

Consolidated Financial Statements

Coastal Contacts Inc.

October 31, 2007 and 2006

AUDITORS' REPORT

To the Shareholders of
Coastal Contacts Inc.

We have audited the consolidated balance sheets of **Coastal Contacts Inc.** as at October 31, 2007 and 2006 and the consolidated statements of net income (loss) and comprehensive loss, cash flows and retained earnings (deficit) for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at October 31, 2007 and 2006 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

Ernst + Young LLP

Chartered Accountants

Vancouver, Canada,
December 19, 2007.

Coastal Contacts Inc.**CONSOLIDATED BALANCE SHEETS**

As at October 31

(\$000's)

| | 2007 | 2006 |
|--|---------|---------|
| ASSETS | | |
| Current | | |
| Cash and cash equivalents <i>[note 5]</i> | 23,367 | 24,273 |
| Short-term investments <i>[note 5]</i> | 3,976 | - |
| Accounts receivable <i>[note 6]</i> | 6,649 | 7,127 |
| Inventory | 8,531 | 12,262 |
| Prepaid expenses | 1,270 | 702 |
| Due from related parties <i>[note 15]</i> | 348 | 610 |
| | 44,141 | 44,974 |
| Property, equipment and leasehold improvements <i>[note 7]</i> | 2,700 | 2,773 |
| Intangible assets <i>[note 8]</i> | 11,712 | 13,632 |
| Goodwill <i>[note 9]</i> | 7,529 | 6,697 |
| | 66,082 | 68,076 |
| LIABILITIES AND SHAREHOLDERS' EQUITY | | |
| Current | | |
| Accounts payable and accrued liabilities <i>[note 6]</i> | 13,881 | 11,793 |
| Income taxes payable | 711 | 212 |
| Deferred revenue | 23 | 205 |
| Current portion of lease inducement | 68 | 53 |
| | 14,683 | 12,263 |
| Long-term lease inducement | 158 | 133 |
| Future income tax liability <i>[note 14]</i> | 3,661 | 4,227 |
| | 18,502 | 16,623 |
| Shareholders' equity | | |
| Share capital <i>[note 10]</i> | | |
| Authorized: | | |
| Unlimited common shares without par value | | |
| Unlimited Class A preferred shares without par value | | |
| Issued and outstanding: | | |
| 71,426,512 common shares [2006 – 74,681,712] | 50,857 | 53,515 |
| Shares held in Treasury | | |
| 78,500 common shares [2006 – 42,700] | (89) | (41) |
| Contributed surplus <i>[note 11]</i> | 973 | 530 |
| Accumulated other comprehensive loss <i>[note 12]</i> | (4,091) | (2,135) |
| Deficit | (70) | (416) |
| | 47,580 | 51,453 |
| | 66,082 | 68,076 |

Commitments and contingencies *[notes 17 and 18]*Subsequent event *[note 10]**See accompanying notes to the consolidated financial statements*

On behalf of the Board:

/s/ Roger V. Hardy
Director

/s/ Jeffrey Mason
Director

Coastal Contacts Inc.

**CONSOLIDATED STATEMENTS OF NET INCOME (LOSS)
AND COMPREHENSIVE LOSS**

(\$000's, except share and per share amounts)

Years ended October 31

| | 2007 | 2006 |
|---|------------|------------|
| | \$ | \$ |
| Sales | 102,174 | 81,014 |
| Cost of sales | 74,497 | 60,709 |
| Gross profit | 27,677 | 20,305 |
| Selling, general and administration | 23,484 | 20,837 |
| Stock-based compensation <i>[note 10]</i> | 443 | 268 |
| Amortization on property, equipment and leasehold improvements | 802 | 553 |
| Amortization on intangible assets | 1,230 | 758 |
| Foreign exchange gains | (37) | (836) |
| Interest on long-term debt | - | 43 |
| Interest income | (833) | (933) |
| Income (loss) before income taxes | 2,588 | (385) |
| Income tax expense - current <i>[note 14]</i> | 901 | 580 |
| Income tax expense - future <i>[note 14]</i> | 62 | 371 |
| Net income (loss) | 1,625 | (1,336) |
| Other comprehensive loss, net of tax | | |
| Unrealized foreign exchange losses on translation of financial statements of self-sustaining foreign operations | (1,956) | (327) |
| Comprehensive loss | (331) | (1,663) |
| Basic earnings (loss) per share | 0.02 | (0.02) |
| Diluted earnings (loss) per share | 0.02 | (0.02) |
| Weighted average number of common shares outstanding – basic <i>[note 13]</i> | 72,948,602 | 68,018,799 |
| Weighted average number of common shares, outstanding – diluted <i>[note 13]</i> | 73,074,756 | 68,018,799 |

See accompanying notes to the consolidated financial statements.

