

Edgar Filing: PARADIGM MEDICAL INDUSTRIES INC - Form 10QSB

PARADIGM MEDICAL INDUSTRIES INC
Form 10QSB
May 22, 2006

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

FORM 10-QSB

QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE
SECURITIES EXCHANGE ACT OF 1934

For Quarter Ended March 31, 2006

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

For the Transition Period >From ___ to

Commission File Number: 0-28498

PARADIGM MEDICAL INDUSTRIES, INC.
(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of
incorporation or organization)

87-0459536
(I.R.S. Employer
Identification No.)

2355 South 1070 West, Salt Lake City, Utah
(Address of principal executive office)

84119
(Zip Code)

Registrant's telephone number, including area code: (801) 977-8970

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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Securities Exchange Act of 1934). Yes No

State the number of shares outstanding of each of the registrant's classes of common equity, as of the latest practicable date:

Common Stock, \$.001 par value	175,959,428

Title of Class	Number of Shares Outstanding as of May 19, 2006
Class A Warrant to Purchase One Share of Common Stock	1,000,000

Title of Class	Number of Warrants Outstanding as of May 19, 2006

Edgar Filing: PARADIGM MEDICAL INDUSTRIES INC - Form 10QSB

PARADIGM MEDICAL INDUSTRIES, INC.
FORM 10-QSB

FOR THE QUARTER ENDED MARCH 31, 2006

INDEX

PART I - FINANCIAL INFORMATION

Item 1. Financial Statements.....	1
Condensed Balance Sheet (unaudited) - March 31, 2006.....	1
Condensed Statements of Operations (unaudited) for the three months ended March 31, 2006 and March 31, 2005.....	2
Condensed Statements of Cash Flows (unaudited) for the three months ended March 31, 2006 and March 31, 2005	3
Notes to Condensed Financial Statements (unaudited).....	4
Item 2. Management's Discussion and Analysis or Plan of Operation	12
Item 3. Controls and Procedures	17

PART II - OTHER INFORMATION

Item 1. Legal Proceedings.....	17
Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.....	19
Item 3. Defaults Upon Senior Securities.....	22
Item 4. Submission of Matters to a Vote of Security Holders.....	22
Item 5. Other Information.....	22
Item 6. Exhibits and Reports on Form 8-K.....	22
Signature Page	25

ii

PARADIGM MEDICAL INDUSTRIES, INC.
CONDENSED BALANCE SHEET
(UNAUDITED)

	March 31, 2006

ASSETS	
Current Assets	
Cash and Cash Equivalents	\$ 400,000
Receivables, Net	319,000
Inventory	820,000
Prepaid Expenses	61,000

Total Current Assets	1,600,000

Edgar Filing: PARADIGM MEDICAL INDUSTRIES INC - Form 10QSB

Intangibles, Net	339,000
Property and Equipment, Net	21,000

Total Assets	\$ 1,960,000
--------------	--------------

LIABILITIES AND STOCKHOLDERS' EQUITY

Current Liabilities:

Trade Accounts Payable	\$ 432,000
Accrued Expenses	732,000
Current Portion of Long-term Debt	5,000

Total Current Liabilities	1,169,000
---------------------------	-----------

Convertible Notes Payable	2,343,000
---------------------------	-----------

Total Long-term Liabilities	2,343,000
-----------------------------	-----------

Total Liabilities	3,512,000
-------------------	-----------

Stockholders' Equity:

Preferred Stock, Authorized:

5,000,000 shares, \$.001 par value

Series A

Authorized: 500,000 shares; issued and outstanding: 5,627 shares at March 31, 2006	-
---	---

Series B

Authorized: 500,000 shares; issued and outstanding: 8,986 shares at March 31, 2006	-
---	---

Series C

Authorized: 30,000 shares; issued and outstanding: zero shares at March 31, 2006	-
---	---

Series D

Authorized: 1,140,000 shares; issued and outstanding: 5,000 shares at March 31, 2006	-
---	---

Series E

Authorized: 50,000 shares; issued and outstanding: 250 shares at March 31, 2006	-
--	---

Series F

Authorized: 50,000 shares; issued and outstanding: 4,598.75 shares at March 31, 2006	-
---	---

Series G

Authorized: 2,000,000 shares; issued and outstanding: 588,235 shares at March 31, 2006	1,000
---	-------

Common Stock, Authorized:

250,000,000 shares, \$.001 par value; issued and

outstanding: 160,800,324 at March 31, 2006	161,000
--	---------

Additional Paid-in-capital	61,238,000
----------------------------	------------

Accumulated Deficit	(62,952,000)
---------------------	--------------

Total Stockholders' Equity	(1,552,000)
----------------------------	-------------

Total Liabilities and Stockholders' Equity	\$ 1,960,000
--	--------------

The accompanying notes are an integral part to these condensed financial statements

Edgar Filing: PARADIGM MEDICAL INDUSTRIES INC - Form 10QSB

1

PARADIGM MEDICAL INDUSTRIES, INC.
 CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
 (UNAUDITED)

	Three Months Ended March 31,	
	2006	2005
	-----	-----
Sales	\$ 463,000	\$ 528,000
Cost of Sales	222,000	214,000
	-----	-----
Gross Profit	241,000	314,000
Operating Expenses:		
General and Administrative	250,000	258,000
Marketing and Selling	78,000	180,000
Research, development and service	124,000	210,000
	-----	-----
Total Operating Expenses	452,000	648,000
	-----	-----
Operating Income (Loss)	(211,000)	(334,000)
	-----	-----
Other Income and (Expense):		
Other Income	2,000	15,000
Other Expense	(3,000)	-
Interest Expense	(544,000)	(4,000)
	-----	-----
Total Other Income (Expense)	(545,000)	11,000
Net Income (Loss) Before Provision for Income Taxes	(756,000)	(323,000)
Provision for Income Taxes	-	-
	-----	-----
Net Income (Loss)	\$ (756,000)	\$ (323,000)
	-----	-----
Earnings (loss) Per Common Share - Basic	\$ (0.01)	\$ (0.01)
	-----	-----
Earnings (loss) Per Common Share - Diluted	\$ (0.01)	\$ (0.01)
	-----	-----
Weighted Average Common Share - Basic	124,647,000	27,121,000
	-----	-----
Weighted Average Common Share - Diluted	124,647,000	27,121,000
	-----	-----

The accompanying notes are an integral part to these condensed financial statements

2

Edgar Filing: PARADIGM MEDICAL INDUSTRIES INC - Form 10QSB

PARADIGM MEDICAL INDUSTRIES, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)

	Three Months Ended March 31 2006	2005
	-----	-----
Cash Flows from Operating Activities:		

Net Loss	\$ (756,000)	\$ (323,000)
Adjustment to Reconcile Net Loss to Net Cash Used In Operating Activities:		
Depreciation and Amortization	16,000	23,000
Stock Option Valuation	23,000	52,000
Beneficial Conversion Interest	482,000	
Issuance of Stock Options and Warrants for Services	18,000	
Provision for Losses on Receivables	1,000	(7,000)
Provision for Losses on Inventory	25,000	
(Increase) Decrease from Changes in:		
Accounts Receivable	80,000	129,000
Inventories	8,000	(25,000)
Prepaid and Other Expenses	(50,000)	22,000
Increase (Decrease) from Changes in:		
Trade Accounts Payable	(27,000)	(7,000)
Accrued Liabilities	28,000	(61,000)
	-----	-----
Net Cash Used in Operating Activities	(152,000)	(197,000)
	-----	-----
Cash Flow from Investing Activities:		

Acquisition of Property and Equipment	(5,000)	
	-----	-----
Net Cash Provided by (Used in) Investing Activities	(5,000)	
	-----	-----
Cash Flows from Financing Activities:		

Principal Payments on Notes Payable and Long-term Debt	(9,000)	(14,000)
Proceeds from Issuance of Common Stock	-	150,000
Proceeds from Issuance of Convertible Notes	500,000	
	-----	-----
Net Cash (Used) Provided by Financing Activities	491,000	(136,000)
	-----	-----
Net Change in Cash	334,000	(61,000)
Cash, Beginning of Period	66,000	131,000
	-----	-----
Cash, End of Period	\$ 400,000	\$ 70,000
	-----	-----

Supplemental Disclosure of Cash Flow Information:

Edgar Filing: PARADIGM MEDICAL INDUSTRIES INC - Form 10QSB

Cash Paid for Interest	\$	1,000	\$	4
	-----		-----	
Cash Paid for Income Taxes	\$	-	\$	
	-----		-----	

The accompanying notes are an integral part to these condensed financial statements

3

PARADIGM MEDICAL INDUSTRIES, INC. NOTES TO FINANCIAL STATEMENTS (UNAUDITED)

Significant Accounting Policies

The accompanying condensed financial statements of the Company have been prepared by the Company, without audit, pursuant to the rules and regulations of the Securities and Exchange Commission. Certain information and disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States have been condensed or omitted pursuant to such rules and regulations. These condensed financial statements reflect all adjustments (consisting only of normal recurring adjustments) that, in the opinion of management, are necessary to present fairly the results of operations of the Company for the periods presented. These condensed financial statements should be read in conjunction with the financial statements and the notes thereto included in the Company's Form 10-KSB for the year ended December 31, 2005. The results of operations for the three months ended March 31, 2006, are not necessarily indicative of the results that may be expected for the fiscal year ending December 31, 2006.

Going Concern

The accompanying financial statements have been prepared on a going concern basis, which contemplates the realization of assets and the satisfaction of liabilities in the normal course of business. Historically, the Company has not demonstrated the ability to generate sufficient cash flows from operations to satisfy its liabilities and sustain operations, and the Company has incurred significant losses. These factors raise substantial doubt about the Company's ability to continue as a going concern.

The Company's continuation as a going concern is dependent on its ability to generate sufficient income and cash flow to meet its obligations on a timely basis and/or obtain additional financing as may be required. The Company is actively seeking options to obtain additional capital and financing.

In addition, the Company has taken significant steps to reduce costs and increase operating efficiencies. Specifically, the Company has significantly reduced the use of consultants, which has resulted in a large decrease in expenses. In addition, the Company has reduced the number of its direct sales representatives, which has resulted in less payroll, travel and other expenses. Although these cost savings have significantly reduced the Company's losses and ongoing cash flow needs, if the Company is unable to obtain equity or debt financing, it may be unable to continue development of its products and may be

Edgar Filing: PARADIGM MEDICAL INDUSTRIES INC - Form 10QSB

required to substantially curtail or cease operations.

