



# Coastal Contacts Inc.

INTERIM CONSOLIDATED FINANCIAL STATEMENTS  
AND MANAGEMENT'S DISCUSSION AND ANALYSIS

FOR THE THREE AND SIX MONTHS ENDED APRIL 31, 2009

INTERIM CONSOLIDATED FINANCIAL STATEMENTS

**COASTAL CONTACTS INC.**

UNAUDITED

FOR THE THREE AND SIX MONTHS ENDED APRIL 30, 2009

**COASTAL CONTACTS INC.**  
**CONSOLIDATED BALANCE SHEETS**

(\$000's)

	April 30, 2009	October 31, 2008
	(Unaudited)	
<b>ASSETS</b>		
<b>Current</b>		
Cash and cash equivalents <i>[note 4]</i>	14,627	15,206
Accounts receivable	7,578	7,279
Income tax receivable	-	57
Inventory	14,759	9,495
Prepaid expenses	1,518	1,693
Future income tax	160	157
Due from related parties	370	361
	39,012	34,248
Property, equipment and leasehold improvements	2,977	3,038
Intangible assets	9,940	11,061
Goodwill	7,602	7,908
	59,531	56,255
<b>LIABILITIES</b>		
<b>Current</b>		
Accounts payable and accrued liabilities	22,312	18,787
Income tax payable	230	-
Deferred revenue	32	27
Lease inducement	66	67
	22,640	18,881
Long-term lease inducement	40	79
Future income tax	3,570	3,825
	26,250	22,785
<b>SHAREHOLDERS' EQUITY</b>		
Share capital <i>[note 5]</i>		
Authorized:		
Unlimited common shares without par value		
Unlimited Class A preferred shares without par value		
Issued and outstanding:		
57,699,619 common shares [2008 – 58,318,643]	40,812	41,250
Shares held in treasury		
599,000 common shares [2008 – nil]	(473)	-
Contributed surplus <i>[note 6]</i>	1,896	1,600
Accumulated other comprehensive loss <i>[note 7]</i>	(3,915)	(2,904)
Deficit	(5,039)	(6,476)
	33,281	33,470
	59,531	56,255

*See accompanying notes to the unaudited interim consolidated financial statements*

Contingency *[note 10]*  
Subsequent Event *[note 11]*

**COASTAL CONTACTS INC.**  
**CONSOLIDATED STATEMENTS OF OPERATIONS AND**  
**COMPREHENSIVE EARNINGS (LOSS)**

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

	Three months ended		Six months ended	
	April 30		April 30	
	2009	2008	2009	2008
Sales	33,301	28,632	64,643	54,007
Cost of sales	23,857	20,503	45,590	39,515
<b>Gross profit</b>	<b>9,444</b>	<b>8,129</b>	<b>19,053</b>	<b>14,492</b>
Advertising	4,252	3,544	8,378	6,680
Selling, general and administration expenses	3,805	3,618	7,465	7,166
Share-based compensation	148	179	296	334
Amortization on property, equipment and leasehold improvements	240	249	455	478
Amortization on intangible assets	364	420	763	791
Foreign exchange (gains) losses	(39)	50	(241)	(195)
Interest income, net	(14)	(155)	(56)	(387)
Restructuring charges	-	844	-	844
<b>Earnings (loss) before income taxes</b>	<b>688</b>	<b>(620)</b>	<b>1,993</b>	<b>(1,219)</b>
Income tax expense	160	72	497	174
<b>Net earnings (loss)</b>	<b>528</b>	<b>(692)</b>	<b>1,496</b>	<b>(1,393)</b>
<b>Other comprehensive earnings (loss)</b>				
Unrealized foreign exchange gains (losses) on translation of financial statements of self-sustaining foreign operations	202	1,468	(1,011)	2,749
<b>Comprehensive earnings</b>	<b>730</b>	<b>776</b>	<b>485</b>	<b>1,356</b>
Basic earnings (loss) per share	0.01	(0.01)	0.03	(0.02)
Diluted earnings (loss) per share	0.01	(0.01)	0.03	(0.02)
Weighted average number of common shares outstanding				
Basic	57,974,911	65,091,658	58,149,443	68,217,592
Diluted	57,988,378	65,091,658	58,155,121	68,217,592

*See accompanying notes to the unaudited interim consolidated financial statements*

**COASTAL CONTACTS INC.**  
**CONSOLIDATED STATEMENTS OF DEFICIT**

(Unaudited) (\$000's)

<b>Six months ended April 30</b>	<b>2009</b>	<b>2008</b>
Deficit, beginning of period	(6,476)	(70)
Net earnings (loss)	1,496	(1,393)
Premium on purchase of common shares for cancellation	(59)	(4,176)
Deficit, end of period	(5,039)	(5,639)

*See accompanying notes to the unaudited interim consolidated financial statements*

**COASTAL CONTACTS INC.**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**

(Unaudited) (\$000's)