Coastal Contacts Inc.

CONSOLIDATED STATEMENTS OF CASH FLOWS
(\$000's)

Years ended October 31

| | 2007 | 2006 |
|---|----------------|----------------|
| | \$ | \$ |
| OPERATING ACTIVITIES | | |
| Net income (loss) | 1,625 | (1,336) |
| Non-cash items: | | |
| Amortization | 2,032 | 1,311 |
| Amortization of deferred lease inducement | (106) | (26) |
| Accrued interest | (137) | (27) |
| Stock-based compensation | 443 | 268 |
| Future income taxes | 62 | 371 |
| Unrealized foreign exchange gains | (281) | (836) |
| Changes in non-cash working capital: | | |
| Accounts receivable | 855 | (1,556) |
| Inventory | 3,502 | (5,059) |
| Prepaid expenses | (650) | 275 |
| Accounts payable and accrued liabilities | 1,824 | 1,091 |
| Income taxes payable | 479 | (138) |
| Deferred revenue | (226) | 128 |
| Due from related parties | - | (288) |
| Cash provided by (used in) operating activities | 9,422 | (5,822) |
| INVESTING ACTIVITIES | | |
| Purchase of short-term investments | (3,886) | - |
| Repayments from related parties | 251 | - |
| Repayment of promissory notes | 58 | - |
| Business acquisition, net of cash acquired | (14) | (3,947) |
| Receipt of leasehold inducements | 134 | - |
| Property, equipment and leasehold improvements | (789) | (1,509) |
| Intangible assets | (1,365) | (1,383) |
| Cash used in investing activities | (5,611) | (6,839) |
| FINANCING ACTIVITIES | | |
| Issuance of common shares | 69 | 3,417 |
| Issuance of Special Warrants | - | 22,500 |
| Purchase of common shares for cancellation | (4,054) | - |
| Bank indebtedness | - | (328) |
| Loan payments | - | (379) |
| Share issue costs | - | (1,581) |
| Cash provided by (used in) financing activities | (3,985) | 23,629 |
| Effect of exchange rate changes on cash and cash equivalent | (732) | (305) |
| Increase (decrease) in cash and cash equivalents | (906) | 10,663 |
| Cash and cash equivalents, beginning of year | 24,273 | 13,610 |
| Cash and cash equivalents, end of year | 23,367 | 24,273 |
| Income taxes paid in cash | 358 | 651 |
| Interest paid in cash | - | 43 |

See accompanying notes to the consolidated financial statements.

Coastal Contacts Inc.

**CONSOLIDATED STATEMENTS OF RETAINED EARNINGS
(DEFICIT)
(\$000's)**

| For years ended October 31 | 2007 | 2006 |
|---|---------|---------|
| Retained earnings (deficit), beginning of year | (416) | 920 |
| Net income (loss) | 1,625 | (1,336) |
| Premium on purchase of common shares for cancellation | (1,279) | - |
| Retained earnings (deficit), end of year | (70) | (416) |

See accompanying notes to the consolidated financial statements.

Coastal Contacts Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

October 31, 2007 and 2006

1. NATURE OF OPERATIONS

Coastal Contacts Inc. (the “Company”) is a global on-line retailer of contact lenses and other vision care products sold through internet sites created and operated by the Company. The Company has operations in North America, Europe and Asia.

2. CHANGE IN ACCOUNTING POLICIES

Effective November 1, 2006, the Company has adopted the recommendations of the Canadian Institute of Chartered Accountants’ (“CICA”) Handbook Sections 1530, *Comprehensive Income*, 3855, *Financial Instruments – Recognition and Measurement*, 3861, *Financial Instruments – Disclosure and Presentation*, and 3865, *Hedges*. Any changes in measurement resulting from applying the new standards on November 1, 2006, were recorded against opening retained earnings or opening other comprehensive income with no impact on net income.

Financial instruments

All financial assets and liabilities are recorded on the balance sheet. Initial recognition of financial assets and liabilities is at fair value. Subsequent measurement of the financial assets and liabilities is determined as follows:

Cash is measured at fair value, with changes in fair value recorded in net income. The carrying amount approximates fair value.

Cash equivalents and short-term investments are comprised of guaranteed investment certificates, bankers’ acceptances and commercial paper. They are classified as held to maturity and reported at amortized cost.

Accounts Receivable, classified as loans and receivables, and accounts payable, classified as other financial liabilities, are measured at fair value at inception, which, due to their short-term nature, approximates their amortized cost.

Promissory notes receivable, classified as loans and receivables, are measured at amortized cost, which approximates face value, with interest earned recorded in net income.

Advances to officers classified as loans and receivables, are measured at amortized cost, which approximates face value, with interest earned recorded in net income.