Net Loss Per Share

Net loss per common share is computed on the weighted average number of common and common equivalent shares outstanding during each period. Common stock equivalents consist of convertible preferred stock, common stock options and warrants. Common equivalent shares are excluded from the computation when their effect is anti-dilutive. Other common stock equivalents consisting of options and warrants to purchase 30,164,690 and 8,760,000 shares of common stock and preferred stock convertible into 909,000 and 2,047,000 shares of common stock at March 31, 2006 and 2005, respectively, have not been included in loss periods because they are anti-dilutive.

For the three months ended March 31, 2006, the options and warrants to purchase 30,164,690 shares of common stock were excluded because of the treasury stock method.

The following table is a reconciliation of the net loss numerator of basic and diluted net loss per common share for the three and nine month periods ended March 31, 2006 and March 31, 2005:

4

	Three Months Ended March 31,	
	2006	2005
	-----	-----
Basic weighted average shares outstanding	124,647,000	27,121,000
Common stock equivalents - convertible preferred stock	909,000	2,047,000
	-----	-----
Diluted weighted average shares outstanding	125,556,000	29,168,000
	-----	-----

Convertible Notes

To obtain funding for the Company's ongoing operations, the Company entered into a securities purchase agreement with four accredited investors on April 27, 2005 for the sale of (i) \$2,500,000 in callable secured convertible notes and (ii) warrants to purchase 16,534,392 shares of its common stock. The sale of the callable secured convertible notes and warrants is to occur in three tranches and the investors are obligated to provide the Company with an aggregate of \$2,500,000 as follows:

- o \$850,000 was disbursed on April 27, 2005;
- o \$800,000 was disbursed on June 23, 2005 after the Company filed a registration statement that registered the shares of common stock underlying the callable secured convertible notes and the warrants; and
- o \$850,000 was disbursed on June 30, 2005, the effective date of the registration statement that registered the shares of common stock underlying the callable secured convertible notes and the warrants.

Each closing under the securities purchase agreement was subject to the following conditions:

Edgar Filing: PARADIGM MEDICAL INDUSTRIES INC - Form 10QSB

- o The Company delivered to the investors duly executed callable secured convertible notes and warrants;
- o No litigation, statute, regulation or order had been commenced, enacted or entered by or in any court, governmental authority or any self-regulatory organization that prohibits consummation of the transactions contemplated by the securities purchase agreement; and
- o No event occurred that could reasonably be expected to have a material adverse effect on the Company's business.

The Company also agreed not, without the prior written consent of a majority-in-interest of the investors, to negotiate or contract with any party to obtain additional equity financing (including debt financing with an equity component) that involves (i) the issuance of common stock at a discount to the market price of the common stock on the date of issuance (taking into account the value of any warrants or options to acquire common stock in connection therewith), (ii) the issuance of convertible securities that are convertible into an indeterminate number of shares of common stock, or (iii) the issuance of warrants during the lock-up period beginning April 27, 2005 and ending on the later of (a) 270 days from April 27, 2005, or (b) 180 days from the date the registration statement is declared effective.

In addition, the Company agreed not to conduct any equity financing (including debt financing with an equity component) during the period beginning April 27, 2005 and ending two years after the end of the above lock-up period unless it first provided each investor an option to purchase its pro-rata share (based on the ratio of each investor's purchase under the Securities Purchase Agreement) of the securities being offered in any proposed equity financing. Each investor must be provided written notice describing any proposed equity financing at least 20 business days prior to the closing of such proposed equity financing and the option must be extended to each investor during the 15-day period following delivery of such notice.

The callable secured convertible notes bear interest at 8% per annum from the date of issuance. Interest is computed on the basis of a 365-day year and is payable quarterly in cash, with six months of interest payable up front. The interest rate resets to zero percent for any month in which the stock price is greater than 125% of the initial market price, or \$.0945, for each trading day during that month. Any amount of principal or interest on the callable secured convertible notes that is not paid when due will bear interest at the rate of 15% per annum from the date due thereof until such amount is paid. The callable secured convertible notes mature in three years from the date of issuance, and are convertible into our common stock at the selling stockholders' option, at the lower of (i) \$.09 or (ii) 60% of the average of the three lowest intraday trading prices for the common stock on the OTC Bulletin Board for the 20 trading days before but not including the conversion date. Accordingly, there is no limit on the number of shares into which the notes may be converted.

The callable secured convertible notes are secured by the Company's assets, including the Company's inventory, accounts receivable and intellectual property. Moreover, the Company has a call option under the terms of the notes. The call option provides the Company with the right to prepay all of the outstanding callable secured convertible notes at any time, provided there is no event of default by the Company and the Company's stock is trading at or below \$.09 per share. An event of default includes the failure by the Company to pay the principal or interest on the callable secured convertible notes when due or to timely file a registration statement as required by the Company or obtain effectiveness with the Securities and Exchange Commission of the registration

Edgar Filing: PARADIGM MEDICAL INDUSTRIES INC - Form 10QSB

statement. Prepayment of the callable secured convertible notes is to be made in cash equal to either (a) 125% of the outstanding principal and accrued interest for prepayments occurring within 30 days following the issue date of the notes; (b) 130% of the outstanding principal and accrued interest for prepayments occurring between 31 and 60 days following the issue date of the notes; or (c) 145% of the outstanding principal and accrued interest for prepayments occurring after the 60th day following the issue date of the notes.

The warrants are exercisable until five years from the date of issuance at a purchase price of \$.20 per share. The investors may exercise the warrants on a cashless basis if the shares of common stock underlying the warrants are not then registered pursuant to an effective registration statement. In the event the investors exercise the warrants on a cashless basis, then the Company will not receive any proceeds therefrom. In addition, the exercise price of the warrants will be adjusted in the event the Company issues common stock at a price below market, with the exception of any securities issued as of the date of the warrants or issued in connection with the callable secured convertible notes issued pursuant to the Securities Purchase Agreement.

The selling stockholders have agreed to restrict their ability to convert their callable secured convertible notes or exercise their warrants and receive shares of our common stock such that the number of shares of common stock held by them in the aggregate and their affiliates after such conversion or exercise does not exceed 4.99% of the then issued and outstanding shares of common stock. However, the selling stockholders may repeatedly sell shares of common stock in order to reduce their ownership percentage, and subsequently convert additional callable secured convertible notes.

The Company is required to register the shares of its common stock issuable upon the conversion of the callable secured convertible notes and the exercise of the warrants. The registration statement must be filed with the Securities and Exchange Commission within 60 days of the April 27, 2005 closing date and the effectiveness of the registration is to be within 135 days of such closing date. Penalties of 2% of the outstanding principal balance of the callable secured convertible notes plus accrued interest are to be applied for each month the registration is not effective within the required time. The penalty may be paid in cash or stock at our option. The Company filed a registration statement with the Securities and Exchange Commission on June 22, 2005 to register the shares of common stock issuable upon the conversion of the callable secured convertible notes and the exercise of the warrants. The registration statement was declared effective on June 29, 2005.

As of June 30, 2005, the average of the three lowest intraday trading prices of the Company's common stock during the preceding 20 trading days as reported on the OTC Bulletin Board was \$.05 and, therefore, the conversion price for the \$2,500,000 in callable secured convertible notes was \$.03. Based on this conversion price, the \$2,500,000 in callable secured convertible notes, excluding interest, were convertible into 83,333,333 shares of the Company's common stock. As of June 30, 2005, none of the callable secured convertible notes had been converted.

Since June 30, 2005, a total of \$657,250 in callable secured convertible notes have been converted into 131,251,200 shares of the Company's common stock pursuant to conversion notices from The NIR Group. The dates of these conversion notices, the amount of the notes converted, the conversion price of the notes converted, and the shares issued to the noteholders upon conversion were as follows:

Date of Notice	Amount of Notes	Conversion Price	Shares Issued to Noteholders
----------------	-----------------	------------------	---------------------------------

Edgar Filing: PARADIGM MEDICAL INDUSTRIES INC - Form 10QSB

of Conversion	Converted	of Notes	Upon Conversion
-----	-----	-----	-----
July 7, 2005	39,900	.0285	1,400,000
July 14, 2005	40,460	.0289	1,400,000
July 20, 2005	32,110	.0247	1,300,000
July 26, 2005	29,682	.0194	1,530,000
July 29, 2005	28,458	.0186	1,530,000
August 8, 2005	22,032	.0144	1,530,000
August 16, 2005	25,480	.014	1,820,000
August 22, 2005	22,386	.0123	1,820,000
August 26, 2005	16,898	.0119	1,420,000
August 27, 2005	4,760	.0119	400,000
September 2, 2005	20,600	.0103	2,000,000
September 12, 2005	16,380	.00819	2,000,000
September 16, 2005	13,800	.0069	2,000,000
September 22, 2005	11,580	.00579	2,000,000
September 28, 2005	11,628	.0051	2,280,000
October 3, 2005	7,157	.003139	2,280,000
October 10, 2005	7,157	.003139	2,280,000
October 12, 2005	6,840	.003	2,280,000
October 19, 2005	8,430	.003	2,810,000
October 25, 2005	8,430	.003	2,810,000
October 31, 2005	8,795	.00313	2,810,000
November 3, 2005	8,599	.00306	2,810,000
November 11, 2005	9,947	.00354	2,810,000
November 15, 2005	11,187	.0033	3,390,000
November 21, 2005	10,814	.00319	3,390,000
December 7, 2005	9,661	.00285	3,390,000
December 13, 2005	9,187	.00271	3,390,000
December 22, 2005	9,840	.00246	4,000,000
December 29, 2005	9,360	.00234	4,000,000
January 5, 2006	8,640	.00216	4,000,000
January 11, 2006	8,476	.002119	4,000,000
January 18, 2006	8,476	.002119	4,000,000
January 24, 2006	8,476	.002119	4,000,000
January 27, 2006	8,556	.002139	4,000,000
February 13, 2006	6,578	.0012	5,481,600
February 21, 2006	6,682	.001219	5,481,600
February 23, 2006	6,907	.00126	5,481,600
February 28, 2006	8,984	.001639	5,481,600
March 7, 2006	15,513	.00283	5,481,600
March 15, 2006	30,971	.00565	5,481,600
March 20, 2006	30,093	.00549	5,481,430
March 27, 2006	24,120	.00804	3,000,000
March 31, 2006	23,220	.00774	3,000,000
	-----		-----
Total	\$ 657,250		131,251,200

To obtain additional funding for the Company's ongoing operations, the Company entered into a second securities purchase agreement on February 28, 2006 with the same four accredited investors for the sale of (i) \$1,500,000 in callable secured convertible notes and (ii) warrants to purchase 12,000,000 shares of its common stock. The sale of the callable secured convertible notes and warrants is to occur in three tranches and the investors are obligated to provide the Company with an aggregate of \$1,500,000 as follows:

- o \$500,000 was disbursed on February 28, 2006;
- o \$500,000 will be disbursed after the Company files a registration

Edgar Filing: PARADIGM MEDICAL INDUSTRIES INC - Form 10QSB

- statement that registers the shares of common stock underlying the callable secured convertible notes and the warrants; and
- o \$500,000 will be disbursed upon the effectiveness of the registration statement the Company intends to file that registers the shares of common stock underlying the callable secured convertible notes and the warrants.