	Three months ended		Six months ended	
	April 30		April 30	
	2009	2008	2009	2008
<b>OPERATING ACTIVITIES</b>				
Net earnings (loss)	528	(692)	1,496	(1,393)
Non-cash items:				
Amortization	604	669	1,218	1,269
Amortization of deferred lease inducement	(20)	(20)	(40)	(40)
Accrued interest	-	(4)	-	(10)
Share-based compensation	148	179	296	334
Future income taxes	(25)	(22)	(38)	(32)
Unrealized foreign exchange (gains) losses	-	5	-	(229)
Changes in non-cash working capital:				
Accounts receivable	550	(128)	(504)	(56)
Inventory	(3,965)	983	(5,523)	(424)
Prepaid expenses	(124)	(151)	298	(242)
Accounts payable and accrued liabilities	6,504	(901)	4,104	1,535
Income tax payable	(233)	(9)	164	(387)
Deferred revenue	(11)	(23)	5	-
<b>Cash provided by (used in) operating activities</b>	<b>3,956</b>	<b>(114)</b>	<b>1,476</b>	<b>325</b>
<b>INVESTING ACTIVITIES</b>				
Maturity of short-term investments	-	-	-	3,976
Repayments from (advances to) related parties	(5)	(9)	(8)	(4)
Acquisition of property, equipment and leasehold improvements	(249)	(367)	(406)	(695)
Acquisition of intangible assets	(21)	(83)	(21)	(361)
Disposition of property and equipment	60	-	60	-
<b>Cash provided by (used in) investing activities</b>	<b>(215)</b>	<b>(459)</b>	<b>(375)</b>	<b>2,916</b>
<b>FINANCING ACTIVITIES</b>				
Purchase of common shares for cancellation	(953)	(9,476)	(970)	(9,786)
Share related costs	-	(165)	-	(165)
<b>Cash used in financing activities</b>	<b>(953)</b>	<b>(9,641)</b>	<b>(970)</b>	<b>(9,951)</b>
Effect of exchange rate changes on cash and cash equivalents	(117)	424	(710)	887
Increase (decrease) in cash and cash equivalents	2,671	(9,790)	(579)	(5,823)
Cash and cash equivalents, beginning of period	11,956	27,334	15,206	23,367
<b>Cash and cash equivalents, end of period</b>	<b>14,627</b>	<b>17,544</b>	<b>14,627</b>	<b>17,544</b>
Income tax paid in cash	488	464	597	1,137

See accompanying notes to the unaudited interim consolidated financial statements

# COASTAL CONTACTS INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

April 30, 2009  
Unaudited

### 1. NATURE OF OPERATIONS AND BASIS OF PRESENTATION

Coastal Contacts Inc. (the "Company") is a global retailer of contact lenses, eyeglasses and related vision care products sold primarily through its internet sites. The Company has customers in North America, Europe and the Asia Pacific region.

These unaudited interim consolidated financial statements have been prepared by the Company in accordance with Canadian generally accepted accounting principles ("GAAP") for interim financial statements, and accordingly, do not include all disclosures required for annual financial statements. These unaudited interim consolidated financial statements reflect the same accounting principles and methods of application as those disclosed in the notes to the Company's audited consolidated financial statements for the year ended October 31, 2008, with the exception of the application of the accounting policies described in Note 2. These unaudited interim consolidated financial statements and notes thereto should be read in conjunction with the audited consolidated financial statements and notes thereto for the year ended October 31, 2008. The consolidated financial statements include accounts of the Company and its wholly owned subsidiaries. All intercompany transactions and balances have been eliminated.

The preparation of these unaudited interim consolidated financial statements and the accompanying notes requires management to make estimates and assumptions that affect the amounts reported. In the opinion of management, these unaudited interim consolidated financial statements reflect all adjustments necessary to state fairly the results for the periods presented. Actual results could vary from these estimates and the operating results for the interim periods presented are not necessarily indicative of the results expected for the full year.

### 2. CHANGE IN ACCOUNTING POLICIES

Effective November 1, 2008, the Company has adopted the following accounting standards issued by the Canadian Institute of Chartered Accountants ("CICA"). These standards have been adopted on a prospective basis with no restatement of prior period financial statements.

#### (a) Inventories

In March 2007, the CICA approved Handbook Section 3031, "*Inventories*" which replaces the existing Handbook Section 3030, "*Inventories*". This standard is effective for interim and annual financial statements relating to fiscal years beginning on or after January 1, 2008, with earlier application encouraged. The standard provides more guidance on the measurement and disclosure requirements for inventories. The adoption of this standard had no impact on the consolidated financial statements.

#### (b) Goodwill and intangible assets

In October 2007, the CICA approved Handbook Section 3064, "*Goodwill and Intangible Assets*" which replaces the existing Handbook Sections 3062, "*Goodwill and Other Intangible Assets*" and 3450 "*Research and Development Costs*". This standard is effective for interim and annual financial statements relating to fiscal years beginning on or after October 1, 2008, with earlier application encouraged. The standard provides guidance on the recognition, measurement and disclosure requirements for goodwill and intangible assets. The adoption of this standard had no impact on the consolidated financial statements.

# COASTAL CONTACTS INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

April 30, 2009

Unaudited

### 3. FUTURE ACCOUNTING POLICIES

#### Transition to International Financial Reporting Standards

In accordance with the Canadian Institute of Chartered Accountants Accounting Standards Board (AcSB), Canadian publicly accountable enterprises will be required to prepare financial statements in accordance with International Financial Reporting Standards (IFRS). This changeover to IFRS from Canadian GAAP will apply to the Company's financial statements for the year beginning on November 1, 2011. The Company will undertake the appropriate measures to ensure compliance with these new standards by the prescribed adoption date. The Company is currently assessing the implications of these standards on the consolidated financial statements.