Coastal Contacts Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

October 31, 2007 and 2006

2. CHANGE IN ACCOUNTING POLICIES, (cont'd.)

Comprehensive income

Comprehensive income includes net earnings and other comprehensive income. Other comprehensive income refers to changes in the net assets from certain transactions and events, other than transactions with shareholders. These changes are recorded directly as a separate component of shareholders' equity and excluded from net earnings. The Company's other comprehensive income includes the foreign currency translation adjustment for its foreign subsidiaries that do not use the Canadian dollar as their measurement currency. Cumulative foreign currency translation adjustment balances of prior years have been reclassified as accumulated other comprehensive income.

The Company's financial instruments consist of cash, bank indebtedness, accounts receivable, short-term investments, accounts payable, loans, and amounts due from related parties. The fair value of these financial instruments approximate their carrying value with the exception of certain related party advances. The fair value of such advances that are non-interest bearing and have no fixed repayment terms cannot be reliably estimated. It is management's opinion that the Company is not exposed to significant interest, currency or credit risk arising from these financial instruments.

Coastal Contacts Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

October 31, 2007 and 2006

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

These consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles. The consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries. All intercompany transactions and balances have been eliminated.

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

Revenue recognition

Revenue from product sales is recognized when the product has been shipped to the customer. At this point, the amount of sales revenue is determinable, no significant vendor obligations remain and the collection of the revenue is reasonably assured. A provision is made for product returns.

Deferred revenue includes revenue collected in advance of the product being shipped to the customer.

Foreign currency translation

The reporting currency of the Company is the Canadian dollar. Assets and liabilities of its subsidiaries with functional currencies other than the Canadian dollar are translated into Canadian dollars at the rates of exchange at the balance sheet date; income and expenses are translated at the average rates of exchange prevailing during the year. The resultant translation adjustments are reported as cumulative foreign currency translation adjustment in comprehensive income.

Monetary assets and liabilities denominated in currencies other than the functional currency are translated into the functional currency at the exchange rate prevailing at the balance sheet date. Revenues and expenses denominated in currencies other than the functional currency are translated at the date prevailing on the transaction date. Foreign currency translation gains or losses are recorded in income in the period in which they occur.

Coastal Contacts Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

October 31, 2007 and 2006

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (cont'd.)

Inventory

Inventory is valued at the lower of cost (determined on a first-in first-out basis) and net realizable value.

Property, equipment and leasehold improvements

Property, equipment and leasehold improvements are recorded at cost less accumulated amortization. Amortization is calculated over the estimated useful life of the assets at the following rates:

| | |
|-------------------------|--------------------------------------|
| Leasehold improvements | Over the remaining term of the lease |
| Furniture and fixtures | 20% declining balance |
| Computer hardware | 30% declining balance |
| Computer software | 50% declining balance |
| Customized ERP software | 20% straight-line |

Intangible assets

Finite life intangible assets are recorded at cost less accumulated amortization. Amortization is calculated over the estimated useful life of the assets at the following rates:

| | |
|---------------------|-----------------------------|
| Website development | 5 years straight-line basis |
| Customer lists | 5 years straight-line basis |

Trade names are considered to have an indefinite life and will not be amortized. Their values are reviewed for possible impairments annually or more frequently if events or changes in circumstances indicate possible impairment, based on the profitability and cash flows of the underlying business.

Coastal Contacts Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

October 31, 2007 and 2006

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (cont'd.)

Goodwill

Goodwill represents the excess of the purchase price over the fair value of the net assets acquired. Goodwill is not amortized and is reviewed for possible impairment annually or more frequently if events or changes in circumstances indicate possible impairment, based on the profitability and cash flows of the reporting units to which the goodwill relates.

Income taxes

Income taxes are accounted for using the liability method of tax allocation. Under this method future income tax assets and liabilities are recognized for the tax consequences of temporary differences by applying substantively enacted statutory tax rates applicable to future years to differences between the financial statement carrying amounts and the tax bases of existing assets and liabilities.

The effect on future taxes for a change in tax rates is recognized in income in the period that includes the substantive enactment. In addition, future tax assets are recognized to the extent their realization is more likely than not.

Stock-based compensation

The Company follows the recommendations of the Canadian Institute of Chartered Accountants ("CICA") Handbook Section 3870, *Stock-Based Compensation and Other Stock Based Payments* which requires the use of the fair value method of accounting for all stock options granted.

Earnings per share

The Company calculates basic earnings per share using the weighted average number of common shares outstanding during the period. Diluted earnings per share are calculated by the treasury stock method. Under the treasury stock method, the weighted average number of common shares outstanding for the calculation of diluted earnings per share assumes that the proceeds to be received on the exercise of dilutive stock options and warrants are applied to repurchase common shares at the average market price for the period. Stock options and warrants are dilutive when the Company has income from continuing operations and when the average market price of the common shares during the period exceeds the exercise price of the options and warrants.