Each closing under the securities purchase agreement is subject to the following conditions:

- o The Company delivers to the investors duly executed callable secured convertible notes and warrants;
- o No litigation, statute, regulation or order had been commenced, enacted or entered by or in any court, governmental authority or any self-regulatory organization that prohibits consummation of the transactions contemplated by the securities purchase agreement; and
- o No event occurred that could reasonably be expected to have a material adverse effect on the Company's business.

The Company also agreed not, without the prior written consent of a majority-in-interest of the investors, to negotiate or contract with any party to obtain additional equity financing (including debt financing with an equity component) that involves (i) the issuance of common stock at a discount to the market price of the common stock on the date of issuance (taking into account the value of any warrants or options to acquire common stock in connection therewith), (ii) the issuance of convertible securities that are convertible into an indeterminate number of shares of common stock, or (iii) the issuance of warrants during the lock-up period beginning February 28, 2006 and ending on the later of (a) 270 days from February 28, 2006, or (b) 180 days from the date the registration statement is declared effective.

In addition, the Company agreed not to conduct any equity financing (including debt financing with an equity component) during the period beginning February 28, 2006 and ending two years after the end of the above lock-up period unless it first provided each investor an option to purchase its pro-rata share (based on the ratio of each investor's purchase under the Securities Purchase Agreement) of the securities being offered in any proposed equity financing. Each investor must be provided written notice describing any proposed equity financing at least 20 business days prior to the closing of such proposed equity financing and the option must be extended to each investor during the 15-day period following delivery of such notice.

The callable secured convertible notes bear interest at 8% per annum from the date of issuance. Interest is computed on the basis of a 365-day year and is payable quarterly in cash, with six months of interest payable up front. The interest rate resets to zero percent for any month in which the stock price is greater than 125% of the initial market price, or \$.0275, for each trading day during that month. Any amount of principal or interest on the callable secured convertible notes that is not paid when due will bear interest at the rate of 15% per annum from the date due thereof until such amount is paid. The callable secured convertible notes mature in three years from the date of issuance, and are convertible into our common stock at the selling stockholders' option, at the lower of (i) \$.02 or (ii) 60% of the average of the three lowest intraday trading prices for the common stock on the OTC Bulletin Board for the 20 trading days before but not including the conversion date. Accordingly, there is no limit on the number of shares into which the notes may be converted.

The callable secured convertible notes are secured by the Company's assets, including the Company's inventory, accounts receivable and intellectual property. Moreover, the Company has a call option under the terms of the notes. The call option provides the Company with the right to prepay all of the

Edgar Filing: PARADIGM MEDICAL INDUSTRIES INC - Form 10QSB

outstanding callable secured convertible notes at any time, provided there is no event of default by the Company and the Company's stock is trading at or below \$.02 per share. An event of default includes the failure by the Company to pay the principal or interest on the callable secured convertible notes when due or to timely file a registration statement as required by the Company or obtain effectiveness with the Securities and Exchange Commission of the registration statement. Prepayment of the callable secured convertible notes is to be made in cash equal to either (a) 125% of the outstanding principal and accrued interest for prepayments occurring within 30 days following the issue date of the notes; (b) 130% of the outstanding principal and accrued interest for prepayments occurring between 31 and 60 days following the issue date of the notes; or (c) 145% of the outstanding principal and accrued interest for prepayments occurring after the 60th day following the issue date of the notes.

The warrants are exercisable until five years from the date of issuance at a purchase price of \$.10 per share. The investors may exercise the warrants on a cashless basis if the shares of common stock underlying the warrants are not then registered pursuant to an effective registration statement. In the event the investors exercise the warrants on a cashless basis, then the Company will not receive any proceeds therefrom. In addition, the exercise price of the

8

warrants will be adjusted in the event the Company issues common stock at a price below market, with the exception of any securities issued as of the date of the warrants or issued in connection with the callable secured convertible notes issued pursuant to the securities purchase agreement.

The noteholders have agreed to restrict their ability to convert their callable secured convertible notes or exercise their warrants and receive shares of our common stock such that the number of shares of common stock held by them in the aggregate and their affiliates after such conversion or exercise does not exceed 4.99% of the then issued and outstanding shares of common stock. However, the selling stockholders may repeatedly sell shares of common stock in order to reduce their ownership percentage, and subsequently convert additional callable secured convertible notes.

The Company is required to register the shares of its common stock issuable upon the conversion of the callable secured convertible notes and the exercise of the warrants. The registration statement must be filed with the Securities and Exchange Commission within 60 days of the February 28, 2006 closing date and the effectiveness of the registration is to be within 135 days of such closing date. Penalties of 2% of the outstanding principal balance of the callable secured convertible notes plus accrued interest are to be applied for each month the registration is not effective within the required time. The penalty may be paid in cash or stock at our option.

As of March 31, 2006, the Company had 160,959,424 shares of its common stock issued and outstanding and \$2,342,750 in callable secured convertible notes outstanding that may be converted into an estimated 390,000,000 shares of common stock at current market prices, and outstanding warrants to purchase 20,534,392 shares of its common stock. Additionally, the Company has an obligation to sell \$1,000,000 in callable secured convertible notes that may be converted into an estimated 167,000,000 shares of common stock at current market prices and issue warrants to purchase 8,000,000 shares of common stock in the near future. Furthermore, the number of shares of common stock issuable upon conversion of the outstanding callable secured convertible notes may increase if the market price of the Company's common stock declines. All the shares, including all of the shares issuable upon conversion of the notes and upon exercise of the warrants, may be sold without restriction. The sale of these shares may depress the market price of the Company's common stock.

Edgar Filing: PARADIGM MEDICAL INDUSTRIES INC - Form 10QSB

The Company's obligation to issue shares upon conversion of the callable secured convertible notes is essentially limitless. The following is an example of the amount of shares of common stock that are issuable upon conversion of \$3,342,750 principal amount of callable secured convertible notes (excluding accrued interest), based on market prices 25%, 50%, and 75% below the market price, as of May 9, 2006 of \$.0099.

% Below Market -----	Price Per Share -----	With 40% Discount -----	Number of Shares Issuable -----	% of Outstanding* -----
25%	\$.0075	\$.0045	742,833,333	461.5%
50%	\$.0050	\$.0030	1,114,250,000	692.3%
75%	\$.0025	\$.0015	2,228,500,000	1,384.5%

*Based on 160,959,424 shares outstanding.

As illustrated, the number of shares of common stock issuable upon conversion of the Company's callable secured convertible notes will increase if the market price of the Company's common stock declines, which will cause dilution to existing stockholders.

The callable secured convertible notes are convertible into shares of the Company's common stock at a 40% discount to the trading price of the common stock prior to the conversion. The significant downward pressure on the price of the common stock as the noteholders convert and sell material amounts of common stock could encourage short sales by investors. This could place further downward pressure on the price of the common stock. The noteholders could sell common stock into the market in anticipation of covering the short sale by converting their securities, which could cause the further downward pressure on the stock price. In addition, not only the sale of shares issued upon conversion or exercise of notes, warrants and options, but also the mere perception that these sales could occur, may have a depressive effect on the market price of the common stock.

The issuance of shares upon conversion of callable secured convertible notes and exercise of warrants may result in substantial dissolution to the interests of other stockholders since the holders of the convertible notes may ultimately convert and sell the full amount issuable upon conversion. Although

the noteholders may not convert their callable secured convertible notes and/or exercise their warrants if such conversion or exercise price would cause them to own more than 4.99% of the Company's outstanding common stock, this restriction does not prevent the noteholders from converting and/or exercising some of their holdings and then converting the rest of their holdings. In this way, the noteholders could sell more than this limit while never holding more than this limit. There is no upper limit on the number of shares that may be issued, which will have the effect of further diluting the proportionate equity interest and voting power of holders of the Company's common stock.

The Company anticipates that the full amount of callable secured convertible notes will be converted into shares of its common stock, in accordance with the terms of the callable secured convertible notes. If the Company is required to repay the callable secured convertible notes, it would be required to use its limited working capital and raise additional funds. If the Company were unable to repay the notes when required, the noteholders could commence legal action against the Company and foreclose on all of its assets to recover the amounts due. Any such action would require the Company to curtail or

Edgar Filing: PARADIGM MEDICAL INDUSTRIES INC - Form 10QSB

cease operations.

Preferred Stock Conversions

Under the Company's Certificate of Incorporation, holders of the Company's Class A and Class B preferred stock have the right to convert such stock into shares of the Company's common stock at the rate of 1.2 shares of common stock for each share of preferred stock. During the three months ended March 31, 2006, no shares of Series A preferred stock and no shares of Series B preferred stock were converted to the Company's common stock.

Holders of Series D preferred have the right to convert such stock into shares of the Company's common stock at the rate of one share of common stock for each share of preferred stock. During the three months ended March 31, 2006, no shares of Series D preferred stock were converted to the Company's common stock.

Holders of Series E preferred have the right to convert such stock into shares of the Company's common stock at the rate of 53.3 shares of common stock for each share of preferred stock. During the three months ended March 31, 2006, no shares of Series E preferred stock were converted to the Company's common stock.