### 4. CASH AND CASH EQUIVALENTS

The Company has \$1,271,895 of cash on hand which is restricted pursuant to a letter of guarantee issued by a financial institution in favour of the Norwegian Customs and Excise Service to secure the payment of duty and value added tax collected by the Company.

### 5. 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, of which none are issued. Common shares issued and outstanding as follows:

	Six Months Ended April 30, 2009		Six Months Ended October 31, 2008	
	#	\$000's	#	\$000's
Balance, beginning of period	58,318,643	41,250	63,430,443	44,996
Purchased and cancelled	(619,024)	(438)	(5,111,800)	(3,746)
Balance, end of period including shares held in treasury	57,699,619	40,812	58,318,643	41,250
Shares purchased not cancelled	(599,000)	(473)	-	-
Balance, end of period	57,100,619	40,339	58,318,643	41,250

On October 24, 2007, the Toronto Stock Exchange accepted the Company's notice of intention to make a Normal Course Issuer Bid for up to 4,607,285 of its common shares through the facilities of the exchange. The bid was terminated on October 24, 2008. As at October 24, 2008, a total 1,266,500 shares had been purchased at an average price of \$1.10 per share. All of these shares have been cancelled. The excess premium of the purchase price over the average stated capital of the shares has been charged to deficit.

# COASTAL CONTACTS INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

April 30, 2009  
Unaudited

### 5. SHARE CAPITAL (continued)

On February 25, 2008, the Company completed the purchase of 6,837,344 common shares pursuant to an Issuer Bid. The shares were repurchased at \$1.25 per share, for a total cost of \$8.5 million and associated expenses. The excess of the purchase price over the average stated capital of the shares has been charged to deficit.

On August 1, 2008, the Company completed the purchase of 5,000,000 of its common shares at \$1.00 per share, for a total of \$5,000,000, plus associated expenses, pursuant to an offer to purchase dated June 19, 2008. All of these shares have been cancelled. The excess premium of the purchase price over the average stated capital of the shares has been charged to deficit.

On December 19, 2008, the Company renewed the Normal Course Issuer Bid with the Toronto Stock Exchange for a maximum eligible repurchase of 3,634,369 common shares. As at April 30, 2009, the Company had repurchased 1,218,024 common shares for an average price of \$0.80 per share, of which 599,000 were classified as shares held in treasury, the remaining shares were cancelled. The excess premium of the purchase price over the average stated capital of the shares has been charged to deficit.

As at April 30, 2009, 403,714 (October 31, 2008 – 807,428) common shares were subject to voluntary pooling restrictions.

#### (b) Share purchase options

The shareholders of the Company have adopted a stock option plan (the "Option Plan") for its directors, officers, employees and service providers. 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 following table contains information with respect to Company share options:

	#	\$
Options outstanding, November 1, 2008	3,176,271	0.69 - 1.14
Granted	940,000	0.80
Forfeited	(15,834)	1.00
<b>Options outstanding, April 30, 2009</b>	<b>4,100,437</b>	<b>0.69 – 1.14</b>

**COASTAL CONTACTS INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

April 30, 2009  
 Unaudited

**5. SHARE CAPITAL (continued)**

The following table summarizes information about Company share purchase options outstanding as at April 30, 2009:

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 \$
\$0.69 - \$0.99	2,107,500	4.07	0.86	408,511	0.93
\$1.00 - \$1.14	1,992,937	3.25	1.07	683,022	1.05
	4,100,437	3.67	0.96	1,091,533	1.00

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:

	2009	2008
Dividend yield	0%	0%
Expected volatility	57%	56%
Risk free interest rate	1.96%	3.12%
Expected lives	5.0 years	5.0 years

**6. CONTRIBUTED SURPLUS**

	\$000's
Balance - November 1, 2008	1,600
Share-based compensation	296
Balance - April 30, 2009	1,896

**COASTAL CONTACTS INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

April 30, 2009  
Unaudited

**7. ACCUMULATED OTHER COMPREHENSIVE LOSS**

	<b>\$000's</b>
Balance - November 1, 2008	(2,904)
Unrealized foreign exchange gains (losses) on translation of financial statements of self-sustaining foreign operations	(1,011)
Balance - April 30, 2009	(3,915)

**8. RELATED PARTY TRANSACTIONS**

	<b>April 30, 2009 \$000's</b>	<b>October 31, 2008 \$000's</b>
Promissory notes receivable	370	361

As at April 30, 2009, there were five promissory notes outstanding, ranging in value from \$0.01 million to \$0.1 million and totalling \$0.32 million. Accumulated interest totals \$0.05 million. These loans are payable on demand and bear interest at a rate of 5% per annum. The debtors are personally liable for the amounts owed.