Coastal Contacts Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

October 31, 2007 and 2006

4. BUSINESS ACQUISITIONS

(i) Acquisition of Mylenses

On August 11, 2006 through the Company's wholly owned subsidiary, Lensco Holdings AB, the Company completed the acquisition of all of the private companies' shares of Eye-1 B.V., Eye-2 B.V. and Condis B.V., ("Mylenses"), a European retailer of contact lenses. The consideration paid consisted of cash of \$3.4 million (2.350 million Euros) and 1.650 million common shares of the Company. The shares issued are subject to a voluntary pooling restriction. Under the terms of the agreement, 40% of the shares were released on August 11, 2007 with the remaining 60% to be released in four equal increments, each six months over the next 2 years, commencing February 11, 2008.

The acquisition was accounted for using the purchase method. Assets acquired and liabilities assumed were recorded at their fair market values as of the date of the acquisition. For purposes of computing the purchase price, the value of the restricted common shares was determined by taking the closing price of the Company's common stock as quoted on the TSX Exchange for the five days before, the day of and the five days following the date of acquisition. This average price was then reduced by a 15% discount due to the restriction provisions associated with the common shares issued. This discount is consistent with the discount applied to previous transactions with the same restrictions.

The following sets forth the purchase price and its allocation to the tangible and intangible assets acquired translated at the currency exchange rates prevailing on the day of acquisition.

| | \$000's |
|---|--------------|
| Cash | 3,358 |
| Restricted common shares | 1,702 |
| Direct acquisition costs | 321 |
| Total consideration | 5,381 |
| Cash | 26 |
| Accounts receivable | 566 |
| Property, equipment and leasehold improvements assets | 244 |
| Mylenses customer list | 893 |
| Mylenses trademarks and tradenames | 3,837 |
| Website development | 187 |
| Current liabilities | (491) |
| Future income tax liability | (1,455) |
| Net assets acquired | 3,807 |
| Goodwill | 1,574 |

Coastal Contacts Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

October 31, 2007 and 2006

4. BUSINESS ACQUISITIONS (cont'd.)

(i) Acquisition of MyLenses (cont'd.)

Following the acquisition, Mylenses purchased inventory in the amount of \$0.7 million from its former parent.

Mylenses operates two websites and each has its own trademarks and tradenames. Goodwill has been allocated to the Dutch reporting unit and is not deductible for income tax purposes. The results of operations have been included in the accompanying consolidated financial statements since August 12, 2006.

(ii) Acquisition of Asianzakka

On October 13, 2006 the Company completed the acquisition of all of the private company shares of Asianzakka PTE. Ltd. ("Asianzakka"), an Asian retailer of contact lenses. The consideration paid consisted of cash of \$0.6 million (0.8 million Singapore Dollars) and 1.0 million common shares of the Company. The shares issues are subject to a voluntary pooling restriction. Under the terms of the agreement, 40% of the shares were released on October 13, 2007, with the remaining 60% to be released in equal four equal increments, each six months over the next 2 years, commencing April 13, 2008.

Under the terms of the agreement, the Company may be required to make contingent payments of 0.8 million Singapore Dollars on January 31, 2008 and 0.4 million Singapore Dollars on July 31, 2008. The payments are contingent on Asianzakka meeting specified revenue and net income margin targets. Since the outcome of the contingency cannot be determined without reasonable doubt, the contingent payments have not been accrued. Should the contingent payments be made at a later date they will be accounted for as an adjustment of the purchase price of Asianzakka.

The acquisition was accounted for using the purchase method whereby assets acquired and liabilities assumed were recorded at their fair market values as of the date of the acquisition. For purposes of computing the purchase price, the value of the restricted common shares was determined by taking the closing price of the Company's common stock as quoted on the TSX Exchange for the five days before, the day of and the five days following the date of acquisition. This average price was then reduced by a 15% discount due to the restriction provisions associated with the common shares issued. This discount is consistent with the discount applied to previous transactions with the same restrictions.

Coastal Contacts Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

October 31, 2007 and 2006

4. BUSINESS ACQUISITIONS (cont'd.)

(ii) Acquisition of Asianzakka (cont'd.)

The following sets forth the purchase price and its allocation to the tangible and intangible assets acquired translated at the currency exchange rates prevailing on the day of acquisition.

| | \$000's |
|--------------------------------------|--------------|
| Cash | 588 |
| Restricted common shares | 811 |
| Direct acquisition costs | 105 |
| Total consideration | 1,504 |
| Cash | 148 |
| Other current assets | 532 |
| Property and equipment | 6 |
| Asianzakka customer lists | 234 |
| Asianzakka trademarks and tradenames | 819 |
| Current liabilities | (617) |
| Future income tax liability | (211) |
| Other assets and liabilities | - |
| Net assets acquired | 911 |
| Goodwill | 593 |

Asianzakka operates under several websites and has several trademarks and trade names. Goodwill has been allocated to the Singapore reporting unit and is not deductible for income tax purposes. The results of operations have been included in the accompanying consolidated financial statements since October 14, 2006.