Holders of Series F preferred have the right to convert such stock into shares of the Company's common stock at the rate of 53.3 shares of common stock for each share of preferred stock. During the three months ended March 31, 2006, no shares of Series F preferred stock were converted to shares of the Company's common stock.

Holders of Series G preferred have the right to convert such stock into shares of the Company's common stock at the rate of one share of common stock for each share of preferred stock. During the three months ended March 31, 2006, no shares of Series G preferred stock were converted to shares of the Company's common stock.

Warrants

The fair value of warrants granted as described herein is estimated at the date of grant using the Black-Scholes option pricing model. The exercise price per share is reflective of the then current market value of the stock. No grant exercise price was established at a discount to market. All warrants are fully vested, exercisable and nonforfeitable as of the grant date. As a result of the financing the Company completed on April 27, 2005 involving the sale of \$2,500,000 in callable secured convertible notes, the Company granted warrants to the noteholders to purchase 16,534,392 shares of its common stock. The warrants have an exercise price of \$.20 per share and expire on April 27, 2010. As a result of the financing the Company completed on February 28, 2006 involving the sale of \$500,000 in callable secured convertible notes, the Company granted warrants to the noteholders to purchase 4,000,000 shares of its common stock. The warrants have an exercise price of \$.10 per share and expire on February 27, 2011.

Stock - Based Compensation

The Company has stock option plans that provide for stock-based employee compensation, including the granting of stock options, to certain key employees. Prior to January 1, 2006, the Company applied APB Opinion No. 25, "Accounting for Stock Issued to Employees", and related interpretations in accounting for awards made under the Company's stock-based compensation plans.

Edgar Filing: PARADIGM MEDICAL INDUSTRIES INC - Form 10QSB

Under this method, compensation expense was recorded on the date of grant only if the current market price of the underlying stock exceeded the exercise price.

10

During the periods presented in the accompanying financial statements, the Company has granted options under its Stock Option Plan. The Company has adopted the provisions of SFAS No. 123(R) using the modified-prospective transition method and the disclosures that follow are based on applying SFAS No. 123(R). Under this transition method, compensation expense recognized during the three months ended March 31, 2005 included: (a) compensation expense for all share-based awards granted prior to, but not yet vested as of January 1, 2006, and (b) compensation expense for all share-based awards granted on or after January 1, 2006. Accordingly, compensation cost of \$23,000 has been recognized for grants of options to employees and directors in the accompanying statements of operations with an associated recognized tax benefit of \$0 of which \$0 was capitalized as an asset for the period ended March 31, 2006. In accordance with the modified-prospective transition method, the Company's financial statements for the prior year have not been restated to reflect, and do not include, the impact of SFAS 123(R). Had compensation cost for the Company's stock option plans and agreements been determined based on the fair value at the grant date for awards in 2005 consistent with the provisions of SFAS No. 123(R), the Company's net loss and basic net loss per common share would have been increased to the pro forma amounts indicated below:

	Three Months Ended March 31, 2006
Net income (loss) - as reported	\$ (756,000)
Plus stock-based employee compensation expense included in reported net loss, net related tax effects	
Less stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects	(78,000)

Pro forma net loss	\$ (834,000)

Basic and diluted net loss per common share, as reported	\$ (0.01)
Basic net loss per share, pro forma	\$ (0.01)
Diluted net loss per share, pro forma	\$ (0.01)

Related Party Transactions

Payments for legal services to the firm of which the Company's chairman of the board of directors is a partner were approximately \$33,000 and \$25,000 for the three months ended March 31, 2006 and 2005 respectively.

Accrued Expenses

Accrued expenses consist of the following at March 31, 2006:

Accrued consulting and litigation reserve	\$ 543,000
Accrued payroll and employee benefits	34,000
Sales taxes payable	9,000
Customer deposits	19,000

Edgar Filing: PARADIGM MEDICAL INDUSTRIES INC - Form 10QSB

Accrued royalties	2,000
Warranty and return allowance	119,000
Other accrued expenses	6,000

Total	\$732,000

Stockholders' Equity

On January 14, 2005, the Company issued 2,000,000 shares of common stock to an accredited investor through a private placement at a price of \$0.75 per share. The Company received a total of \$150,000 in cash from the private placement transaction and issued as a commission warrants to purchase 200,000 shares of the Company's common stock at \$.15 per share.

11

On February 1, 2005, the Company issued a total of 515,206 shares of common stock to two accredited investors that had purchased shares of the Company's Series G convertible preferred stock in a private placement transaction. Under the terms of the private offering, the Company was required to file a registration statement with the Securities and Exchange Commission to register the common shares issuable to the Series G preferred stockholders upon conversion of their Series G preferred shares and exercise of their warrants. The 515,206 shares represented a penalty for the Company not having a registration statement declared effective within 120 days of the initial closing of the offering. The value of these shares was \$52,000.

On April 7, 2005, the Company issued 250,000 registered shares of common stock to the law firm of Mackey Price Thompson & Ostler in payment of legal services that the law firm provided to the Company in the amount of \$22,500.

Item 2: Management's Discussion and Analysis or Plan of Operation

This report contains forward-looking statements and information relating to the Company that is based on beliefs of management as well as assumptions made by, and information currently available to management. These statements reflect its current view respecting future events and are subject to risks, uncertainties and assumptions, including the risks and uncertainties noted throughout the document. Although the Company has attempted to identify important factors that could cause the actual results to differ materially, there may be other factors that cause the forward-looking statements not to come true as anticipated, believed, projected, expected or intended. Should one or more of these risks or uncertainties materialize, or should underlying assumptions prove incorrect, actual results may differ materially from those described herein as anticipated, believed, projected, estimated, expected or intended.

Critical Accounting Policies

Revenue Recognition. The Company recognizes revenue in compliance with Staff Accounting Bulletin 101, Revenue Recognition in Financial Statements (SAB 101), as revised by Staff Accounting Bulletin No. 104, Revenue Recognition (SAB 104). SAB 101 and SAB 104 detail four criteria that must exist before revenue is recognized:

1. Persuasive evidence of an arrangement exists. Prior to shipment of product, the Company required a signed purchase order and, depending upon the customer, a down payment toward the final invoiced price or full payment in advance with certain international product distributors.

Edgar Filing: PARADIGM MEDICAL INDUSTRIES INC - Form 10QSB

2. Delivery and performance have occurred. Unless the purchase order requires specific installation or customer acceptance, the Company recognizes revenue when the product ships. If the purchase order requires specific installation or customer acceptance, the Company recognizes revenue when such installation or acceptance has occurred. Title to the product passes to its customer upon shipment. This revenue recognition policy does not differ among its various different product lines. The Company guarantees the functionality of its product. If its product does not function as marketed when received by the customer, the Company either makes the necessary repairs on site or has the product shipped to the Company for the repair work. Once the product has been repaired and retested for functionality, it is re-shipped to the customer. The Company provides warranties that generally extend for one year from the date of sale. Such warranties cover the necessary parts and labor to repair the product as well as any shipping costs that may be required. The Company maintains a reserve for estimated warranty costs based on its historical experience and management's current expectations.

3. The sales price is fixed or determinable. The purchase order received from the customer includes the agreed-upon sales price. The Company does not accept customer orders, and therefore does not recognize revenue, until the sales price is fixed.

4. Collectibility is reasonably assured. With limited exceptions, the Company requires down payments on product prior to shipment. In some cases the Company requires payment in full prior to shipment. The Company also performs credit checks on new customers and ongoing credit checks on existing customers. The Company maintains an allowance for doubtful accounts receivable based on historical experience and management's current expectations.

Recoverability of Inventory. Since its inception, the Company has purchased several complete lines of inventory. In some circumstances the Company has been able to utilize certain items acquired and others remain unused. On a quarterly basis, the Company attempts to identify inventory items that have shown relatively no movement or very slow movement. Generally, if an item has shown little or no movement for over a year, it is determined not to be recoverable and a reserve is established for that item. In addition, if the Company identifies products that have become obsolete due to product upgrades or enhancements, a reserve is established for such products. The Company intends to make efforts to sell these items at significantly discounted prices. If items are sold, the cash received would be recorded as revenue, but there would be no

12

cost of sales on such items due to the reserve that has been recorded. At the time of sale, the inventory would be reduced for the item sold and the corresponding inventory reserve would also be reduced.

Recoverability of Goodwill and Other Intangible Assets. The Company's intangible assets consist of goodwill, product and technology rights, engineering and design costs, and patent costs. Intangibles with a determined life are amortized on a straight-line basis over their determined useful life and are also evaluated for potential impairment if events or circumstances indicate that the carrying amount may not be recoverable. Intangibles with an indefinite life, such as goodwill, are not amortized but are tested for impairment on an annual basis or when events and circumstances indicate that the asset may be impaired. Impairment tests include comparing the fair value of a reporting unit with its carrying net book value, including goodwill. To date, the Company's determination of the fair value of the reporting unit has been based on the estimated future cash flows of that reporting unit.

Edgar Filing: PARADIGM MEDICAL INDUSTRIES INC - Form 10QSB

Allowance for Doubtful Accounts. The Company records an allowance for doubtful accounts to offset estimated uncollectible accounts receivable. Bad debt expense associated with the increases in the allowance for doubtful accounts is recorded as part of general and administrative expense. The Company's accounting policy generally is to record an allowance for receivables over 90 days past due unless there is significant evidence to support that the receivable is collectible.

General

The following Management's Discussion and Analysis of Financial Condition and Results of Operations, contains forward-looking statements, which involve risks and uncertainty. The Company's actual results could differ materially from those anticipated in these forward-looking statements as a result of certain factors discussed in this section. The Company's fiscal year is from January 1 through December 31.

The Company is engaged in the design, development, manufacture and sale of high technology diagnostic and surgical eye care products. Given the "going concern" status of the Company, management has focused efforts on those products and activities that will, in its opinion, achieve the most resource efficient short-term cash flow. As seen in the results for the three months ended March 31, 2006, diagnostic products have been the major focus and the Photon(TM) and other extensive research and development projects have been put on hold pending future evaluation when the Company's financial position improves. The Company does not focus on a specific diagnostic product or products but, instead, on the entire diagnostic product group.

Results of Operations

Three Months Ended March 31, 2006, Compared to Three Months Ended March 31, 2005

Net sales for the three months ended March 31, 2006 decreased by \$65,000, or 12%, to \$463,000 as compared to \$528,000 for the same period of 2005. This reduction in sales was primarily due to reduced sales of the P40, P45 and P60 UBM Ultrasound Biomicroscopes and the P37 A/B Scan Ocular Ultrasound Diagnostics.