**COASTAL CONTACTS INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

April 30, 2009  
 Unaudited

**9. SEGMENTED INFORMATION**

The Company operates in one business segment, the sale of contact lenses, glasses and related vision care products. 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 \$000's	Sweden \$000's	Norway \$000's	Other \$000's	Total \$000's
<b>Revenue</b>					
<b>Three months ended April 30, 2009</b>	<b>4,893</b>	<b>7,266</b>	<b>4,676</b>	<b>16,466</b>	<b>33,301</b>
Three months ended April 30, 2008	4,126	7,643	4,619	12,244	28,632
<b>Six months ended April 30, 2009</b>	<b>9,467</b>	<b>14,487</b>	<b>9,139</b>	<b>31,550</b>	<b>64,643</b>
Six months ended April 30, 2008	8,054	13,862	8,771	23,320	54,007
<b>Property, equipment and leasehold improvements</b>					
<b>As at April 30, 2009</b>	-	<b>1,481</b>	-	<b>1,496</b>	<b>2,977</b>
As at October 31, 2008	-	1,703	-	1,335	3,038
<b>Intangible assets</b>					
<b>As at April 30, 2009</b>	-	<b>3,561</b>	-	<b>6,379</b>	<b>9,940</b>
As at October 31, 2008	-	4,086	-	6,975	11,061
<b>Goodwill</b>					
<b>As at April 30, 2009</b>	-	<b>5,483</b>	-	<b>2,119</b>	<b>7,602</b>
As at October 31, 2008	-	5,721	-	2,187	7,908

Included in "Other" are revenues to non-related customers in the Company's country of home domicile of \$5.7 million and \$10.3 million for the three months and six months ended April 30, 2009 (2008 - \$3.0 million and \$5.7 million). Property, equipment and leasehold improvements located in the Company's country of home domicile were \$1.5 million at April 30, 2009 (2008 - \$1.3 million), and intangible assets were \$1.1 million at April 30, 2009 (2008 - \$1.5 million).

**10. CONTINGENCY**

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 sought an order to restrict Coastal Contacts Inc. from selling contact lenses to members of the public in British Columbia. On April 25, 2008, the Supreme Court of British Columbia denied the petition filed by the Opticians.

**COASTAL CONTACTS INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

April 30, 2009  
Unaudited

**10. CONTINGENCY (continued)**

On May 26, 2008, the Company received a notice of appeal filed by the Opticians with the British Columbia Court of Appeal seeking to overturn the ruling by the Supreme Court of British Columbia.

On August 14, 2008 the Company filed a statement of claim against the Opticians for certain statements made relating to the sale of contact lenses. The Company is unable to predict the outcome of the claim at this time.

On May 13, 2009, the appeal filed by the opticians was heard by the British Columbia Court of Appeal and defended against by the Company. A decision has not been rendered by the British Columbia court of Appeal, nor can the date of a decision be estimated. Management of the Company believes the original petition and subsequent appeal is without merit.

**11. SUBSEQUENT EVENT**

On May 27, 2009, a subsidiary company of Coastal Contacts Inc. entered into an agreement, with its primary bank, for a secured overdraft facility, totaling 25,000,000 Swedish Krona (approximately CAD\$3.7 million) with interest payable at a rate of 1% above the Stockholm Interbank Offered Rate.

**12. COMPARATIVE FIGURES**

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

## **Management's Discussion and Analysis of Financial Condition and Results of Operations for the three and six months ended April 30, 2009**

**June 10, 2009**

This Management's Discussion and Analysis of Financial Condition and Results of Operations ("MD&A") is dated as of June 10, 2009 and should be read in conjunction with Coastal Contacts Inc.'s (the "Company", "our", "we", "us", "Coastal Contacts" or "Coastal") unaudited interim consolidated financial statements for the fiscal quarter ended April 30, 2009 and the corresponding notes thereto. We prepare our consolidated financial statements in accordance with Canadian generally accepted accounting principles ("GAAP") and use Canadian dollars as our reporting currency.

### **Forward-looking statements**

All statements made in this management's discussion and analysis, other than statements of historical fact, are forward-looking statements. The words "may", "would", "could", "will", "intend", "plan", "anticipate", "believe", "estimate", "expect", "goal", "target", "should," "likely," "potential," "continue," "project," "forecast," "prospects," and similar expressions typically are used to identify forward-looking statements. Examples of such forward-looking statements within this document include statements relating to: our ability to achieve consistent and sustainable growth through the continued development of our core business; the execution of our growth initiatives including expansion into new markets and expansion of market share within existing markets; our perception of the contact lens industry or market and anticipated trends in that market in any of the countries in which we do business; our anticipated ability to procure products, or the terms under which we may procure our products; our anticipated business operations, inventory levels, ability to handle specific order and call volumes, ability to fill and timely ship orders, ability to achieve greater marketing efficiency or similar statements; the anticipated outcome of ongoing litigation; our relationships with suppliers; our anticipated results of operations, including but not limited to anticipated sales, revenues, earnings, tax benefits or similar matters; sufficiency of cash flows; and our perceptions regarding volatility in and impact of foreign currency exchange rates.

Forward-looking statements are based on the then-current expectations, beliefs, assumptions, estimates and forecasts about our business and the industry and markets in which we operate. Forward-looking statements are not guarantees of future performance and involve risks, uncertainties and assumptions which are difficult to predict. Assumptions underlying our expectations regarding forward-looking statements or information contained in this MD&A include, among others: that we will maintain our position in the markets we operate in and expand into other markets in a favourable manner; that we will have sufficient capital to continue making investments in advertising and personnel to support our business and new product lines, including our prescription eyeglass business; that we will be able to generate and maintain sufficient cash flows to support our operations; that we will be successful in defending against the appeal by, and in prosecuting our claim against, the College of Opticians in British Columbia; that we will be able to establish and/or maintain necessary relationships with suppliers; and that we will retain key personnel. The foregoing list of assumptions is not exhaustive.

