interest in essentially all of our and our material domestic subsidiaries' assets.

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The Credit Agreement imposes certain financial and operational restrictions, including financial covenants that require us to maintain a maximum consolidated funded debt leverage ratio of not greater than 4.00 to 1.00, a senior funded debt ratio of not greater than 2.50 to 1.00, a minimum quarterly adjusted EBITDA, and a minimum fixed charge ratio of greater than 1.25 to 1.00. The covenants also restrict our ability, among other things, to make certain investments, incur certain types of indebtedness or liens, make acquisitions in excess of \$20 million except in compliance with certain criteria, and repurchase shares of common stock, pay dividends or dispose of assets above specified thresholds. The Credit Agreement also contains customary events of default, including payment defaults, material inaccuracies in our representations and warranties, covenant defaults, bankruptcy and involuntary proceedings, monetary judgment defaults in excess of specified amounts, cross-defaults to certain other agreements, change of control, and ERISA defaults.

*Other Financing*

On October 4, 2005, Mentor Medical Systems B.V. ( Mentor BV ), a wholly-owned subsidiary of Mentor Corporation entered into a Loan and Overdraft Facility (the Facility ) with Cooperative RaboBank Leiden, Leiderdorp en Oestgstgeest U.A. ( RaboBank ).

The Facility provides Mentor BV with an initial 15 million loan and overdraft facility, which began decreasing by 375,000 quarterly in September 2006. Under the Facility, Mentor BV may borrow up to 12.5 million in fixed amount advances, with terms of three to six months, and a further sublimit of up to 5 million of loans in fixed amount advances with a term of up to 5 years. Up to 10 million of the Facility may be drawn in the form of U.S. dollars.

Funds under the Facility are available to Mentor BV to finance certain dividend payments to Mentor Corporation and for other normal business purposes. On March 31, 2006 we borrowed \$14 million under the Facility to partially fund our repatriation of foreign earnings for reinvestment in the U.S. and had fully repaid the balance by December 31, 2006. Accordingly, \$18.6 million was available under this facility at December 31, 2007.

Interest on borrowings under the Facility is at a rate equal to 0.55% over the RaboBank base lending rate, Euribor, or LIBOR depending upon the currency and term of each borrowing. Interest rates on borrowings other than overdrafts are fixed for the term of the advance.

Borrowings by Mentor BV under the Facility are guaranteed by Mentor s wholly-owned subsidiary, Mentor Medical Systems C.V., through a Joint and Several Debtorship Agreement. In addition, borrowings under the Facility are secured by a mortgage on certain real estate owned by Mentor BV.

The Facility imposes certain financial and operational restrictions on Mentor BV, including financial covenants that require Mentor BV and Mentor Medical Systems CV to maintain a minimum combined defined solvency ratio, a maximum combined debt leverage ratio of not greater than 4 to 1, a senior funded debt ratio of not greater than 2.5 to 1, minimum quarterly operational results, and a minimum interest coverage ratio of greater than 5 to 1. The Facility also contains customary events of default, including cross default and material or adverse change provisions. If an event of default occurs, the commitments under the Facility may be terminated and the principal amount and all accrued but unpaid interest and other amounts owed thereunder may be declared immediately due and payable. As of December 31, 2007, all covenants and restrictions had been satisfied. Mentor BV paid 15,000 in certain fees to the RaboBank upon entry into the Facility, and Mentor BV will be obligated to pay, over the 10 year term of the Facility, a commitment fee of 0.25% of the committed and unborrowed balances. Fees are payable quarterly in arrears.

On July 2, 2007 we acquired all of the outstanding shares of Perouse Plastique, SAS, including the assumption of approximately 3.0 million in net debt. Approximately 0.4 million was repaid in the nine months ended December 31, 2007, leaving 2.6 million or approximately \$3.8 million, of which \$1.1 million is current and \$2.7 million is long term. The debt consists primarily of installment loans with an average term of 6 years and a weighted average interest rate of 3.0%.

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At December 31, 2007, we had approximately \$1.1 million in short term borrowings and \$2.7 million in long term debt outstanding. The total amount of additional borrowings available to us under all lines of credit was \$217.9 million at December 31, 2007, and \$216.5 million at March 31, 2007.

*Convertible Subordinated Notes*

On December 22, 2003, we completed an offering of \$150 million of convertible subordinated notes due January 1, 2024, pursuant to Rule 144A under the Securities Act of 1933. The notes bear interest at 2<sup>3</sup>/<sub>4</sub>% per annum and are convertible into shares of our common stock at an initial conversion price of \$29.289 per share and are subordinated to all existing and future senior debt. As a result of our dividend increase the conversion price has been adjusted to \$28.9736 and each \$1,000 principal amount will be convertible into 34.5142 shares of common stock. Concurrent with the issuance of the convertible subordinated notes, we entered into convertible bond hedge and warrants transactions with respect to our common stock, the exposure for which is held by Credit Suisse First Boston LLC for a net cash payment of \$18.5 million. Both the bond hedge and the warrants transactions may be settled at our option either in cash or net shares and expire January 1, 2009. The convertible bond hedge and warrants transactions combined are intended to reduce the potential dilution from conversion of the notes by effectively increasing the conversion price per share, from our perspective, to approximately \$39.0030.

During the quarter, the market price condition was satisfied, giving holders of the notes the option to convert the notes into common shares at the aforementioned adjusted conversion price per share. The warrant holder also has the right to purchase 5.2 million shares when the share price of our common stock as quoted on the NYSE exceeds the current exercise price of \$39.0030 per share.

We do not have any off-balance sheet arrangements that are currently material or reasonably likely to be material to our financial position or results of operations.