Coastal Contacts Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

October 31, 2007 and 2006

5. CASH, CASH EQUIVALENTS AND SHORT-TERM INVESTMENTS

| | 2007 | 2006 |
|--|----------------|----------------|
| | \$000's | \$000's |
| Cash | 11,099 | 3,976 |
| Held to maturity guaranteed investment certificates, bankers acceptances and commercial paper | 11,916 | 19,940 |
| Other cash investments | 352 | 357 |
| Total cash and cash equivalents | 23,367 | 24,273 |
| Short-term investments, held to maturity, including bankers acceptances and commercial paper | 3,976 | - |
| | 27,343 | 24,273 |

The short-term investments mature 91- 290 days from the date of investment with an average interest rate of 4.5% (2006 – 4.6%).

6. ACCOUNTS RECEIVABLE, ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

Accounts receivable

| | 2007 | 2006 |
|---------------------------------|----------------|----------------|
| | \$000's | \$000's |
| Accounts receivable | 6,664 | 7,281 |
| Allowance for doubtful accounts | (619) | (607) |
| Value added tax receivable | 604 | 453 |
| | 6,649 | 7,127 |

Accounts payable and accrued liabilities

| | 2007 | 2006 |
|--------------------------|----------------|----------------|
| | \$000's | \$000's |
| Accounts payable - trade | 10,902 | 9,864 |
| Accrued liabilities | 2,657 | 1,633 |
| Value added tax payable | 322 | 296 |
| | 13,881 | 11,793 |

Coastal Contacts Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

October 31, 2007 and 2006

7. PROPERTY, EQUIPMENT AND LEASEHOLD IMPROVEMENTS

| | Cost \$000's | Accumulated Amortization \$000's | Net Book Value \$000's |
|-------------------------|-------------------------|---|---------------------------------------|
| 2007 | | | |
| Leasehold improvements | 943 | 367 | 576 |
| Computer hardware | 917 | 423 | 494 |
| Computer software | 451 | 291 | 160 |
| Customized ERP Software | 1,462 | 484 | 978 |
| Furniture and fixtures | 781 | 289 | 492 |
| | 4,554 | 1,854 | 2,700 |
| 2006 | | | |
| Leasehold improvements | 915 | 200 | 715 |
| Computer hardware | 735 | 258 | 477 |
| Computer software | 311 | 144 | 167 |
| Customized ERP Software | 1,184 | 249 | 935 |
| Furniture and fixtures | 688 | 209 | 479 |
| | 3,833 | 1,060 | 2,773 |

As at October 31, 2007, capital projects in progress not subject to amortization were \$0.4 million (2006 - \$0.6 million).

Coastal Contacts Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

October 31, 2007 and 2006

8. INTANGIBLE ASSETS

| | Cost \$000's | Accumulated Amortization \$000's | Net Book Value \$000's |
|-------------------------------------|-------------------------|---|---------------------------------------|
| 2007 | | | |
| Website creation | 3,402 | 849 | 2,553 |
| Brand names and Trademarks acquired | 7,386 | - | 7,386 |
| Customer lists acquired | 3,490 | 1,717 | 1,773 |
| | <u>14,278</u> | <u>2,566</u> | <u>11,712</u> |
| 2006 | | | |
| Website creation | 1,930 | 295 | 1,635 |
| Brand names and Trademarks acquired | 8,800 | — | 8,800 |
| Customer lists acquired | 4,236 | 1,039 | 3,197 |
| | <u>14,966</u> | <u>1,334</u> | <u>13,632</u> |

9. GOODWILL

| | October 31, 2006 \$000's | Additions and adjustments \$000's | Currency Impact \$000's | October 31, 2007 \$000's |
|---------------------------|---|--|--|---|
| Business Acquisitions: | | | | |
| Acquisition of Lensway | 5,583 | - | (262) | 5,321 |
| Acquisition of Yourlenses | 160 | - | (6) | 154 |
| Acquisition of MyLenses | 590 | 986 | (62) | 1,514 |
| Acquisition of Asianzakka | 364 | 230 | (54) | 540 |
| Total Goodwill | <u>6,697</u> | <u>1,216</u> | <u>(384)</u> | <u>7,529</u> |

Coastal Contacts Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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10. SHARE CAPITAL