For the three months ended March 31, 2006, sales from the Company's diagnostic products totaled \$413,000, or 89% of total revenues, compared to \$384,000, or 73% of total revenues for the same period of 2005. The remaining 11% of sales, or \$50,000 during the three months ended March 31, 2006 was from parts, disposables, and service revenue.

Sales of the P40, P45 and P60 UBM Ultrasound Biomicroscopes decreased to \$60,000 during the three months ended March 31, 2006, or 13% of total quarterly revenues for the period, compared to \$142,000, or 27% of total revenues, for the same period last year. Sales of the Blood Flow Analyzer(TM) increased by \$17,000 to \$51,000, or 11% of total revenues, for the three months ended March 31, 2006, compared to net sales of \$34,000, or 6% of total revenues, during the same period in 2005. Sales from the P37 A/B Scan Ocular Ultrasound Diagnostic decreased to \$82,000, or 18% of total revenues, for the three month period ended March 31, 2006, down compared to \$18,000, or 3% of total revenues, for the same period last year. Combined sales of the LD 400 and TKS 5000 autoperimeters and the CT 200 Corneal Topographer were \$208,000, or 45% of the total revenues, for the three months ended March 31, 2006, compared to \$186,000, or 35% of total revenues, for the same period of 2005.

Sales have been lower during the three months ended March 31, 2006 for the Company due to a variety of reasons. Sales of the P40, P45 and P60 UBM

Ultrasound Biomicroscope decreased primarily as a result of ongoing software development and hardware configuration problems with the new P60, which received FDA 510(k) premarket approval on May 26, 2005 that allowed the device to be sold in the United States. The hardware configuration problems have since been resolved and the Company continues to work on resolving the software development problems. The Company anticipates reversing the downward trend in sales through additional efforts by the Company to gain more widespread support for the P60 through increased clinical awareness, product development and improved marketing plans.

Sales of surgical products are at a standstill pending FDA approval of the Photon(TM) laser system. In the three month period ended March 31, 2006, the Company realized no sales in the surgical line consisting of the Precisionist Thirty Thousand(TM) and the Photon(TM) laser system. There were also no sales in the surgical line for the comparable period of 2005.

Gross profit for the three months ended March 31, 2006 decreased by 7% to 52% of total revenues, compared to 59% of total revenues for the same period in 2005. The decrease in gross profit was mainly due to the ongoing development expenses of the new P60 UBM and the costs associated with the physical move of the Company's production and warehouse operations and corporate offices into a reduced area in the Company's leased office and warehouse space in order to realize savings in the monthly rent of such facilities. There was no increase or decrease to cost of sales as a result of a change to the reserve for obsolete inventory in 2006.

Marketing and selling expenses decreased by \$102,000, or 56%, to \$78,000, for the three months ended March 31, 2006, from \$180,000 for the comparable period in 2005. The reduction was due primarily to a reduced number of sales representatives and lower travel related and associated sales expenses.

General and administrative expenses decreased by \$8,000, or 3%, to \$250,000 for the three months ended March 31, 2006, from \$258,000 for the comparable period in 2005. The decrease in general and administrative expenses was primarily due to the expenses associated with the financing obtained in February 2006.

In addition, during the first quarter of 2005, the Company issued 515,206 shares of common stock to two shareholders that had purchased shares of the Company's Series G convertible preferred stock in a private offering. Under the terms of the private offering, the Company was required to file a registration statement with the Securities and Exchange Commission for the purpose of registering the common shares issuable to the Series G preferred stockholders upon conversion of their Series G preferred shares and exercise of their warrants. The shares were issued as a penalty for the Company not having a registration statement declared effective within 120 days of the initial closing of the private offering.

Also during 2005, the Company collected \$1,000 in receivables that were previously allowed in the allowance for doubtful accounts. During 2005, the Company increased allowance for doubtful accounts by \$100,000.

Research, development and service expenses decreased by \$86,000, or 40%, to \$124,000 for the three months ended March 31, 2006, compared to \$210,000 in the same period of 2005. Most of the increase was due to the costs of development and compliance with regulatory requirements in releasing the new P60 UBM.

Due to our ongoing cash flow difficulties, most of the Company's

Edgar Filing: PARADIGM MEDICAL INDUSTRIES INC - Form 10QSB

vendors and suppliers were contacted during 2004 and 2005 with attempts to negotiate reduced payments and settlement of outstanding accounts payable. While some vendors refused to negotiate and demanded payment in full, some vendors were willing to settle for a reduced amount. The accounts payable forgiven by vendors and suppliers resulted in a gain of \$12,000 and \$206,000 during the years ended December 31, 2005 and 2004, respectively. In 2006 the Company is continuing its negotiations with some vendors and suppliers.

Liquidity and Capital Resources

The Company used \$152,000 in cash in operating activities for the three months ended March 31, 2006, compared to \$197,000 for the three months ended March 31, 2005. The decrease in cash used for operating activities for the three months ended March 31, 2006 was primarily attributable to the Company's net loss and decreases in accounts payable and accrued liabilities and an increase in inventory, specifically for the P60 UBM. The Company used \$5,000 in investing activities for the three months ended March 31, 2006, compared to zero for the three months ended March 31, 2005. Net cash received in financing activities was \$491,000 for the three months ended March 31, 2006, versus cash provided from financing activities of \$136,000 in the same period in 2005. The Company had working capital of \$431,000 as of March 31, 2006, compared to a working capital deficit of \$191,000 as of March 31, 2005. In January 2005, the Company sold 2,000,000 shares of its common stock to an accredited investor for \$150,000 in cash. In the past, the Company has relied heavily upon sales of the Company's common and preferred stock to fund operations. There can be no assurance that such equity funding will be available on terms acceptable to the Company in the future.

14

As of March 31, 2006, the Company had net operating loss carry-forwards (NOLs) of approximately \$53 million. These loss carry-forwards are available to offset future taxable income, if any, and have begun to expire in 2001 and extend for twenty years. The Company's ability to use net operating loss carryforwards (NOLs) to offset future income is dependant upon certain limitations as a result of the pooling transaction with Vismed and the tax laws in effect at the time of the NOLs can be utilized. The Tax Reform Act of 1986 significantly limits the annual amount that can be utilized for certain of these carryforwards as a result of change of ownership.

As of March 31, 2006, the Company had accounts payable of \$432,000, a significant portion of which was over 90 days past due, compared to accounts payable of \$745,000 as of March 31, 2005. The Company has contacted many of the vendors or companies that have significant amounts of payables past due in an effort to delay payment, renegotiate a reduced settlement payment, or establish a longer-term payment plan. While some companies have been willing to renegotiate the outstanding amounts, others have demanded payment in full. Under certain conditions, including but not limited to judgments rendered against the Company in a court of law, a group of creditors could force the Company into bankruptcy due to its inability to pay the liabilities arising out of such judgments at that time. In addition to the accounts payable noted above, the Company also has non-cancelable capital lease obligations and operating lease obligations that require the payment of approximately \$194,000 in 2005, and \$14,000 in 2006.

The Company has taken numerous steps to reduce costs and increase operating efficiencies. These steps consist of the following:

1. The Company closed its San Diego facility. In so doing, numerous manufacturing, accounting and management responsibilities were consolidated. In addition, such closure resulted in significant headcount reductions as well as

Edgar Filing: PARADIGM MEDICAL INDUSTRIES INC - Form 10QSB

savings in rent and other overhead costs.

2. The Company has significantly reduced the use of consultants, which has resulted in a large decrease to these expenses.

3. The Company has reduced its direct sales force to three representatives, which has resulted in less payroll, travel and other selling expenses.

Because the Company has significantly fewer sales representatives, its ability to generate sales has been reduced.

The Company has taken measures to reduce the amount of uncollectible accounts receivable such as more thorough and stringent credit approval, improved training and instruction by sales personnel, and frequent direct communication with the customer subsequent to delivery of the system. The allowance for doubtful accounts was 24% of total outstanding receivables as of March 31, 2006 and 20% as of December 31, 2005 compared to 14% of total outstanding receivables as of March 31, 2005. The allowance for doubtful accounts increased from \$101,000 at December 31, 2006 to \$102,000 at March 31, 2006.

The Company intends to continue its efforts to reduce the allowance for doubtful accounts as a percentage of accounts receivable. The Company has ongoing efforts to collect a significant portion of the sales price in advance of the sale or in a timely manner after delivery. During the three months ended March 31, 2006, the Company added a net of \$1,000 to the allowance for doubtful accounts. The Company believes that by requiring a large portion of payment prior to shipment, it has greatly improved the collectibility of its receivables.

The Company carried an allowance for obsolete or estimated non-recoverable inventory of \$1,382,000 at March 31, 2006 and \$1,418,000 at March 31, 2005, or 63% and 65% of total inventory, respectively. The Company's means of expansion and development of product has been largely from acquisition of businesses, product lines, existing inventory, and the rights to specific products. Through such acquisitions, the Company has acquired substantial inventory, some of which the eventual use and recoverability was uncertain. In addition, the Company has a significant amount of inventory relating to the Photon(TM) laser system, which does not yet have FDA approval in order to sell the product domestically. Therefore, the allowance for inventory was established to reserve for these potential eventualities.

On a quarterly basis, the Company attempts to identify inventory items that have shown relatively no movement or very slow movement. Generally, if an item has shown little or no movement for over a year, it is determined not to be recoverable and a reserve is established for that item. In addition, if the

Company identifies products that have become obsolete due to product upgrades or enhancements, a reserve is established for such products. The Company intends to make efforts to sell these items at significantly discounted prices. If items are sold, the cash received would be recorded as revenue, but there would be no cost of sales on such items due to the reserve that has been recorded. At the time of sale, the inventory would be reduced for the item sold and the corresponding inventory reserve would also be reduced.

At this time, the Company's Photon(TM) Laser Ocular Surgery Workstation requires regulatory FDA approval in order to be sold in the United States. Any possible future efforts to complete the clinical trials on the Photon(TM) in

Edgar Filing: PARADIGM MEDICAL INDUSTRIES INC - Form 10QSB

order to file for FDA approval would depend on the Company obtaining adequate funding. The Company estimates that the funds needed to complete the clinical trials in order to obtain the necessary regulatory approval on the Photon(TM) to be approximately \$225,000.