We believe that funds generated from operations, our cash, cash equivalents and marketable securities, plus funds available under our line of credit agreements will be adequate to meet our working capital needs and capital expenditure investment requirements and commitments for the foreseeable future. However, it is possible that we may need to raise additional funds to finance unforeseen requirements or to consummate acquisitions of other businesses, products or technologies through the sale of equity or debt securities to the public or to selected investors, or by borrowing money from financial institutions. In addition, even though we may not need additional funds in the short-term, we may still elect to sell additional equity or debt securities or borrow for other reasons. There are no assurances that we will be able to obtain additional funds on terms that would be favorable to us, or at all. If funds are raised by issuing additional equity securities or convertible debt securities, the ownership percentage of existing shareholders would be reduced. In addition, equity or debt securities issued by us may have rights, preferences or privileges senior to those of our common stock.

**Item 3. Quantitative and Qualitative Disclosures about Market Risk**

There have been no material changes in our exposure to market risk as reported in Item 7A in our Annual Report on Form 10-K for the fiscal year ended March 31, 2007.

**Item 4. Controls and Procedures**

We maintain disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the Exchange Act )) that are designed to ensure that information required to be disclosed in our reports filed or submitted under the Exchange Act, is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure. In designing and evaluating the disclosure controls and procedures, management recognized that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and management necessarily was required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures.

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We carried out an evaluation under the supervision and with the participation of management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures as of December 31, 2007, the end of the period covered by this report. Based on that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective at the reasonable assurance level as of December 31, 2007.

Further, management has determined that there have been no changes in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) during the quarter ended December 31, 2007 that materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

**PART II OTHER INFORMATION****Item 1. Legal Proceedings**

In the ordinary course of our business we experience product-related and other varied types of claims that sometimes result in litigation or other legal proceedings. Although there can be no certainty, we do not anticipate that any of these proceedings will have a material adverse effect on us.

**Item 1A. Risk Factors**

Our business faces many risks. The risks described below may not be the only risks we face. Additional risks that we do not yet know of or that we currently think are immaterial may also impair our business operations. If any of the events or circumstances described in the following risks actually occurs, our business, financial condition or results of operations could suffer and the trading price of our common stock or our convertible notes could decline. You should consider the following risks before deciding to invest in our common stock or convertible notes.

***The FDA approval of our MemoryGel breast implants in the U.S. is conditioned on our compliance with several significant post-approval conditions, including conducting a large scale, 10-year study of patients who receive the implants. These conditions may adversely affect the market acceptance and usage rates of our MemoryGel implants, may impact our ability to compete, and may cause us to incur significant unanticipated expenses. Our failure to comply with these conditions in a timely manner may cause delay in market acceptance or result in our inability to continue to sell our MemoryGel implants in the U.S.***

On November 17, 2006, the U.S. Food and Drug Administration ( FDA ) approved for sale our MemoryGel silicone gel-filled breast implants with post-approval conditions. The post-approval conditions and other requirements associated with the FDA s approval include the following: continuation of the Mentor Core Study through 10 years, physician training prior to accessing the device, a large post-approval study for 10 years, completion of additional device failure studies, focus group studies with patients on the format and content of the approved labeling, utilization of a formal informed decision process with patient labeling, cessation of new enrollment in the Mentor Adjunct Study, and implementation of device tracking.

Our compliance with these FDA-mandated post-approval conditions, including changes to our post-approval study protocol effective April 2007, is dependent upon the cooperation of physicians and patients. If we are unable to gain that cooperation, or if patients or physicians prefer to use the competitors products as a result of our post-approval study requirements, there may be an adverse effect on our ability to comply with the post-approval conditions. In addition, the existence of the post-approval study, including administrative burden and follow-up requirements, may adversely affect the acceptance and usage rates of our products. In connection with complying with the post-approval conditions, we could incur significant unanticipated expenses, including costs to gain physician and patient cooperation and costs of post-market patient monitoring and data collection activities, which would have a material adverse effect on our market share, sales and results of operations. In addition, if we are unable to comply with these post-approval conditions, the FDA may withdraw the approval of the PMA, and we would be unable to continue selling MemoryGel breast implants in the U.S., which would also have a material adverse effect on market share, revenue and results of operations. Further, our sales and results of operations could be affected if market conversion to silicone gel-filled breast implants from saline breast implants does not occur at the rate we anticipated.

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On October 20, 2006, we received the Medical Licenses for our MemoryGel and Contour Profile Gel (CPG) breast implants in Canada. These licenses also came with conditions that are similar to those required by the FDA. If we fail to comply with these post-approval conditions, Health Canada may suspend the licenses, which would have a material adverse effect on our market share, sales and results of operations.

***Significant product liability or other claims or product recalls may force us to pay substantial damage awards and other expenses that could exceed our accruals and insurance coverages. Unexpected increases in the number of limited warranty claims for our products may surpass our product warranty reserves.***

The manufacture and sale of medical devices and biologics exposes us to significant risk of product liability and other tort claims. Both currently and in the past, we have had a number of product liability claims relating to our products, and we will be subject to additional product liability claims in the future for both past and current products, some of which may have a negative impact on our business. Our liability with regard to products includes liability related to certain products manufactured and/or sold by us prior to our business or product line divestitures. If a product liability claim or series of claims, including class action or consolidated claims, is brought against us for uninsured liabilities or in excess of our insurance coverage, our business could suffer. Some manufacturers that suffered such claims in the past have been forced to cease operations and declare bankruptcy.