Persons reading this MD&A are cautioned that forward-looking statements or information are only predictions, and that our actual future results or performance may be materially different due to a number of factors. These factors include, but are not limited to: changes in the market; potential downturns in economic conditions; consumer credit risk; our ability to implement our business

strategies; competition; limited suppliers; inventory risk; disruption in our distribution facilities; mergers and acquisitions; foreign currency exchange rate fluctuations; regulatory requirements; demand for contact lenses and related vision care products; competition and dependence on the internet and other risks detailed in our filings with the Canadian securities regulatory authorities. Reference should be made to the section entitled "Risk Factors" contained in our most recently filed Annual Information Form dated January 29, 2009, for a detailed description of the risks and uncertainties relating to our business. These risks, as well as others, could cause actual results and events to vary significantly. Accordingly, readers should not place undue reliance on forward-looking statements and information, which are qualified in their entirety by this cautionary statement. These forward-looking statements are made as of the date of this MD&A and we expressly disclaim any intent or obligation to update these forward-looking statements, unless we specifically state otherwise and except as required by applicable law.

## **Overview**

Coastal Contacts is a leading worldwide direct to consumer retailer of vision care products, with customers in North America, Europe and the Asia Pacific region. Since our inception in 2000, our business has grown to 1.2 million orders shipped in our 2008 fiscal year representing over \$118 million in revenues, which equates to revenue growth of over 300% over the last five fiscal years. Our business is designed to offer lower prices and superior levels of service when compared to the traditional retail optical shops, the majority of which are owner managed locations. In our operating facilities in North America and Europe, we maintain eyeglass assembly facilities and significant contact lens inventories, which allow us to provide our customers with greater selection, faster delivery times and competitive prices.

Specifically, our direct to consumer approach has been designed to reduce the time and effort required by contact lens wearers to replenish their contact lens supply as compared to traditional models. Traditionally, customers were required to travel to their optical store to replenish their contact lens supplies. Through our websites such as [www.clearlycontacts.ca](http://www.clearlycontacts.ca) or [www.lensway.com](http://www.lensway.com), or our toll free phone numbers, our customers can order quickly and easily, and have their contact lenses delivered to their home or office, often at significantly lower retail prices.

Recent market data estimates the global market for soft contact lenses at \$5.3 billion in 2008 with worldwide growth rates estimated in the range of 8% to 9%. Much of this growth is outside of the United States, where we generate more than 85% of our revenues.

We entered the prescription eyeglass market in fiscal 2008 with a relatively lean operating structure that eliminated the need for expensive retail space. Our relatively low overhead burden and direct purchasing allows us to deliver eyeglasses to customers at prices that are typically lower than the traditional model. Leveraging our database of vision corrected customers is a particular opportunity for us as allows us to introduce prescription eyeglasses at a lower cost than many of our online competitors.

Initially focused on North American markets, we have now successfully executed a strategy of global market diversification, achieving the largest market share of any direct to consumer contact lens retailer in many global markets. We are focused on achieving consistent and sustainable growth through the continued development of our business. Our growth strategies include the expansion into new markets through existing distribution hubs, the expansion of market share within existing markets, the introduction of new products, such as prescription eyeglasses and strategic acquisitions.

**Results of Operations – three and six months ended April 30, 2009 compared to the three and six months ended April 30, 2008**

(\$000's)	For the three months ended April 30,		For the six months ended April 30,	
	2009	2008	2009	2008
<b>Sales</b>	33,301	28,632	64,643	54,007
<b>Gross profit</b>	9,444	8,129	19,053	14,492
<b>Income (loss) before taxes</b>	688	(620)	1,993	(1,219)
<b>Net income (loss)</b>	528	(692)	1,496	(1,393)
<b>Adjusted EBITDA <sup>1</sup></b>	1,426	917	3,451	841

Sales increased by \$4.7 million or 16% in the second quarter of 2009 to \$33.3 million (324,577 orders shipped) from \$28.6 million (291,607 orders shipped) in the second quarter of 2008. Sales increased by \$10.6 million or 20% in the first six months of 2009 to \$64.6 million from \$54.0 million in the first six months of 2008. During the three months ended April 30, 2009 our sales grew 11% due to an increase in shipped orders and 4% due to an increase in our average revenue per order compared to the same period in 2008. Foreign currency exchange rates did not have a significant impact on revenues when comparing the three months ended April 30, 2009 to the respective period in 2008. In the first six months ended April 30, 2009, our sales grew 10% due to an increase in shipped orders, 4% as a result of favorable foreign currency exchange rates, and 6% due to an increase in our average revenue per order, exclusive of foreign exchange compared to the same period in 2008. Our sales increased as a result of continued growth in marketing investments and the prescription eyeglasses business we launched in fiscal 2008.

Our gross margin in the three months ended April 30, 2009 was 28%, unchanged from the comparative period in 2008. For the six months ended April 30, 2009, our gross margin increased to 29% from 27% when compared to the same period in 2008, primarily as a result of increases in retail pricing, particularly in North America and favourable foreign exchange rate fluctuations.