Effect of Inflation and Foreign Currency Exchange

The Company has not realized a reduction in the selling price of its products as a result of domestic inflation. Nor has it experienced unfavorable profit reductions due to currency exchange fluctuations or inflation with its foreign customers. All sales transactions to date have been denominated in U.S. dollars.

Impact of New Accounting Pronouncements

In May 2005, the FASB issued SFAS No. 154, Accounting Changes and Error Corrections. This statement replaces APB Opinion No. 20 and SFAS No. 3. APB Opinion No. 20 previously required that most voluntary changes in accounting principle be recognized by including the cumulative effect of changing to the new accounting principle in the net income of the period of the change. SFAS No. 154 requires retrospective application to prior periods' financial statements of changes in accounting principle, unless it is impracticable to determine either the period-specific effects or the cumulative effect of the change. When it is impracticable to determine the period-specific effects of an accounting change on one or more individual prior periods presented, this statement requires that the accounting principle be applied to the balances of assets and liabilities as of the beginning of the earliest period for which retrospective application is practicable and that a corresponding adjustment be made to the opening balance of retained earnings for that period, rather than being reported in an income statement. The new standard will be effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005. The Company believes the adoption of new standard will not have a material effect on its financial position, results of operations, cash flows, or previously issued financial reports.

In February 2006, the FASB issued SFAS No. 155, Accounting for Certain Hybrid Financial Instruments. This statement is an amendment of FASB Statements Nos. 133 and 140 to address what had been characterized as a temporary exemption from the application of the bifurcation requirements of Statement No. 133 to beneficial interests in securitized financial assets. Prior to the effective date of Statement No. 133, the FASB received inquiries on the application of the exception in paragraph 14 of Statement No. 133 to beneficial interests in securitized financial assets. In response to the inquiries, Implementation Issue D1 indicated that, pending issuance of further guidance, entities may continue to apply the guidance related to accounting for beneficial interests in paragraphs 14 and 362 of Statement No. 140. Those paragraphs indicate that any security that can be contractually prepaid or otherwise settled in such a way that the holder of the security would not recover substantially all of its recorded investment should be subsequently measured like investments in debt securities classified as available-for-sale or trading under FASB Statement No. 115, Accounting for Certain Investments in Debt and Equity Securities, and may not be classified as held-to-maturity. Further, Implementation Issue D1 indicated that holders of beneficial interests in securitized financial assets that are not subject to paragraphs 14 and 362 of Statement No. 140 are not required to apply Statement No. 133 to those beneficial interests until further guidance is issued. The Company believes the adoption of new standards will not have a material effect on its financial position, results of operations, cash flows, or previously issued financial reports.

In March 2006, the FASB issued SFAS No. 156, Accounting for Servicing of Financial Assets. This statement amends FASB Statement No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of

Edgar Filing: PARADIGM MEDICAL INDUSTRIES INC - Form 10QSB

Liabilities, with respect to the accounting for separately recognized servicing assets and servicing liabilities. In this statement the board decided to broaden the scope of the project to include all servicing assets and servicing liabilities. Servicing assets and servicing liabilities may be subject to significant interest rate and prepayment risks, and many entities use financial instruments to mitigate those risks. Currently, servicing assets and servicing liabilities are amortized over the expected period of estimated net servicing income or loss and assessed for impairment or increased obligation at each reporting date. The board acknowledged that the application of the lower of carrying amount or fair value measurement attribute to servicing assets results in asymmetrical recognition of economic events, because it requires recognition of all decreases in fair value but limits recognition of increases in fair value to the original carrying amount.

16

Statement No. 156 requires that all separately recognized servicing assets and servicing liabilities be initially measured at fair value, if practicable. The board concluded that fair value is the most relevant measurement attribute for the initial recognition of all servicing assets and servicing liabilities, because it represents the best measure of future cash flows. This statement permits, but does not require, the subsequent measurement of servicing assets and servicing liabilities at fair value. An entity that uses derivative instruments to mitigate the risks inherent in servicing assets and servicing liabilities is required to account for those derivative instruments at fair value. Under this statement, an entity can elect subsequent fair value measurement of its servicing assets and servicing liabilities by class, thus simplifying its accounting and providing for income statement recognition of the potential offsetting changes in fair value of the servicing assets, servicing liabilities, and related derivative instruments. An entity that elects to subsequently measure servicing assets and servicing liabilities at fair value is expected to recognize declines in fair value of the servicing assets and servicing liabilities at fair value is expected to recognize declines in fair value of the servicing assets and servicing liabilities more consistently than by reporting other-than-temporary impairments. The Company believes the adoption of new standards will not have a material effect on its financial position, results of operations, cash flows, or previously issued financial reports.

Item 3. Controls and Procedures

a) Evaluation of disclosure controls and procedures.

Under the supervision and with the participation of the Company's management, including its principal executive officer and principal financial officer, the Company evaluated the effectiveness of the design and operation of its disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as of March 31, 2006. Based on this evaluation, the Company's principal executive officer and principal financial officer concluded that, as of the end of the period covered by this report, the Company's disclosure controls and procedures were effective and adequately designed to ensure that the information required to be disclosed by the Company in the reports it files or submits under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in applicable rules and forms.

b) Changes in internal controls over financial reporting.

During the three months ended March 31, 2006, there has been no change in the Company's internal control over financial reporting that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

Edgar Filing: PARADIGM MEDICAL INDUSTRIES INC - Form 10QSB

PART II Other Information

Item 1. Legal Proceedings

An action was brought against the Company in March 2000 by George Wiseman, a former employee, in the Third District Court of Salt Lake County, State of Utah. The complaint alleges that the Company owes Mr. Wiseman 6,370 shares of its common stock plus costs, attorney's fees and a wage penalty (equal to 1,960 additional shares of its common stock) pursuant to Utah law. The action is based upon an extension of a written employment agreement. The Company disputes the amount allegedly owed and intends to vigorously defend against the action.

An action was brought against the Company on September 11, 2000 by PhotoMed International, Inc. and Daniel M. Eichenbaum, M.D. in the Third District Court of Salt Lake County, State of Utah. The action involves an amount of royalties that are allegedly due and owing to PhotoMed International, Inc. and Dr. Eichenbaum under a license agreement dated July 7, 1993, with respect to the sale of certain equipment, plus costs and attorneys' fees. Certain discovery has taken place and the Company has paid royalties of \$15,717, which the Company believes brings all payments current as of the date of last payment on January 7, 2005. The Company has been working with PhotoMed and Dr. Eichenbaum to ensure that the calculations have been correctly made on the royalties paid as well as the proper method of calculation for the future.

It is anticipated that once the parties can agree on the correct calculations on the royalties, the legal action will be dismissed. An issue in dispute concerning the method of calculating royalties is whether royalties should be paid on returned equipment. Since July 1, 2001, only one Photon(TM) laser system has been sold and no systems returned. Thus, the amount of royalties due, according to the Company's calculations, is \$981. The Company made payment of this amount to Photomed and Dr. Eichenbaum on January 5, 2005 and, as a result, seeks to have the legal action dismissed. However, if the

17

parties are unable to agree on a method for calculating royalties, there is a risk that PhotoMed and Dr. Eichenbaum might amend their complaint to request termination of the license agreement and, if successful, the Company would lose its right to manufacture and sell the Photon(TM) laser system.

An action was filed on June 20, 2003, in the Third Judicial District Court, Salt Lake County, State of Utah (Civil No. 030914195) by CitiCorp Vendor Finance, Inc., formerly known as Copelco Capital, Inc. The complaint claims that \$49,626 plus interest is due for the leasing of three copy machines that were delivered to the Company's Salt Lake City facilities on or about April of 2000. The action also seeks an award of attorney's fees and costs incurred in the collection. The Company filed an answer to the complaint disputing the amounts allegedly owed due to machine problems and a claimed understanding with the vendor. The Company returned two of the machines. The Company was engaged in settlement discussions with CitiCorp until counsel for CitiCorp withdrew from the case. New counsel for CitiCorp was appointed. After an initial meeting with new counsel, the Company provided initial disclosures to the new counsel.

On August 3, 2003, a complaint was filed against the Company by Corinne Powell, a former employee, in the Third Judicial District Court, Salt Lake County, State of Utah (Civil No. 030918364). Defendants consist of the Company and Randall A. Mackey, Dr. David M. Silver and Keith D. Igotz, directors of the Company. The complaint alleges that at the time the Company laid off Ms. Powell on March 25, 2003, she was owed \$2,030 for business expenses, \$11,063 for

Edgar Filing: PARADIGM MEDICAL INDUSTRIES INC - Form 10QSB

accrued vacation days, \$12,818 for unpaid commissions, the fair market value of 50,000 stock options exercisable at \$5.00 per share that she claims she was prevented from exercising, attorney's fees and a continuing wage penalty under Utah law. On March 29, 2005, the Company agreed to a settlement with Ms. Powell of her claims for unpaid business expenses, accrued vacation days, and unpaid commissions by agreeing to pay her the sum of \$13,000. The Company made payment to Ms. Powell for the agreed upon settlement amount. The Company believes the remaining claims are without merit and intends to vigorously defend against such claims.

On September 10, 2003, an action was filed against the Company by Larry Hicks in the Third Judicial District Court, Salt Lake County, State of Utah, (Civil No. 030922220), for payments due under a consulting agreement with the Company. The complaint claims that monthly payments of \$3,083 are due for the months of October 2002 to October 2003 under the consulting agreement and, if the agreement is terminated, for the sum of \$110,000 minus whatever the Company has paid Mr. Hicks prior to such termination, plus costs, attorney's fees and a wage penalty pursuant to Utah law. The Company has filed an answer in which it denies any liability to Mr. Hicks. Formal discovery in the matter has commenced. The Company disputes the amount allegedly owed and intends to vigorously defend against such action.

On November 7, 2003, a complaint was filed against the Company by Todd Smith, a former employee, in the Third Judicial District Court, Salt Lake County, State of Utah (Civil No. 030924951 CN). Defendants consist of the Company and Randall Mackey, a director of the Company. The complaint alleges that while an employee of the Company, Mr. Smith was granted stock options to purchase 16,800 shares of common stock exercisable at \$5.00 per share. Mr. Smith claims unpaid wages in the amount of the fair market value of the stock options he claims he was prevented from exercising, attorney's fees, and a continuing wage penalty under Utah law. The Company believes the claims are without merit and intends to vigorously defend against such action.