[a] Issued and outstanding common shares

Authorized share capital comprises an unlimited number of common shares without par value and an unlimited amount of Class A preferred shares without par value. Common shares are issued and outstanding as follows:

| | 2007 | | 2006 | |
|---|---------------------------------|---------|---------------------------------|---------|
| | Number of Common Shares # | \$000's | Number of Common Shares # | \$000's |
| Balance - beginning of year | 74,681,712 | 53,515 | 51,632,951 | 26,264 |
| Issued in private placement | - | - | 9,000,000 | 21,070 |
| Purchased and cancelled | (3,805,200) | (2,727) | - | - |
| Issued on exercise of warrants | - | - | 3,163,715 | 3,480 |
| Issued on exercise of options | 550,000 | 69 | 8,193,618 | 188 |
| Issued in purchase of MyLenses [note 4] | - | - | 1,650,000 | 1,702 |
| Issued in purchase of Asianzakka [note 4] | - | - | 1,041,428 | 811 |
| Balance - end of year including | | | | |
| shares held in treasury | 71,426,512 | 50,857 | 74,681,712 | 53,515 |
| Shares repurchased not cancelled | (78,500) | (89) | (42,700) | (41) |
| Balance - end of year | 71,348,012 | 50,768 | 74,639,012 | 53,474 |

On January 31, 2006, the Company closed on an underwritten bought deal 9,000,000 special warrants by way of private placement, at a price of \$2.50 per special warrant, for gross cash proceeds of \$22.5 million. The Company paid underwriters a commission equal to 6% of the gross proceeds and up to \$30,000 for underwriters' expenses and fees related to the offering. Net proceeds were \$21.1 million after underwriters' commission and other underwriting costs. The special warrants and common shares issuable upon exercise of the special warrants were subject to resale restrictions for a period of four months from the closing date. Each special warrant is exercisable to acquire one common share of the Company for no additional consideration. These warrants were exercised on March 30, 2006 into common shares.

Coastal Contacts Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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10. SHARE CAPITAL (cont'd.)

On October 16, 2006, the Toronto Stock Exchange accepted the Company's notice of intention to make a Normal Course Issuer Bid for its common shares through the facilities of the exchange. Effective October 18, 2006, the Company was able to commence making purchases and cancellations of up to a maximum of 4,933,641 common shares, at the market price for the common shares at the time of acquisition. The bid was terminated on October 17, 2007. As at October 17, 2007, a total of 3,818,600 shares had been purchased, of which 13,400 shares had not yet been cancelled. These shares were cancelled in November 2007. 3,805,200 shares were purchased at an average price per share of \$1.05 and were cancelled during the year ended October 31, 2007. The excess of the purchase price over the average stated capital of the shares has been charged to retained earnings.

On October 24, 2007, the Toronto Stock Exchange accepted the Company's notice of intention to make a Normal Course Issuer Bid for its common shares through the facilities of the exchange. Effective October 26, 2007, the Company was able to commence making purchases and cancellations of up to a maximum of 4,607,285 common shares, at the market price for the common shares at the time of acquisition. As at October 31, 2007, a total of 65,100 shares had been purchased, none of which had been cancelled. These shares were cancelled in November 2007.

As at October 31, 2007, 1,620,879 (2006 – 6,667,995) shares were subject to voluntary pooling restrictions.

Coastal Contacts Inc.

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10. SHARE CAPITAL (cont'd.)

[b] Share purchase options

The shareholders of the Corporation have adopted a stock option plan (the "Option Plan") for its directors, officers and employees. The Option Plan provides that options to purchase common shares may be granted to eligible persons on terms determined within the limitations set out in the Option Plan. The maximum number of common shares to be reserved for issuance at any one time under the Option Plan and any other employee incentive plan is 10% of the then issued and outstanding common shares. The exercise price for a share purchase option granted under the Option Plan may not be less than that permitted by applicable regulatory authorities. Options granted may be subject to vesting requirements. Non-assignable options will be granted for a period which may not exceed five years from the date of the grant and will expire within 90 days upon the participant ceasing to be a director, officer or an employee of the Company. The Option Plan is administered by the Company's Compensation and Corporate Governance Committee. The Option Plan is subject to the rules and policies of the TSX Exchange.

The following table contains information with respect to Company share purchase options:

| | # | \$ |
|---------------------------------------|-------------|--------------|
| Options outstanding, October 31, 2005 | 9,183,915 | 0.005 – 1.00 |
| Granted | 150,000 | 1.37 |
| Exercised | (8,193,615) | 0.005 – 1.00 |
| Options outstanding, October 31, 2006 | 1,140,300 | 0.125 – 1.37 |
| Granted | 1,805,000 | 0.87– 1.14 |
| Exercised | (550,000) | 0.125 |
| Forfeited | (186,361) | 1.00-1.37 |
| Expired | (500) | 0.175 |
| Options outstanding, October 31, 2007 | 2,208,439 | 0.87 – 1.37 |

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10. SHARE CAPITAL (cont'd.)