Advertising expenses increased to \$4.3 million (13% of sales) in the second quarter of 2009, compared to \$3.5 million (12% of sales) during the same period in 2008. During the six months ended April 30, 2009, advertising expenses increased to \$8.4 million (13% of sales), compared to \$6.7 million (12% of sales) during the same period in 2008. Increases in advertising costs are a result of customer acquisition programs in growth markets where we are targeting a leadership position, and our continued promotion of our prescription eyeglasses business.

<sup>1</sup> Adjusted EBITDA, shipped orders, reorders and reorder rate(s) are non-GAAP measures that do not have a standardized meaning prescribed by Canadian GAAP and are therefore unlikely to be comparable to similar measures presented by other companies. Refer to Supplemental Non-GAAP measures on page 12 for further information and a reconciliation of net income to adjusted EBITDA.

The majority of our investments in advertising are made with the goal of sustaining the market leader position we have achieved in some markets, establishing similar leadership positions in the emerging markets in which we participate and expanding our prescription eyeglasses business. We believe that in the long run, achieving dominant market positions will afford us greater retail pricing strength and improve advertising efficiencies, which are measured by advertising costs as a proportion of total revenues. In addition to size and market position, our reorder rate, which is in excess of 70%, further enhances advertising efficiencies and creates a profitable and recurring revenue stream. Our goal is to replicate this in new geographies and with new products, by offering similar levels of service, and by investing in similar brand-building marketing techniques.

Selling, general and administrative expenses ("SG&A") increased 6% to \$3.8 million in the second fiscal quarter of 2009, as compared with \$3.6 million in the second quarter of 2008, and increased 4% to \$7.5 million in the six months ended April 30, 2009, from \$7.2 million in 2008. While employee costs increased to support our growing operations and our prescription eyeglasses business, SG&A costs grew at a rate slower than that of sales as we achieved further operating leverage.

In the quarter and six months ended April 30, 2009 we recognized a foreign currency exchange gain on the translation of our monetary assets of \$0.04 million and \$0.2 million, respectively, compared to losses of \$0.05 million and a gain of \$0.2 million in the same periods of the previous year. Foreign exchange rates have been particularly volatile recently compared to historical averages. This volatility may continue and could materially impact our forecasted and actual operating results in the future.

Amortization for the quarter ended April 30, 2009 decreased by \$0.07 million from the same quarter of the previous year to \$0.6 million. Amortization decreased by \$0.05 million in the six months ended April 30, 2009 compared to the same period in 2008.

During the quarter ended April 30, 2008, we incurred a one-time restructuring charge associated with the consolidation of our Dutch and Asian operations totaling \$0.8 million.

Our income tax expense increased overall as a result of growth in our taxable income. Our income tax rates, as a percentage of taxable income in the countries in which we generate taxable income, remained unchanged in the second quarter of fiscal 2009 compared to the same period of fiscal 2008. Certain operations generate taxable income, while in certain other jurisdictions we have incurred losses historically that can be applied against current and future taxable earnings to reduce our tax liability on those earnings. As we remain uncertain of realizing the future benefit of those losses, we have taken a valuation allowance against these future tax assets. Consequently, our consolidated tax expense, as a percentage of income before income taxes, will vary from quarter to quarter in line with the mix of net income within each taxable jurisdiction.

### **Liquidity and Capital Resources**

At April 30, 2009 we had cash and cash equivalents of \$14.6 million, as compared to \$15.2 million at October 31, 2008.

Cash provided by operating activities for the three months ending April 30, 2009 was \$4.0 million, as compared with \$0.1 million used in the same period last year. We generated \$1.2 million in the quarter through earnings excluding non cash items, and accounts receivables declined by \$0.6 million. We increased inventory by \$4.0 million in the quarter, as we purchased a significant amount

of a traditionally rapid-turning inventory category near the end of the fiscal quarter to take advantage of favourable pricing. These inventory levels are in excess of what we would normally carry and we expect to turn the majority of the additional inventory by the end of our third fiscal quarter of 2009. Consistent with this purchase and the growth of our business, our accounts payable and accrued liabilities grew \$6.5 million in the second quarter of 2009. In the six months ending April 30, 2009, \$1.5 million was generated from operating activities compared to \$0.3 million in the six months ending April 30, 2008.

We used \$0.2 million during the second quarter of the 2009 and \$0.4 million in the six months ending April 30, 2009 to purchase equipment relating to our growing prescription eyeglass business. This compares to \$0.5 million used in the same quarter in 2008 to purchase equipment and leasehold improvements predominantly in relation to our prescription eyeglasses business and \$2.9 million of cash provided in the comparative six month period of 2008 as short term investments totaling \$4.0 million matured and exceeded spending on property, equipment and website development.

We used \$1.0 million in the second quarter of the 2009 fiscal year to purchase 1.2 million of our common shares for cancellation under an active normal course issuer bid compared to \$9.6 million used to purchase 7.7 million of our common shares for cancellation in the same period last year under a previous normal course issuer bid and tender offer. For the six months ended April 30, 2009, we used \$1.0 million to buy back 1.2 million of our common shares, compared to \$10.0 million of cash used in the same period of 2008 for to purchase 7.9 million of our common shares.