On March 31, 2005, an action was filed against the Company by Joseph W. Spadafora in the United States District Court, District of Utah (Civil No. 2:05CV00278 TS). The complaint alleges that Dr. Spadafora was a clinical investigator in the study for the FDA involving the Company's Photon(TM) laser system where he performed numerous surgeries using the Photon(TM). Dr. Spadafora contends that in meetings with Company personnel he suggested ways in which the handpiece on the Photon(TM) could be improved. Dr. Spadafora further contends that on August 5, 1999, when the Company filed a patent application for an improved handpiece with the United States Patent and Trademark Office, he was not named as one of the inventors or a co-inventor on the patent application.

On September 24, 2004, the Company was issued a patent entitled, "Laser Surgical Handpiece with Photon Trap." Because the Company did not list Dr. Spadafora as one of the inventors or a co-inventor on the patent, Dr. Spadafora is requesting in his complaint that a court order be entered declaring that he is the inventor or co-inventor of the patent and, as a result, is entitled to all or part of the royalties and profits that the Company earned or will earn from the sale of any product incorporating or using the improved handpiece, plus interest and attorney's fees. Formal discovery has been in progress. The Company disputes the claims made by Dr. Spadafora and intends to vigorously defend against such action.

The Company is not a party to any other material legal proceedings outside the ordinary course of its business or to any other legal proceedings, which, if adversely determined, would have a material adverse effect on its financial condition or results of operations.

Edgar Filing: PARADIGM MEDICAL INDUSTRIES INC - Form 10QSB

Completion of Settlement of Federal and State Class Action Lawsuits

On August 26, 2005, the federal court entered an order and final judgment granting final approval of the settlement agreement reached on February 22, 2005 in the federal court class action lawsuit and dismissing the complaint filed in the lawsuit with prejudice as against the Company and its former executive officers, Thomas F. Motter, Mark R. Miehle and John W. Hemmer. In addition, the court permanently enjoined class members in the lawsuit and their successors and assigns from instituting any other actions against the Company and its former executive officers that had been or could have been asserted by the class members against the Company and its former executive officers in the federal court class action lawsuit.

Following the entry of the order and final judgment in the federal court class action lawsuit, there was a 30 days period to appeal the order and final judgment. The 30 day period lapsed and no appeal was made of the order and final judgment. Consequently, the order and final judgment entered by the federal court is non-appealable. Under the terms of settlement of the federal court class action lawsuit, U.S. Fire Insurance Company, which issued a Directors and Officers Liability and Company Reimbursement Policy to the Company for the period from July 10, 2002 to July 10, 2003, agreed to pay the sum of \$1,507,500 in cash to the class members that purchased securities of the Company during the period between April 17, 2002 and November 4, 2002.

On August 23, 2005, the state court entered a final judgment and order of dismissal with prejudice, granting final approval of the terms of settlement reached on February 23, 2005 in the state court class action lawsuit, dismissing the state class action lawsuit and all claims contained therein against the Company and its former executive officers, and enjoining the class members in the lawsuit from prosecuting the settled claims against the Company and its former executive officers.

Following the entry of the final judgment and order of dismissal with prejudice in the state court class action lawsuit, there was a 30 day period to appeal the final judgment and order. The 30 day period has now lapsed and no appeal was made of the final judgment and order. Consequently, the final judgment and order entered by the state court is non-appealable. Under the terms of settlement of the state court class action lawsuit, U.S. Fire agreed to pay the sum of \$625,000 in cash to the class members that purchased shares of Series E Convertible preferred stock on or about July 11, 2001.

The federal court class action lawsuit was initially filed on May 14, 2003 by Richard Meyer, individually and on behalf of all others similarly situated, in the United States District Court for the District of Utah. The lawsuit was consolidated into a single action on June 28, 2004 with two other class action lawsuits -- the class action lawsuit filed by Michael Marone on June 2, 2003 and the class action lawsuit filed by Lidia Milian on July 11, 2003 against Paradigm Medical and its former executive officers in the same court. The consolidated action was captioned: In re: Paradigm Medical Industries Securities Litigation, with lead plaintiffs Rock Solid Investments of Miami, Inc., Brito & Brito Accounting, Inc. and Joseph Savanjo.

The state court class action lawsuit was initially filed on October 14, 2003 by Albert Kinzinger, Jr., individually and on behalf of all others similarly situated, against Paradigm Medical and its former executive officers in the Third District Court for Salt Lake County, State of Utah.

On February 22, 2005, the Company executed written settlement agreements to settle the federal and state court class action lawsuits. As a condition to the settlement agreements, the courts in such lawsuits must have entered orders granting final approval of the settlements reached in those

Edgar Filing: PARADIGM MEDICAL INDUSTRIES INC - Form 10QSB

respective actions, and such orders must have become final and non-appealable.

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

Callable Secured Convertible Notes and Warrants

To obtain funding for the Company's ongoing operations, the Company entered into a securities purchase agreement on February 28, 2006 with four accredited investors for the sale of (i) \$1,500,000 in callable secured convertible notes and (ii) warrants to purchase 12,000,000 shares of its common

19

stock. The sale of the callable secured convertible notes and warrants is to occur in three tranches and the investors are obligated to provide the Company with an aggregate of \$1,500,000 as follows:

- o \$500,000 was disbursed on February 28, 2006;
- o \$500,000 will be disbursed after the Company files a registration statement that registers the shares of common stock underlying the callable secured convertible notes and the warrants; and
- o \$500,000 will be disbursed upon the effectiveness of the registration statement the Company intends to file that registers the shares of common stock underlying the callable secured convertible notes and the warrants.

Each closing under the securities purchase agreement is subject to the following conditions:

- o The Company delivers to the investors duly executed callable secured convertible notes and warrants;
- o No litigation, statute, regulation or order had been commenced, enacted or entered by or in any court, governmental authority or any self-regulatory organization that prohibits consummation of the transactions contemplated by the securities purchase agreement; and
- o No event occurred that could reasonably be expected to have a material adverse effect on the Company's business.

The Company also agreed not, without the prior written consent of a majority-in-interest of the investors, to negotiate or contract with any party to obtain additional equity financing (including debt financing with an equity component) that involves (i) the issuance of common stock at a discount to the market price of the common stock on the date of issuance (taking into account the value of any warrants or options to acquire common stock in connection therewith), (ii) the issuance of convertible securities that are convertible into an indeterminate number of shares of common stock, or (iii) the issuance of warrants during the lock-up period beginning February 28, 2006 and ending on the later of (a) 270 days from February 28, 2006, or (b) 180 days from the date the registration statement is declared effective.

In addition, the Company agreed not to conduct any equity financing (including debt financing with an equity component) during the period beginning February 28, 2006 and ending two years after the end of the above lock-up period unless it first provided each investor an option to purchase its pro-rata share (based on the ratio of each investor's purchase under the Securities Purchase Agreement) of the securities being offered in any proposed equity financing. Each investor must be provided written notice describing any proposed equity financing at least 20 business days prior to the closing of such proposed equity financing and the option must be extended to each investor during the 15-day period following delivery of such notice.

Edgar Filing: PARADIGM MEDICAL INDUSTRIES INC - Form 10QSB

The callable secured convertible notes bear interest at 8% per annum from the date of issuance. Interest is computed on the basis of a 365-day year and is payable quarterly in cash, with six months of interest payable up front. The interest rate resets to zero percent for any month in which the stock price is greater than 125% of the initial market price, or \$.0275, for each trading day during that month. Any amount of principal or interest on the callable secured convertible notes that is not paid when due will bear interest at the rate of 15% per annum from the date due thereof until such amount is paid. The callable secured convertible notes mature in three years from the date of issuance, and are convertible into our common stock at the selling stockholders' option, at the lower of (i) \$.02 or (ii) 60% of the average of the three lowest intraday trading prices for the common stock on the OTC Bulletin Board for the 20 trading days before but not including the conversion date. Accordingly, there is no limit on the number of shares into which the notes may be converted.

The callable secured convertible notes are secured by the Company's assets, including the Company's inventory, accounts receivable and intellectual property. Moreover, the Company has a call option under the terms of the notes. The call option provides the Company with the right to prepay all of the outstanding callable secured convertible notes at any time, provided there is no event of default by the Company and the Company's stock is trading at or below \$.02 per share. An event of default includes the failure by the Company to pay the principal or interest on the callable secured convertible notes when due or to timely file a registration statement as required by the Company or obtain effectiveness with the Securities and Exchange Commission of the registration statement. Prepayment of the callable secured convertible notes is to be made in cash equal to either (a) 125% of the outstanding principal and accrued interest for prepayments occurring within 30 days following the issue date of the notes; (b) 130% of the outstanding principal and accrued interest for prepayments occurring between 31 and 60 days following the issue date of the notes; or (c) 145% of the outstanding principal and accrued interest for prepayments occurring after the 60th day following the issue date of the notes.

20

The warrants are exercisable until five years from the date of issuance at a purchase price of \$.10 per share. The investors may exercise the warrants on a cashless basis if the shares of common stock underlying the warrants are not then registered pursuant to an effective registration statement. In the event the investors exercise the warrants on a cashless basis, then the Company will not receive any proceeds therefrom. In addition, the exercise price of the warrants will be adjusted in the event the Company issues common stock at a price below market, with the exception of any securities issued as of the date of the warrants or issued in connection with the callable secured convertible notes issued pursuant to the securities purchase agreement.

The noteholders have agreed to restrict their ability to convert their callable secured convertible notes or exercise their warrants and receive shares of our common stock such that the number of shares of common stock held by them in the aggregate and their affiliates after such conversion or exercise does not exceed 4.99% of the then issued and outstanding shares of common stock. However, the selling stockholders may repeatedly sell shares of common stock in order to reduce their ownership percentage, and subsequently convert additional callable secured convertible notes.

The Company is required to register the shares of its common stock issuable upon the conversion of the callable secured convertible notes and the exercise of the warrants. The registration statement must be filed with the Securities and Exchange Commission within 60 days of the February 28, 2006

Edgar Filing: PARADIGM MEDICAL INDUSTRIES INC - Form 10QSB

closing date and the effectiveness of the registration is to be within 135 days of such closing date. Penalties of 2% of the outstanding principal balance of the callable secured convertible notes plus accrued interest are to be applied for each month the registration is not effective within the required time. The penalty may be paid in cash or stock at our option.