The following table summarizes information about Company stock options outstanding as at October 31, 2007:

| Range of exercise price \$ | Share purchase options Outstanding | | | Share purchase options Exercisable | |
|----------------------------|------------------------------------|---|------------------------------------|------------------------------------|------------------------------------|
| | Number of common shares issuable | Weighted average remaining contractual life (years) | Weighted average exercise price \$ | Number of common shares issuable | Weighted average exercise price \$ |
| \$0.87 - \$0.99 | 1,033,667 | 4.40 | 0.91 | 96,403 | 0.97 |
| \$1.00 | 355,772 | 1.55 | 1.00 | 355,772 | 1.00 |
| \$1.09 - \$1.37 | 819,000 | 4.62 | 1.14 | 72,511 | 1.18 |
| | 2,208,439 | 4.03 | 1.01 | 524,686 | 1.02 |

On January 31, 2006, an officer entered into a call option agreement with a principal shareholder for 300,000 options. These options are exercisable at \$1.00 per share. 120,000 of these options vested on January 31, 2007 while the remaining options will vest in equal six month increments over 2 years. Using the Black-Scholes option-pricing model, the Company estimates the fair value of this option grant to be \$0.3 million.

On November 22, 2006, an officer entered into a call option agreement with a principal shareholder for 300,000 options. These options are exercisable at \$0.99 per share and vest in equal monthly increments over 3 years. Using the Black-Scholes option-pricing model, the Company estimates the fair value of this option grant to be \$0.1 million.

The fair value of the option grants are estimated on the date of the grant using the Black-Scholes option-pricing model with the following weighted average assumptions:

| | 2007 | 2006 |
|-------------------------|-----------|-----------|
| Dividend yield | 0% | 0% |
| Expected volatility | 62% | 59% |
| Risk free interest rate | 4.3% | 4.0% |
| Expected lives | 3.0 years | 2.7 years |

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11. CONTRIBUTED SURPLUS

| | 2007 | 2006 |
|---|----------------|----------------|
| | \$000's | \$000's |
| Balance - beginning of year | 530 | 593 |
| Stock-based compensation | 443 | 268 |
| Reclassification to share capital on exercise of warrants | - | (331) |
| Balance - end of year | 973 | 530 |

12. ACCUMULATED OTHER COMPREHENSIVE INCOME

| | 2007 | 2006 |
|---|----------------|----------------|
| | \$000's | \$000's |
| Balance – beginning of year | (2,135) | (1,808) |
| Unrealized foreign exchange losses on translation of financial statements of self-sustaining foreign operations | (1,956) | (327) |
| Balance – end of the year | (4,091) | (2,135) |

13. EARNINGS PER SHARE

| | 2007 | 2006 |
|--|-------------|-------------|
| Weighted average number of common shares outstanding - basic | 72,948,602 | 68,018,799 |
| Stock options | 126,154 | - |
| Weighted average number of common shares outstanding - diluted | 73,074,756 | 68,018,799 |

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14. INCOME TAXES

Future income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Significant components of the Company's future tax assets and liabilities are as follows:

| | 2007 | 2006 |
|--|----------------|----------------|
| | \$000's | \$000's |
| Future tax assets | | |
| Non-capital loss carryforwards | 2,303 | 1,980 |
| Net book value of capital assets in excess of tax value | (404) | (220) |
| Share issue costs | 581 | 865 |
| Other | 195 | 159 |
| Total future tax assets | 2,675 | 2,784 |
| Valuation allowance | (2,675) | (2,784) |
| Total future tax assets | - | - |
| Future tax liabilities | | |
| Expense recognized for tax purposes in foreign jurisdictions | 714 | 371 |
| Net book value of capital assets in excess of tax value | 425 | 306 |
| Carrying value of intangible assets in excess of tax basis | 2,522 | 3,550 |
| | 3,661 | 4,227 |

The potential income tax benefits relating to the future tax assets have not been recognized in the consolidated financial statements where their realization did not meet the requirements of "more likely than not" under the liability method of tax allocation.