Additionally, we offer product replacement and certain financial assistance for surgical procedures that fall within our limited warranties and coverage periods of implantation on our breast implant products, and we accrue or expense costs as incurred for those limited warranties. As a competitive market response to offers made by our primary competitor as a result of the silicone gel breast implant post-approval environment in the U.S., during the fourth quarter of fiscal 2007, we began a limited-time offer of free enrollment in our Enhanced Advantage Limited Warranty for MemoryGel implants implanted after February 15, 2007. Such accruals are based on estimates, taking into consideration relevant factors such as historical experience, warranty periods, estimated costs, existence and levels of insurance and insurance retentions, identified product quality issues, if any, and, to a limited extent, information developed by using actuarial techniques. We assess the adequacy of these accruals periodically and adjust the amounts as necessary based on actual experience and changes in future expectations. Changes to actual warranty claims incurred could have a material impact on the actuarial analysis, which in turn could materially impact our reported expenses and results of operations. In addition, from time to time, we adjust the terms of our limited warranty programs which could materially impact our reported expenses and results of operations. In addition to product liability or warranty claims, we could experience a material design or manufacturing failure, a quality system failure, other safety issues, or heightened regulatory scrutiny that would warrant a recall of products we manufacture or products we distribute that are manufactured by another company. A recall of some of our products could result in exposure to additional product liability claims, significant expense to perform the recall, and lost sales.

***We are subject to substantial government regulation, which could have a material adverse effect on our business.***

***Any delay or failure to gain regulatory approval for our products, or the ability of our competitors to get new products, which compete with our existing products, approved before us, could also materially adversely affect our business.***

The production and marketing of our products and our ongoing research and development activities, including pre-clinical testing and clinical trial activities, are subject to extensive regulation and review by numerous governmental authorities both in the U.S. and abroad. Most of the medical devices and biologics we develop must undergo rigorous pre-clinical and clinical testing and an extensive regulatory approval process before they can be marketed. Certain of our products are required to undergo review by a panel of outside experts selected by the FDA, which makes a recommendation to the FDA as to whether the product(s) should or should not be approved. This process makes it potentially longer, more difficult, and/or more costly to bring our products to market, and we cannot guarantee that any of our unapproved products will be approved or how long it may take for any one particular product to be approved. The pre-marketing approval process can be particularly expensive, uncertain and lengthy, and a number of devices, drugs and biologics for which FDA approval has been sought by other companies have never been approved for marketing. In addition to testing and approval procedures, extensive regulations also govern manufacturing, packaging, labeling, storage, distribution, record-keeping, advertising, complaint handling, and marketing procedures. If we do not comply with applicable regulatory requirements, such violations could result in

non-approval, suspensions of clinical trials, suspension or withdrawal of regulatory approvals, product recalls, civil penalties and criminal fines, product seizures, operating restrictions, injunctions, and criminal prosecution.

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Delays in, withdrawal of, or rejection by the FDA or other government entity of approval(s) of our products, including delay in the review of our Contour Profile Gel pre-market approval application ( PMA ), our PuragePlus PMA, other dermal filler PMAs, and our botulinum toxin biologics license application ( BLA ) may also adversely affect our business. Such delays, withdrawals, or rejections may be encountered due to, among other reasons, government or regulatory delays, lack of demonstrated safety or efficacy during clinical trials, safety issues, manufacturing issues, slower than expected rate of patient recruitment for clinical trials, inability to follow patients after treatment in clinical trials, inconsistencies between early clinical trial results and results obtained in later clinical trials, varying interpretations of data generated by clinical trials, adverse publicity, or changes in regulatory policy or requirements in the U.S. and abroad. In the U.S., there has been a continuing trend toward more stringent FDA requirements in the areas of product approval and enforcement, causing medical device and biologics manufacturers to experience longer research and development timelines, longer review and approval cycles, greater risk and uncertainty, and higher expenses. Internationally, there is a risk that we may not be successful in meeting the quality standards or other certification requirements. Even if regulatory approval of a product is granted, such approval may entail limitations on uses for which the product may be labeled and promoted or stringent post-marketing requirements, or may prevent us from broadening the uses of our current products for different applications. If we incur significant unanticipated expenses (for example, in connection with post-market patient monitoring and data collection activities for our MemoryGel breast implants), it could have a material adverse effect on our results of operations. In addition, to the extent permissible by law, we may not receive governmental approval to export our products in the future, and countries to which products are to be exported may not approve them for import. We may also be required to withdraw or recall our products after we receive approvals and begin commercial sales if we, the FDA or a foreign government agency determines that there is a higher than average incidence of post-treatment complications with our products as a result of subsequent clinical experience and/or data. From time to time, we are subject to inquiry by government agencies in this regard.

In addition, our competitors may have pending regulatory submissions for similar or superior products which may gain approval before our product applications, and any such approvals could have a material adverse effect on our business.

Our manufacturing facilities and the manufacturing facilities of our third-party suppliers are also subject to continual governmental review and inspection as part of the product approval process and after products are approved. The FDA has stated publicly that compliance with manufacturing regulations will be scrutinized strictly. A governmental authority may challenge our compliance with applicable federal, state and/or foreign regulations. In addition, any discovery of previously unknown problems with one of our products or facilities may result in restrictions on the product or the facility, including, but not limited to, product recalls, withdrawal of the product from the market or other enforcement actions.

From time to time, legislative or regulatory proposals are introduced that, if implemented, could alter the review and approval process relating to medical devices, combination products, biologics, or related to the sale of our products. It is possible that the FDA or other governmental authorities will issue additional regulations, which could further reduce or restrict the sales of either our presently marketed products or products under development.

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Any change in legislation or regulations that govern the review and approval process relating to our current and/or future products or restrict the manner by which we may sell our products could make it more difficult and/or costly to obtain approval for new products, and/or to produce, market, and distribute existing products.

***If we are unable to continue to develop and commercialize new technologies and products, we may experience a decrease in demand for our products, or our products could become obsolete.***

The medical device and biologics industries are highly competitive and are subject to significant and rapid technological change. We believe that our ability to develop or acquire new technologies and products is crucial to our success. We are continually engaged in product research and development, product improvement programs, and required clinical studies to develop new technologies and to maintain and improve our competitive position. Any significant delays in the above or termination or failure of our clinical trials or delays in our ability to timely respond to the FDA or other regulatory authorities inquiries, requirements and requests would materially and adversely affect our research, development, and commercialization timelines. We cannot guarantee that we will be successful in enhancing existing products or in developing or acquiring new products or technologies that will timely achieve regulatory approval or success in the marketplace.