As of March 31, 2006, the Company had 160,959,424 shares of its common stock issued and outstanding and \$2,342,750 in callable secured convertible notes outstanding that may be converted into an estimated 390,000,000 shares of common stock at current market prices, and outstanding warrants to purchase 20,534,392 shares of its common stock. Additionally, the Company has an obligation to sell \$1,000,000 in callable secured convertible notes that may be converted into an estimated 167,000,000 shares of common stock at current market prices and issue warrants to purchase 8,000,000 shares of common stock in the near future. Furthermore, the number of shares of common stock issuable upon conversion of the outstanding callable secured convertible notes may increase if the market price of the Company's common stock declines. All the shares, including all of the shares issuable upon conversion of the notes and upon exercise of its warrants, may be sold without restriction. The sale of these shares may depress the market price of the Company's common stock.

The Company's obligation to issue shares upon conversion of the callable secured convertible notes is essentially limitless. The following is an example of the amount of shares of common stock that are issuable upon conversion of \$3,342,750 principal amount of callable secured convertible notes (excluding accrued interest), based on market prices 25%, 50%, and 75% below the market price, as of May 9, 2006 of \$.0099.

% Below Market -----	Price Per Share -----	With 40% Discount -----	Number of Shares Issuable -----	% of Outstanding* -----
25%	\$.0075	\$.0045	742,833,333	461.5%
50%	\$.0050	\$.0030	1,114,250,000	692.3%
75%	\$.0025	\$.0015	2,228,500,000	1,384.5%

*Based on 160,959,424 shares outstanding.

As illustrated, the number of shares of common stock issuable upon conversion of the Company's callable secured convertible notes will increase if the market price of the Company's common stock declines, which will cause dilution to existing stockholders.

The callable secured convertible notes are convertible into shares of the Company's common stock at a 40% discount to the trading price of the common stock prior to the conversion. The significant downward pressure on the price of the common stock as the noteholders convert and sell material amounts of common stock could encourage short sales by investors. This could place further downward pressure on the price of the common stock. The noteholders could sell common stock into the market in anticipation of covering the short sale by converting their securities, which could cause the further downward pressure on the stock price. In addition, not only the sale of shares issued upon conversion or exercise of notes, warrants and options, but also the mere perception that these sales could occur, may have a depressive effect on the market price of the common stock.

The issuance of shares upon conversion of callable secured convertible notes and exercise of warrants may result in substantial dissolution to the

Edgar Filing: PARADIGM MEDICAL INDUSTRIES INC - Form 10QSB

interests of other stockholders since the holders of the convertible notes may ultimately convert and sell the full amount issuable upon conversion. Although the noteholders may not convert their callable secured convertible notes and/or exercise their warrants if such conversion or exercise price would cause them to own more than 4.99% of the Company's outstanding common stock, this restriction does not prevent the noteholders from converting and/or exercising some of their holdings and then converting the rest of their holdings. In this way, the noteholders could sell more than this limit while never holding more than this limit. There is no upper limit on the number of shares that may be issued, which will have the effect of further diluting the proportionate equity interest and voting power of holders of the Company's common stock.

The Company anticipates that the full amount of callable secured convertible notes will be converted into shares of its common stock, in accordance with the terms of the callable secured convertible notes. If the Company is required to repay the callable secured convertible notes, it would be required to use its limited working capital and raise additional funds. If the Company were unable to repay the notes when required, the noteholders could commence legal action against the Company and foreclose on all of its assets to recover the amounts due. Any such action would require the Company to curtail or cease operations.

Item 3. Defaults Upon Senior Securities

None

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

None

Item 5. Other Information

None

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits

The following Exhibits are filed herewith pursuant to Rule 601 of Regulation S-B or are incorporated by reference to previous filings.

Exhibit

Exhibit No. -----	Document Description -----
2.1	Amended Agreement and Plan of Merger between Paradigm Medical Industries, Inc., a California corporation and Paradigm Medical Industries, Inc., a Delaware corporation(1)
3.1	Certificate of Incorporation(1)
3.2	Amended Certificate of Incorporation(8)
3.3	Bylaws(1)
4.1	Specimen Common Stock Certificate (2)
4.2	Specimen Class A Warrant Certificate(2)
4.3	Form of Class A Warrant Agreement(2)
4.4	Underwriter's Warrant with Kenneth Jerome & Co., Inc.(3)
4.5	Specimen Series C Convertible Preferred Stock Certificate(4)
4.6	Certificate of the Designations, Powers, Preferences and Rights of the Series C Convertible Preferred Stock(4)
4.7	Specimen Series D Convertible Preferred Stock Certificate (5)
4.8	Certificate of the Designations, Powers, Preferences and Rights of the Series D Convertible Preferred Stock (6)

Edgar Filing: PARADIGM MEDICAL INDUSTRIES INC - Form 10QSB

- 4.9 Warrant to Purchase Common Stock with Dr. Michael B. Limberg (6)
- 4.10 Certificate of Designations, Powers, Preferences and Rights of the Series G Convertible Preferred Stock (7)
- 10.1 Exclusive Patent License Agreement with PhotoMed(1)
- 10.2 Consulting Agreement with Dr. Daniel M. Eichenbaum(1)
- 10.3 1995 Stock Option Plan (1)
- 10.4 License Agreement with Sunnybrook Health Science Center(8)

22

- 10.5 Employment Agreement with John Y. Yoon(9)
- 10.6 Stock Purchase and Sale Agreement with William Ungar (10)
- 10.7 Employment Agreement with Aziz A. Mohabbat (11)
- 10.8 Investment Banking Agreement with Alpha Advisory Services, Inc. (12)
- 10.9 Manufacturing and Distribution Agreement with E-Technologies, Inc. (12)
- 10.10 Settlement Agreement with Innovative Optics, Inc., Barton Dietrich Investments, L.P. and United States Fire Insurance Company (13)
- 10.11 Stipulation and Agreement of Settlement (14)
- 10.12 Supplemental Agreement (14)
- 10.13 Stipulation of Settlement (14)
- 10.14 Supplemental Agreement (14)
- 10.15 Securities Purchase Agreement with AJW Partners, LLC, AJW Offshore, Ltd., AJW Qualified Partners, LLC and New Millennium Capital Partners II, LLP (the "Purchasers") (15)
- 10.16 Form of Callable Secured Convertible Note with each purchaser(15)
- 10.17 Form of Stock Purchase Warrant with each purchaser(15)
- 10.18 Security Agreement with Purchasers(15)
- 10.19 Intellectual Property Security Agreement with Purchasers(15)
- 10.20 Registration Rights Agreement with Purchasers(15)
- 10.21 Stock Purchase Agreement with Mackey Price Thompson & Ostler(16)
- 10.22 Employment Agreement with Raymond P.L. Cannefax(17)
- 10.23 Securities Purchase Agreement with AJW Partners, LLC, AJW Offshore, Ltd., AJW Qualified Partners, LLC and New Millennium Capital Partners II, LLP(18)
- 10.24 Form of Callable Secured Convertible Note with each purchaser(18)
- 10.25 Form of Stock Purchase Warrant with each purchaser(18)
- 10.26 Security Agreement with Purchasers(18)
- 10.27 Intellectual Property Security Agreement with Purchasers(18)
- 10.28 Registration Rights Agreement with Purchasers(18)
- 31.1 Certification pursuant to 18 U.S.C. Section 1350, as enacted by Section 302 of the Sarbanes-Oxley Act of 2002
- 31.2 Certification pursuant to 18 U.S.C. Section 1350, as enacted by Section 302 of the Sarbanes-Oxley Act of 2002
- 32.1 Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
- 32.2 Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

-
- (1) Incorporated by reference from Registration Statement on Form SB-2, as filed on March 19, 1996.
 - (2) Incorporated by reference from Amendment No. 1 to Registration Statement on Form SB-2, as filed on May 14, 1996.
 - (3) Incorporated by reference from Amendment No. 2 to Registration Statement on Form SB-2, as filed on June 3, 1996.
 - (4) Incorporated by reference from Annual Report on Form 10-KSB, as filed on April 16, 1998.
 - (5) Incorporated by reference from Registration Statement on Form

Edgar Filing: PARADIGM MEDICAL INDUSTRIES INC - Form 10QSB

- SB-2, as filed on April 29, 1999.
- (6) Incorporated by reference from Report on Form 10-QSB, as filed on August 16, 2000.
 - (7) Incorporated by reference from Report on Form 10-QSB, as filed on November 14, 2003.
 - (8) Incorporated by reference from Amendment No. 2 to Registration Statement on Form SB-2, as filed on December 15, 2003.
 - (9) Incorporated by reference from Current Report on Form 8-K, as filed on March 23, 2004.
 - (10) Incorporated by reference from Quarterly Report on Form 10-QSB, as filed on August 16, 2004.
 - (11) Incorporated by reference from Amendment No. 6 to Registration Statement on Form SB-2, as filed on October 20, 2004.
 - (12) Incorporated by reference from Report on Form 10-QSB, as filed on November 15, 2004.
 - (13) Incorporated by reference from Current Report on Form 8-K, as filed on January 27, 2005.
 - (14) Incorporated by reference from Current Report on Form 8-K, as filed on February 23, 2005.
 - (15) Incorporated by reference from Current Report on Form 8-K, as filed on May 18, 2005.
 - (16) Incorporated by reference from Registration Statement on Form SB-2, as filed on June 22, 2005.
 - (17) Incorporated by reference from Current Report on Form 8-K, as filed on January 18, 2006.
 - (18) Incorporated by reference from Current Report on Form 8-K, as filed on March 1, 2006.

23

(b) Reports on Form 8-K

Current Report on Form 8-K, as filed on January 18, 2006.
Current Report on Form 8-K, as filed on March 1, 2006.

24

SIGNATURES

In accordance with the requirements of the Exchange Act, the registrant caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

PARADIGM MEDICAL INDUSTRIES, INC.

May 19, 2006

/s/ Raymond P.L. Cannefax

Raymond P.L. Cannefax
President and Chief Executive Officer

May 19, 2006

/s/ Luis A. Mostacero

Luis A. Mostacero, Vice President of
Finance, Treasurer and Secretary