Significant components of the income tax expense attributable to continuing operations are as follows:

| | 2007 | 2006 |
|--|----------------|----------------|
| | \$000's | \$000's |
| Current income tax expense | 901 | 580 |
| Future income tax recovery relating to reversal of taxable temporary differences | 62 | 371 |
| | 963 | 951 |

Coastal Contacts Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

October 31, 2007 and 2006

14. INCOME TAXES (cont'd.)

The reconciliation of income taxes attributable to continuing operations computed at the statutory income tax rates to income tax expense, at the statutory tax rate of 34.1% [2006 – 34.75%] is as follows:

| | 2007 | 2006 |
|--|----------------|----------------|
| | \$000's | \$000's |
| Income tax expense (recovery) at statutory tax rates | 883 | (134) |
| Expenses not deductible for income tax purposes | 403 | 98 |
| Financing costs deductible for income tax purposes | (312) | (318) |
| Non-capital losses generated | 338 | 1,960 |
| Foreign tax rate differential | (181) | (575) |
| Change in future tax rate | (206) | - |
| Other | 38 | (80) |
| | 963 | 951 |

As at October 31, 2007, the Company has non-capital loss carryforwards of \$7.3 million for Canadian income tax purposes that expire as follows:

| | \$000's |
|------|----------------|
| 2010 | 304 |
| 2014 | 440 |
| 2026 | 5,639 |
| 2027 | 962 |
| | 7,345 |

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15. RELATED PARTY TRANSACTIONS

| | 2007 | 2006 |
|-----------------------------|----------------|----------------|
| | \$000's | \$000's |
| Promissory notes receivable | 342 | 376 |
| Advances to officers | 6 | 234 |
| | <u>348</u> | <u>610</u> |

During 2006, the Company issued nine promissory notes from officers ranging in value from \$0.01 million to \$0.1 million and totaling \$0.36 million. These loans are payable on demand and bear interest at 5% per annum. During the year, repayments were made on the loans in the amount of \$0.06 million (2006 - \$0.1 million).

During the year, the Company made other advances to officers in the amount of \$0.07 million, and received repayments of \$0.3 million (2006 – advanced \$0.07 million).

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16. SEGMENTED INFORMATION

The Company operates in one business segment, the sale of contact lenses. The Company ships product from North America and Europe to customers in North America, Europe and Asia.

Geographical information is based on the location of the customers in which the Company sells contact lenses and accessories. Intercompany revenues have been excluded from the revenues in the country of shipment. Certain comparative figures have been adjusted to reflect this reporting.

| | United States | Sweden | Norway | Other | Total |
|---|----------------------|----------------|----------------|----------------|----------------|
| | \$000's | \$000's | \$000's | \$000's | \$000's |
| Revenue | | | | | |
| Year ended October 31, 2007 | 16,972 | 25,968 | 15,981 | 43,253 | 102,174 |
| Year ended October 31, 2006 | 25,665 | 21,638 | 12,634 | 21,077 | 81,014 |
| Property, equipment and leasehold improvements | | | | | |
| As at October 31, 2007 | — | 1,466 | — | 1,234 | 2,700 |
| As at October 31, 2006 | — | 1,439 | — | 1,334 | 2,773 |
| Intangible assets | | | | | |
| As at October 31, 2007 | — | 4,506 | — | 7,206 | 11,712 |
| As at October 31, 2006 | — | 4,978 | — | 8,654 | 13,632 |
| Goodwill | | | | | |
| As at October 31, 2007 | — | 5,475 | — | 2,054 | 7,529 |
| As at October 31, 2006 | — | 5,743 | — | 954 | 6,697 |

Included in "Other" are revenues to non-related customers in the Company's home domicile of \$8.6 million year ended October 31, 2007 (2006 - \$3.6 million). Property, equipment and leasehold improvements located in the Company's home domicile were \$1.1 million at October 31, 2007 (2006 - \$1.4 million), and intangible assets were \$1.8 million at October 31, 2007 (2006 - \$1.1 million).

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17. COMMITMENTS

The Company is committed to minimum annual payments, primarily related to lease costs on its warehouse and office premises, as follows:

| | \$000's |
|---------------------|----------------|
| 2008 | 1,277 |
| 2009 | 948 |
| 2010 | 542 |
| 2011 | 133 |
| 2012 and thereafter | - |
| | <u>2,900</u> |

Operating costs on leases have been excluded.

18. CONTINGENCIES

- (a) Under the terms of the agreement to acquire the shares of Asianzakka PTE. Ltd., the Company may be required to make contingent payments of 0.8 million Singapore Dollars (\$0.5 million) on January 31, 2008 and 0.4 million Singapore Dollars (\$0.3 million) on July 31, 2008. The payments are contingent on Asianzakka meeting specified revenue and net income margin targets. The liability has not been accrued in the financial statements as the amount of the liability cannot be determined at this time.
- (b) On September 6, 2007, the Company received a petition filed by the College of Opticians Of British Columbia (the "Opticians") in the Supreme Court of British Columbia. The Opticians seek an order to restrict Coastal Contacts Inc. from selling contact lenses to members of the public in British Columbia. Management of the Company believes the petition is without merit, and intends to vigorously defend against these actions.

19. COMPARATIVE FIGURES

Certain comparative figures have been reclassified to conform to the current year's presentation.