There is also a risk that our products may not gain market acceptance among physicians, patients and the medical community generally. The degree of market acceptance of any medical device or other product that we develop will depend on a number of factors, including demonstrated clinical safety and efficacy, cost-effectiveness, potential advantages over alternative products, user/patient acceptance, and our marketing and distribution capabilities. Physicians will not recommend our products if clinical and/or other data and/or other factors do not demonstrate their safety and efficacy compared to competing products, or if our products do not best meet the needs of the individual patient. If our new products do not achieve significant market acceptance, our sales and income may not grow as much as expected, or may even decline.

***If we are unable to compete effectively with existing or new competitors, we could experience price reductions, reduced demand for our products, reduced margins and loss of market share, and our business, results of operations, and financial condition would be adversely affected.***

Our products compete with other competitive medical products manufactured by major companies and may face future competition from new products currently under development by others.

Competition in our industry occurs on a variety of levels, including but not limited to the following:

- developing and bringing new products to market before others or providing benefits superior to those of existing products;

- developing new technologies to improve existing products;

- developing new products at a lower cost to provide the same benefits as existing products at the same or lower price;

- creating or entering new markets with existing products;

- increasing or improving service-related programs;

- advertising in a manner that creates additional awareness and demand; and

- marketing and selling bundled products.

The competitive environment requires an ongoing, extensive search for technological innovations and the ability to market products effectively. Consequently, we must continue to effectively execute on various competitive levels to properly position our products in the marketplace and maintain our market share, sales and gross margins.

In particular, we face competition from Allergan, Inc., which in March 2006 acquired Inamed Corporation, our then largest competitor in the U.S. and internationally for our breast aesthetics product line. As a result of Allergan's acquisition of Inamed, we are now competing against a much larger company with a larger portfolio of aesthetic



medicine products, which may enable Allergan to compete more effectively with us. Outside the U.S., we compete with Allergan and various smaller competitors. Notwithstanding relative sizes, some of the smaller competitors have strong market positions in their home markets, which increases the challenges associated with maintaining and growing our international business. Within the U.S., we compete with Allergan, and another company has publicly stated that it will have FDA approval of competitive products in the near future.

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***If we suffer negative publicity concerning the safety of our products, our sales may be harmed and we may be forced to withdraw products.***

Physicians and potential patients may have a number of concerns about the safety of our current and former products, including our breast implants, whether or not such concerns have a basis in generally accepted science or peer-reviewed scientific research. Negative publicity, whether accurate or inaccurate, concerning our products could reduce market or governmental acceptance of our products, delay product approvals, or result in decreased product demand or product withdrawal. For example, we may be required to recall or withdraw our products if we, the FDA, or a foreign government agency determine that use of our products results in a higher-than-average rate of post-treatment complications based on clinical experience and/or data. If one foreign government agency were to request or require a withdrawal or recall of one or more of our products, the safety concerns leading to that government agency's request may be investigated by regulatory bodies in other countries, which could result in additional withdrawals or recalls as well as negative publicity regarding our products. In addition, significant negative publicity could result in an increased number of product liability claims, whether or not these claims are supported by applicable law.

***If changes in the economy and consumer spending reduce consumer demand for our products, our sales and profitability could suffer.***

Certain elective procedures, such as breast augmentation, body contouring and facial injections, which comprise the majority of our revenues, are not covered by insurance. Adverse changes in the economy or other conditions or events may have an adverse effect on consumer spending, cause consumers to reassess their spending choices, and reduce the demand for these surgeries. Any such changes, conditions or events could have an adverse effect on our sales and results of operations. In particular, uncertainties in the U.S. economy that were observed in the third fiscal quarter of 2008 may adversely affect discretionary consumer spending and may adversely affect our revenue.

***If we are unable to implement new information technology systems or upgrade existing systems, our ability to manufacture and sell products, maintain regulatory compliance, and manage and report our business activities may be impaired, delayed, or diminished, which would cause substantial business interruption and loss of sales, customers, and profits.***

We have implemented multiple information technology systems throughout our operations, including an enterprise resource planning system which is our primary business management system, and are constantly in the process of upgrading these systems to current version releases. We intend to continue to implement these systems, as appropriate, for all of our businesses worldwide. Many other companies have had severe problems with computer system implementations. With regard to all of our information technology system implementations and upgrades, we use controlled project plans, and we believe we have assigned adequate staffing and other resources to the projects to ensure its successful integration; however, there is no assurance that the system designs will meet our current and future business needs or that they will operate as designed. We are heavily dependent on such information technology systems, and any failure or delay in the system implementation or upgrades would cause a substantial interruption to our business, may create additional expense, and could adversely affect sales, customer relations and results of operations.

**Table of Contents*****If we are unable to acquire companies, businesses or technologies as part of our growth strategy or to successfully integrate past acquisitions, our growth, sales, and profitability could suffer.***

A significant portion of our historic growth has been the result of acquisitions of other companies, businesses and technologies. In October 2005, we announced our intention to refocus our business solely on aesthetic medicine and in June 2006, we sold our surgical urology and clinical and consumer healthcare businesses. This refocus consumed a significant amount of management attention and may have distracted us from pursuing acquisition opportunities in the short term. We intend to continue acquiring other businesses and technologies to facilitate our future business strategies. There can be no assurance that we will be able to identify appropriate acquisition candidates, consummate transactions, or obtain agreements with terms favorable to us. Once a business is acquired, any inability to integrate the business, failure to retain and develop its workforce, or establish and maintain appropriate communications, performance expectations, regulatory compliance procedures, accounting controls, and reporting procedures could adversely affect our future sales and results of operations.