We believe that existing available cash, together with cash flow from operating activities will be sufficient to support the NCIB and our operations to the end of the 2010 fiscal year. Subsequent to the end of the quarter we entered into a secured overdraft facility with our European bank making 25 million Swedish Krona (approximately CAD\$3.7 million) available to us, with interest payable at a rate of 1% above the Stockholm Interbank Offered Rate.

We are actively expanding our product offerings and seeking strategic acquisitions. We may seek additional sources of financing, including equity offerings that would be dilutive to the interests of current shareholders, for accelerated growth, acquisitions of companies or assets or other activities, and there can be no assurance that such funds will be available on satisfactory terms or at all. Failure to obtain such financing could delay or prevent our planned growth, which could adversely affect our business, financial condition and results of operations.

### **Critical Accounting Estimates**

The Company prepares its consolidated financial statements in accordance with Canadian GAAP. The preparation of consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements as well as the reported amounts of revenues and expenses during the reporting period. Estimates are based upon historical experience and other assumptions that are believed to be reasonable under the circumstances. These estimates are evaluated on an on-going basis and form the basis for making decisions regarding the carrying value of assets and liabilities and the reported amount of revenues and expenses. Actual results may differ from these estimates under different assumptions.

We have identified the following as critical accounting estimates, which are defined as those that are reflective of significant judgments and uncertainties, are the most pervasive and important to the

presentation of our financial condition and results of operations and could potentially result in materially different results under different assumptions and conditions.

#### *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.

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

#### *Accounting for Long-lived Assets*

The ability to realize long-lived assets which are primarily comprised of customer lists and website creation costs are evaluated periodically as events or circumstances indicate a possible inability to recover their carrying amount. Such evaluation is based on assessment of reorder rates and various analyses, including undiscounted cash flow and profitability projections that incorporate, as applicable, the impact on the existing business. The analyses necessarily involve significant management judgment. Any impairment loss, if indicated, is measured as the amount by which the carrying amount of the asset exceeds the estimated fair value of the asset.

#### *Accounting for Goodwill and Intangible Assets with Indefinite Lives*

Goodwill represents the excess of the purchase price over the fair value of the net assets acquired. Goodwill is not amortized and we perform an annual impairment test of our recorded goodwill. In addition, we test our other indefinite-lived intangible assets for impairment. These impairment tests can be significantly altered by estimates of future performance, long-term discount rates used or market price valuation multiples. The analyses necessarily involve significant management judgment. These estimates will likely change over time. Goodwill and intangible assets with indefinite lives totaled \$17.5 million and \$19.0 million at April 30, 2009 and October 31, 2008, respectively. The change in total goodwill and intangible assets with indefinite lives during the three and six months ended April 30, 2009 resulted from the foreign currency exchange rate impact on these assets held in self sustaining subsidiaries. The impact of this change is unrealized and reflected in the Company's comprehensive earnings.

#### *Allowance for Doubtful Accounts*

We offer credit to customers in most of the regions that we operate in. Credit customers do not have to pay for the order until the goods are received – generally estimated to be less than 15 days. The majority of the individual receivable balances are small amounts of less than \$150 and there are a large number of records. Given the composition of the receivable portfolio, using a specific balance approach to determine an allowance for doubtful accounts for the bulk of the receivables is not feasible. Consequently, management estimates an allowance for doubtful accounts based on the aging of the receivable portfolio. The analyses necessarily involve significant management judgment. These analyses can be significantly altered by estimates of the probability of future collection or changes in payment patterns of customers. The allowance for doubtful accounts was \$0.9 million and \$0.8 million at April 30, 2009 and October 31, 2008, respectively.

### *Share-based Compensation*

The fair value of each share purchase option grant is estimated on the date of the grant using the Black-Scholes option-pricing model. The amount of share-based compensation associated with any share purchase options that are granted will be estimated and expensed, based on the vesting schedule, using assumptions involving the estimated dividend yield, expected volatility, the risk-free interest rate and the expected lives of the share purchase options.

### *Income Taxes*

We account for income taxes using the liability method of accounting. Under the liability method, future income tax assets and liabilities are determined based on differences between the carrying amounts of balance sheet items and their corresponding tax values. The determination of the income tax provision requires management to interpret regulatory requirements and to make certain judgements. While income tax filings are subject to audits and assessments, management believes that adequate provision has been made for all income tax obligations. However, changes in the interpretations or judgements may result in an increase or decrease in our income tax provision in the future. The amount of any such increase or decrease cannot be reasonably estimated.

### **Change in Accounting Policies**

Effective November 1, 2008, the Company has adopted the following accounting standards issued by the Canadian Institute of Chartered Accountants ("CICA"). These standards have been adopted on a prospective basis with no restatement of prior period financial statements.

#### *Inventories*

In March 2007, the CICA approved Handbook Section 3031, "*Inventories*" which replaces the existing Handbook Section 3030, "*Inventories*". This standard is effective for interim and annual financial statements relating to fiscal years beginning on or after January 1, 2008, with earlier application encouraged. The standard provides more guidance on the measurement and disclosure requirements for inventories. The adoption of this standard only impacted disclosures in the financial statements.