For example, in July 2007, we completed the acquisition of Perouse Plastie SAS, a medical device company based in Bornel, France. Risks and uncertainties relating to the Perouse acquisition that may adversely affect our future sales and results of operations include that the businesses of Mentor and Perouse may not be integrated successfully, that anticipated synergies and international growth opportunities may not be fully realized or may take longer to be realized than expected and possible disruption of the Perouse business, including with customers, employees, suppliers or third parties.

***We agreed to indemnify Coloplast against specified losses in connection with Coloplast's purchase of our Urology Business, and any demands for indemnification may result in expenses we do not anticipate and distract the attention of our management from our continuing businesses. In addition, we retain responsibility for various legal liabilities related to the Urology business.***

We agreed to indemnify Coloplast against specified losses in connection with the June 2006 sale of our urology business and generally retain responsibility for various legal liabilities that accrued prior to closing. We also made representations and warranties to Coloplast about the condition of our urology business. If Coloplast makes an indemnification claim because it has suffered a loss or a third party has commenced an action against Coloplast, we may incur substantial expenses resolving Coloplast's claim or defending Coloplast and ourselves against the third party action, which would harm our operating results. In addition, our ability to defend ourselves may be impaired because our former urology business employees are now employees of Coloplast or other companies, and our management may have to devote a substantial amount of time to resolving the claim. In addition, these indemnity claims may divert management attention from aesthetics business. It may also be difficult to determine whether a claim from a third party stemmed from actions taken by us or Coloplast, and we may expend substantial resources trying to determine which party has responsibility for the claim.

***We may not realize some of the benefits of the Coloplast transaction.***

Coloplast has agreed to indemnify us for the availability of up to \$7.1 million of certain tax credits; however, we cannot be sure that we will be able to utilize those tax credits before they expire due to any number of factors including, but not limited to, changes in ownership in excess of the applicable tax rules, sufficient income in the jurisdictions in which we have the credits, and other possible reasons the tax credits might be disallowed. If the foreign tax credits are disallowed and we are not able to recover from Coloplast, we may not be able to realize the full amount, or any, of those tax credits.

***We depend upon our key personnel and our ability to attract, train, and retain employees.***

Our success depends significantly on the continued individual and collective contributions of our senior management team. Additionally, several members of our senior management team have recently joined the company. Our future success depends on our ability to hire, train, and retain skilled employees. Competition for such employees is intense. The loss of the services of any member of our senior management or the inability to hire and retain experienced management personnel could adversely affect our ability to execute our business plan and harm our operating results.



**Table of Contents*****State legislatures and taxing authorities may create new laws or change their interpretation of existing state and local tax laws that may affect future product demand or create unforeseen tax liabilities.***

If any state legislature or other government authority creates new laws to assess sales taxes on medical procedures or products determined by them to be cosmetic, our physician and patient customers may have to pay more for our products and future demand may decrease. In addition, taxing authorities may determine that our products are not eligible for exemptions and are thus taxable based on their interpretations of existing tax laws. Such taxing authorities may then determine that we owe additional taxes, penalties, and interest related to product sales from prior periods. These determinations would have a negative effect on our results of operations.

***If our intellectual property rights do not adequately protect our products or technologies, others could compete against us more directly, which would hurt our profitability.***

Our success depends in part on our ability to obtain patents or rights to patents, protect trade secrets, operate without infringing upon the proprietary rights of others, and prevent others from infringing on our patents, trademarks, and other intellectual property rights. We will be able to protect our intellectual property from unauthorized use by third parties only to the extent that it is covered by valid and enforceable patents, trademarks, or licenses. Patent protection generally involves complex legal and factual questions and, therefore, enforceability of patent rights cannot be predicted with certainty; thus, any patents that we own or license from others may not provide us with adequate protection against competitors. Moreover, the laws of certain foreign countries do not recognize intellectual property rights or protect them to the same extent as do the laws of the United States.

In addition to patents and trademarks, we rely on trade secrets and proprietary know-how. We seek protection of these rights, in part, through confidentiality and proprietary information agreements. These agreements may not provide sufficient protection or adequate remedies for violation of our rights in the event of unauthorized use or disclosure of confidential and proprietary information. Failure to protect our proprietary rights could seriously impair our competitive position.

***If third parties claim we are infringing their intellectual property rights, we could suffer significant litigation, indemnification, or licensing expenses or be prevented from marketing our products.***

Our commercial success depends significantly on our ability to operate without infringing the patents and other proprietary rights of others. However, regardless of our intent, our current or future technologies of our existing operations or those current technologies of our discontinued operations, may infringe the patents or violate other proprietary rights of third parties. In the event of such infringement or violation we may face expensive litigation, damages, or indemnification obligations and may be prevented from selling existing products and pursuing product development or commercialization.

***We depend on the continued use of our manufacturing plants and on single and sole source suppliers for certain raw materials and licensed or manufactured products, and the loss of, or disruption to, any plant or supplier could adversely affect our ability to manufacture or sell many of our products.***

Significant damage to or the loss of our manufacturing facilities could adversely affect our ability to manufacture and/or sell many of our products. In addition, we currently rely on single or sole source suppliers for raw materials used in many of our products, including silicone. The manufacturing of our products is complex and highly regulated, and any changes to our products may result in delays or disruptions of our manufacturing capacity or the manufacturing capacity of our third-party suppliers. In the event that our manufacturing plants or third-party suppliers cannot meet our requirements, we cannot guarantee that we would be able to produce enough manufactured goods or obtain a sufficient amount of quality raw materials from other suppliers in a timely manner. We also depend on third-party manufacturers and suppliers for components and licensed products. In connection with the sale of our urology business to Coloplast, we have entered into a supply agreement with Coloplast for certain components of our breast aesthetic products and Coloplast is our sole source for these components, and if we were unable to obtain the supply, our business would be harmed. We may determine that we do not want to continue to purchase products from Coloplast, or Coloplast may be unable to meet our needs in a timely manner, either of which may disrupt our business during the period we negotiate a supply agreement with and qualify the manufacturing process of a third party or begin production of the components ourselves. In addition, we depend on Genzyme for the supply of dermal filler products, Tutogen Medical, Inc. for the supply of NeoForm, a human tissue product used in breast reconstruction

procedures, and Niadyne, Inc. for the supply of NIA-24, and if we were no longer able to satisfy demand for these products through our relationships with Genzyme, Tutogen Medical and Niadyne, respectively, our business could be harmed. If there is a disruption in the supply of any of these single or sole source products, our future sales and results of operations would be adversely affected.

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***Our international business exposes us to a number of risks.***

Approximately one-third of our sales from our continuing operations are derived from international operations. Accordingly, any material decrease in foreign sales would have a material adverse effect on our overall sales and results of operations. Most of our international sales are denominated in Euros, British Pounds, Canadian dollars or U.S. dollars. Depreciation or devaluation of the local currencies of countries where we sell our products may result in our products becoming more expensive in local currency terms, thus reducing demand, which could have an adverse effect on our operating results. Our international operations and financial results may be adversely affected by other factors, including the following:

- foreign government regulation of medical products;
- product liability, intellectual property and other claims;
- new U.S. export or local market import license requirements;
- political or economic instability in our target markets;
- trade restrictions;
- changes in tax laws and tariffs;
- managing foreign distributors and manufacturers;
- managing foreign branch offices and staffing; and
- competition.

***Health care reimbursement or reform legislation could materially affect our business.***

If any domestic or international health care reform or other legislation or regulations are passed that impose limits on the amount of reimbursement for certain types of medical procedures or products, or on the number or type of medical procedures that may be performed, or that has the effect of restricting a physician's ability to select specific products for use in patient procedures, such changes could have a material adverse effect on the demand for our products. Our revenues partially depend on U.S. and foreign government health care programs and private health insurers reimbursing patients' medical expenses. Physicians, hospitals, and other health care providers may not purchase our products if they do not receive satisfactory reimbursement from these third-party payers for the cost of procedures using our products. In the U.S., there have been, and we expect that there will continue to be, a number of federal and state legislative and regulatory proposals to implement greater governmental control over the healthcare industry and its related costs. These proposals create uncertainty as to the future of our industry and may have a material adverse effect on our sales and profitability and our ability to raise capital or to form collaborations. In a number of foreign markets, the pricing and profitability of healthcare products are subject to governmental influence or control. In addition, legislation or regulations that impose restrictions on the price that may be charged for healthcare products or medical devices may adversely affect our sales and results of operations.

**Table of Contents*****If our use of hazardous materials results in contamination or injury, we could suffer significant financial loss.***

We are subject to federal, state, local and foreign environmental laws and regulations. Our manufacturing and research and development activities involve the controlled use and disposal of potentially hazardous materials, chemicals and biological materials, which require compliance with various laws and regulations regarding the use, storage, and disposal of such materials. We believe our continuing and discontinued operations comply in all material respects with applicable environmental laws and regulations in each country where we have a business presence. Although we continue to make expenditures for environmental protection, we do not anticipate any additional significant expenditures, in complying with such laws and regulations, that would have a material impact on our results of operations or competitive position. We are not aware of any pending litigation or significant financial obligations arising from current or past environmental practices that are likely to have a material adverse effect on our financial position. We cannot assure, however, that environmental claims or indemnification obligations relating to our continuing or discontinued operations or properties currently or previously owned or operated by us will not develop in the future, nor can we predict whether any such claims, if they were to develop, would require significant expenditures on our part. We cannot eliminate the risk of accidental contamination or injury from these materials. In the event of an accident or environmental discharge, we may be held liable for any resulting damages, which may exceed our financial resources and any applicable insurance coverage. In addition, we are unable to predict what legislation or regulations may be adopted or enacted in the future with respect to environmental protection and waste disposal.

In the U.S., each of our domestic manufacturing facilities is subject to regulation by the United States Environmental Protection Agency and other state and local environmental agencies. For example, in Texas, we are subject to regulation by the local Air Pollution Control District as a result of some of the chemicals used in our manufacturing processes. In our Wisconsin operations, we are also subject to regulation by the U.S. Department of Health and Human Services, Centers for Disease Control due to the nature of the biological agent used to manufacture our botulinum toxin product, *Clostridium botulinum* type A, which is still in the development phase. Prior to the June 2, 2006 Coloplast transaction, we were also subject to regulation by the United States Nuclear Regulatory Commission in our Oklahoma facility due to the manufacture and distribution of brachytherapy seeds using radioactive iodine I-125 and palladium Pd-103. We may have continuing direct liability, or through our indemnification provisions, for any violations that arose prior to the Coloplast transaction.

In Europe, each of our manufacturing facilities is subject to regulation by country-specific environmental protection agencies. For example, in Leiden, as a result of some of the chemicals and other materials used in our manufacturing processes, we are subject to regulation by Dutch law on environmental control and the Dutch emission guidelines ( NeR ) that regulate the exhaust of certain chemicals and hazardous waste regulations. In France, we are subject to regulation by the Ministry of Environment.

Failure to comply with the regulations and requirements of these various agencies could affect our ability to manufacture products and may have a significant negative impact on sales and results of operations.

***Changes in financial accounting standards may cause adverse unexpected revenue or expense fluctuations and affect our reported results of operations.***

New or recently adopted accounting standards could have a significant effect on our reported results and may even affect our reporting of transactions completed before the change is effective. New pronouncements and varying interpretations of existing pronouncements have occurred and may occur in the future. Changes to existing rules or current practices may adversely affect our reported financial results and require restatement of previously issued results for retroactive application of the new accounting standard.

***Our operating results may fluctuate substantially, and could precipitate unexpected movement in the price of our common stock and convertible notes.***

Our common stock trades on the New York Stock Exchange under the symbol MNT. On February 1, 2008, the closing price of our common stock on the New York Stock Exchange was \$32.77 per share. On December 22, 2003, we completed an offering of \$150 million of convertible subordinated notes ( notes ) due January 1, 2024 pursuant to Rule 144A under the Securities Act of 1933. The notes bear interest at 2<sup>3</sup>/<sub>4</sub>% per annum, are convertible into shares of our common stock at an adjusted conversion price of \$28.9736 per share and are subordinated to all existing and



future senior debt. The market prices of our stock and convertible securities are subject to significant fluctuations in response to the factors set forth above and other factors, many of which are beyond our control including such factors as changes in pricing policies by our competitors and the timing of significant orders and shipments.

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Such factors, as well as other economic conditions, may adversely affect the market price of our securities, including our common stock and convertible notes. There could be periods in which we experience shortfalls in revenue and/or earnings from levels expected by securities analysts and investors, which could have an immediate and significant adverse effect on the trading price of our securities, including our common stock and our convertible notes.

***Hedging transactions and other transactions may affect the value of the notes.***

In connection with the original issuance of our 2<sup>3</sup>/<sub>4</sub>% convertible subordinated notes in December 2003, we entered into convertible note hedge and warrant transactions with respect to our common stock with Credit Suisse First Boston International (an affiliate of Credit Suisse First Boston LLC), the initial purchaser of the notes, to reduce the potential dilution from conversion of the notes up to a price of our common stock (approximately \$39.0030 per share at the current warrant strike price). In connection with these hedging arrangements, Credit Suisse First Boston International and/or its affiliates has taken, and we expect will continue to take, positions in our common stock in secondary market transactions and/or will enter into various derivative transactions. Such hedging arrangements could adversely affect the market price of our common stock. In addition, the existence of the notes may encourage market participants to short sell our common stock because the conversion of the notes could depress the price of our common stock.

***Our Restated Articles of Incorporation provides our Board with the authority to issue blank check preferred stock. The issuance of blank check preferred stock could adversely affect the market price and the rights and powers, including voting rights, of our common stock, and decrease the amount of earnings and assets allocable to or available for distribution to holders of our common stock.***

Our Restated Articles of Incorporation provide for the issuance of preferred stock in one or more series, with rights, preferences, privileges and restrictions to be determined by the Board in its discretion.

The preferred stock could be or become convertible into common stock, which may be perceived as having a protective effect on our existing shareholders and having the effect of deterring unsolicited or hostile takeover attempts. The preferred stock is designed to provide our Board of Directors with the flexibility to issue such preferred stock, should they, at some time in the future, determine that such measures are necessary or desirable.

Any future issuance of preferred stock could affect our shareholders in a number of respects. If we issue preferred stock convertible into common stock or other securities that have rights, preferences and privileges senior to those of our common stock, the holders of our common stock may suffer significant dilution. In addition, the issuance of any shares of preferred stock, including preferred stock convertible into common stock, could adversely affect the market price of our common stock.

Any preferred stock issued would have priority over the common stock upon liquidation and might have priority rights as to dividends, voting and other features. Accordingly, the issuance of preferred stock could decrease the amount of earnings and assets allocable to or available for distribution to holders of common stock and adversely affect the rights and powers, including voting rights, of the common stock.

Our Board of Directors may also issue preferred stock in connection with such activities as public or private offerings of shares for cash, acquisitions of other companies and other financing opportunities. We do not have any current plans, commitments, arrangements or agreements, written or otherwise, to issue or designate any of the blank check preferred stock to be authorized by the amendment.

Our Board of Directors may also choose to consider adopting a shareholder rights plan, or poison pill, as an anti-takeover defense at some future point. Shareholder rights plans involve the issuance to common shareholders of a right to purchase shares of convertible preferred stock under certain circumstances. In order to implement such a plan, the Board of Directors must have the ability to create and issue a class of preferred stock with certain terms and we must also have available sufficient shares of common stock to effect the conversion. A future issuance of blank check preferred stock and/or the subsequent adoption of a shareholder rights plan (which would then be possible) could prevent or deter the acquisition by a third party, especially if the transaction was not previously approved by our Board of Directors. Our shareholders will be solely reliant upon the business judgment of our Board of Directors regarding the various terms and conditions which may be ascribed to any series of preferred stock created in the future. Moreover, the ability to designate and issue new series of blank check preferred stock without additional shareholder action or vote deprives shareholders of notice that such actions are being considered and of providing input in the process.



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**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds**

**Issuer Purchases of Equity Securities**

Our Board of Directors has authorized a stock repurchase program, primarily to reduce the overall number of shares outstanding and to offset the dilutive effects of our employee stock option plans and dilution related to our convertible notes from the inclusion of contingently convertible debt in fully diluted earnings per share calculations. All shares repurchased under the program are retired and are no longer deemed to be outstanding. The timing of repurchases is subject to market conditions, cash availability and the terms of our 10b5-1 stock purchase plans, if any. There is no guarantee that shares authorized for repurchase by the Board will ultimately be repurchased.

On June 16, 2006 we entered into a stock purchase plan with Citigroup Global Markets Inc. for the purpose of repurchasing up to 5 million shares of our common stock, up to a cumulative purchase price of \$166 million, under a Rule 10b5-1 Plan (the "10b5 Plan") compliant with Rule 10b-18. In connection with the entry into the 10b5 Plan, our Board of Directors increased the authorized number of shares available for repurchase pursuant to our stock repurchase program from 3.3 million to 5 million shares. We repurchased 4.1 million shares of our common stock for a total purchase price of \$166 million, and this 10b5 Plan terminated on June 15, 2007.

On June 18, 2007 we entered into a second stock purchase plan ("2007 10b5 Plan") with Citigroup Global Markets Inc. for the purpose of repurchasing our common stock, up to a cumulative purchase price of \$200 million, under another Rule 10b5-1 Plan compliant with Rule 10b-18. In connection with the entry into the 2007 10b5 Plan, our Board of Directors increased the authorized number of shares available for repurchase pursuant to our stock repurchase program by 5 million shares. We have repurchased 4.8 million shares of our common stock under the 2007 10b5 Plan for a total purchase price of \$200 million. Although 0.8 million shares remain authorized as of February 1, 2008, authorized funding for the 2007 10b5 Plan has been exhausted. The 2007 10b5 Plan terminates on June 17, 2008. The repurchase program may be suspended or discontinued at any time.

During the three months ended December 31, 2007 the Company repurchased 0.3 million shares of its common stock for a total purchase price of \$9.9 million and 8,000 shares for the payment of withholding taxes related to the lapsing of restrictions on certain outstanding restricted stock grants. These purchases were not made under any 10b5-1 Plan.

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The table below sets forth certain share repurchase information for the quarter ended December 31, 2007.

**ISSUER PURCHASES OF EQUITY SECURITIES** <sup>(1) (2) (3)</sup>

(in thousands except per share amounts)		Total Number of Shares Purchased	Average Price Paid per Share \$	Total Number of Shares Purchased as Part of Publicly Announced Plans	Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs
October 1	October 31, 2007				1,074
November 1	November 30, 2007	263 <sup>(4)</sup>	40.47	263	811
December 1	December 31, 2007				811
Total		263	\$ 40.47	263	811

(1) During the period, no shares were purchased under the 2007 10b5 Plan.

(2) In the first quarter of fiscal 1996, our Board of Directors authorized an ongoing stock repurchase program. The initial authorization was for the repurchase of up to one million shares. Subsequently, the Board of Directors has authorized the repurchase of an additional 31.0 million shares, including 5.0 million, 1.7 million and 5.0 million shares in

June 2007,  
June 2006 and  
March 2006,  
respectively.  
These share  
amounts have  
been adjusted for  
the two-for-one  
stock split  
affected  
December 2002.

- (3) We have not set a date for the stock repurchase program to expire.
- (4) Balance includes approximately 8,000 shares repurchased for payment of withholding taxes upon the vesting of certain restricted stock grants.

**Item 3. Defaults Upon Senior Securities**

None.

**Item 4. Submission of Matters to a Vote of Security Holders**

None.

**Item 5. Other Information**

None.

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**Item 6. Exhibits**

- 3.1 Composite Restated Articles of Incorporation of Mentor Corporation dated December 12, 2002 Incorporated by reference to Exhibit 3.1 of the Annual Report on Form 10-K for the year ended March 31, 2003.
- 3.2 Articles of Amendment to Restated Articles of Incorporation of Mentor Corporation Incorporated by reference to Exhibit 3.1 of the Registrant's Current Report on Form 8-K filed on October 3, 2007.
- 3.3 Amended and Restated Bylaws of Mentor Corporation dated September 17, 2007 Incorporated by reference to Exhibit 3.2 of the Registrant's Current Report on Form 8-K filed on September 21, 2007.
- 4.1 Indenture 2 3/4 % Convertible Subordinated Notes Due 2024, dated December 22, 2003 Incorporated by reference to Exhibit 4.1 of the Registrant's Quarterly Report on Form 10-Q for the quarter ended December 31, 2003.
- 10.1\* Mentor Corporation 1991 Long-Term Incentive Plan as amended and restated as of September 17, 2007.
- 10.2\* Mentor Corporation 2005 Long-Term Incentive Plan as amended and restated as of September 17, 2007.
- 10.3\* Separation and Release Agreement dated October 27, 2007, between Mentor Corporation and Loren L. McFarland Incorporated by reference to Exhibit 10.1 of the Registrant's Current Report on Form 8-K filed on October 30, 2007.
- 10.4\* Consulting Agreement dated October 27, 2007, between Mentor Corporation and Loren L. McFarland Incorporated by reference to Exhibit 10.2 of the Registrant's Current Report on Form 8-K filed on October 30, 2007.
- 10.5\* Form of Indemnity Agreement between Mentor Corporation and Michael O Neill Incorporated by reference to Exhibit 10.1 of the Registrant's Current Report on Form 8-K filed on November 13, 2007.
- 10.6\* Employment Agreement, dated November 13, 2007, between Mentor Corporation and Michael O Neill Incorporated by reference to Exhibit 10.2 of the Registrant's Current Report on Form 8-K filed on November 13, 2007.
- 10.7\* Amended and Restated Employment Agreement with Joshua Levine dated as of December 21, 2007.
- 10.8\* Amended and Restated Employment Agreement with Michael O Neill dated as of December 21, 2007.
- 10.9\* Amended and Restated Employment Agreement with Joseph A. Newcomb dated as of December 21, 2007.
- 10.10\* Amended and Restated Employment Agreement with Edward S. Northup dated as of December 21, 2007.
- 31.1 Certification of Principal Executive Officer Pursuant To Section 302 of The Sarbanes-Oxley Act of 2002.
- 31.2 Certification of Principal Financial Officer Pursuant To Section 302 of The Sarbanes-Oxley Act of 2002.
- 32.1 CEO Certification Pursuant To 18 U.S.C. Section 1350, As Adopted Pursuant To Section 906 of The Sarbanes-Oxley Act of 2002.

32.2 CFO Certification Pursuant To 18 U.S.C. Section 1350, As Adopted Pursuant To Section 906 of The Sarbanes-Oxley Act of 2002.

\* Management contract or compensatory plan or arrangement.



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**SIGNATURES**

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.

**MENTOR CORPORATION**

(Registrant)

**MENTOR CORPORATION**

DATE: February 6, 2008

/s/ JOSHUA H. LEVINE  
Joshua H. Levine  
President and Chief Executive Officer  
*(Principal Executive Officer)*

DATE: February 6, 2008

/s/ MICHAEL O NEILL  
Michael O Neill  
Vice President, Chief Financial Officer and Treasurer  
*(Principal Financial Officer)*

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\* Management  
contract or  
compensatory  
plan or  
arrangement.