#### *Goodwill and intangible assets*

In October 2007, the CICA approved Handbook Section 3064, "*Goodwill and Intangible Assets*" which replaces the existing Handbook Sections 3062, "*Goodwill and Other Intangible Assets*" and 3450 "*Research and Development Costs*". This standard is effective for interim and annual financial statements relating to fiscal years beginning on or after October 1, 2008, with earlier application encouraged. The standard provides guidance on the recognition, measurement and disclosure requirements for goodwill and intangible assets. The adoption of this standard only impacted disclosures in the financial statements.

## **Future Accounting Policies**

### *Transition to International Financial Reporting Standards*

In accordance with the Canadian Institute of Chartered Accountants Accounting Standards Board (AcSB), Canadian publicly accountable enterprises will be required to prepare financial statements in accordance with International Financial Reporting Standards (IFRS). This changeover to IFRS from Canadian GAAP will apply to the Company's financial statements for the year beginning on November 1, 2011. The Company will undertake the appropriate measures to ensure compliance with these new standards by the prescribed adoption date. The Company is currently assessing the implications of these standards on the consolidated financial statements.

### **Common Shares**

As at April 30, 2009, we had 57,100,619 common shares and 4,100,437 options outstanding. Of these securities, 403,714 common shares are subject to voluntary pooling agreements and 2,593,008 options have not yet vested as of April 30, 2009.

### Quarterly Financial Information

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

Quarter ended	Apr. 30, 2009	Jan. 31, 2009	Oct. 31, 2008	July 31, 2008	Apr. 30, 2008	Jan. 31, 2008	Oct. 31, 2007	July 31, 2007
<b>Sales</b>	<b>33,301</b>	31,342	32,027	32,725	28,632	25,375	26,657	27,310
<b>Net Income (loss)</b>	<b>528</b>	968	397	211	(692)	(701)	257	374
<b>Weighted Average # of shares - Basic</b>	<b>57,975</b>	58,318	58,451	63,430	65,092	71,275	72,015	72,454
<b>Weighted Average # of shares – Diluted</b>	<b>57,988</b>	58,320	58,605	63,535	65,353	71,275	72,194	73,031
<b>Basic Earnings (Loss) per share</b>	<b>0.01</b>	0.02	0.01	0.00	(0.01)	(0.01)	0.00	0.01
<b>Diluted Earnings (Loss) per share</b>	<b>0.01</b>	0.02	0.01	0.00	(0.01)	(0.01)	0.00	0.01

Seasonality may impact our revenue distribution throughout the year. Our sales are generally stronger during the spring, summer and fall months. Our industry generally experiences lower sales during the winter.

## Related Party Balances

As at April 30, 2009, there were five promissory notes outstanding, receivable from officers, ranging in value from \$0.01 million to \$0.1 million and totaling \$ 0.32 million (October 31, 2008: \$0.32 million) and, accumulated interest totaled \$ 0.05 million (October 31, 2008: \$0.04 million). These loans are payable on demand and bear interest at a rate of 5% per annum. The debtors are personally liable for the amounts owed.

## Contractual Obligations

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

	\$000's
2009	959
2010	1,022
2011	548
2012	482
2013 and thereafter	562
	<u>3,573</u>

Operating costs on leases have been excluded. We have no obligations for annual payments related to long-term debt or capital lease obligations.

## Contingent Liabilities

In September 2007, we received a petition filed by the College of Opticians of British Columbia (the "Opticians") in the Supreme Court of British Columbia. The Opticians sought an order to prevent us from selling contact lenses to members of the public in British Columbia. In April, 2008, the Supreme Court of British Columbia denied the petition filed by the Opticians.

In May 2008, we received a notice of appeal filed by the Opticians with the British Columbia Court of Appeal seeking to overturn the ruling by the Supreme Court of British Columbia. In August 2008, we filed a statement of claim against the Opticians for certain statements made relating to the sale of contact lenses. The Company is unable to predict the outcome of the claim at this time.

In May 2009, the appeal filed by the Opticians was heard by the British Columbia Court of Appeal and defended against by the Company. A decision has not been rendered by the British Columbia Court of Appeal, nor can a date of a decision be estimated. Although the outcome of the appeal cannot be determined at this time, management of the Company believes the original petition and subsequent appeal is without merit.

In the ordinary course of our business, inquiries are made periodically by regulatory authorities and assertions are made. We review these and respond to them in due course. To date, no reservation or provision has been made in the financial statements in connection with these matters.

## **Off-Balance Sheet Arrangements**

The Company does not have any off-balance sheet arrangements as defined by applicable securities regulations in Canada at April 30, 2009 that have, or are reasonably likely to have, a current or future material effect on our results of operations or financial condition.

## **Critical Suppliers**

We currently purchase significant amounts of inventory from a limited number of major suppliers. We believe that alternative suppliers are available should those suppliers refuse or be unable to provide us with products.

## **Disclosure Controls and Procedures**

Disclosure controls and procedures are designed to provide reasonable assurance that all relevant information is gathered and reported to senior management, including the Chief Executive Officer ("CEO") and Chief Financial Officer ("CFO"), on a timely basis so that appropriate decisions can be made regarding public disclosure.

As of April 30, 2009, an evaluation of the design of the Company's disclosure controls and procedures as defined in National Instrument 52-109 was carried out. Based on that evaluation, the CEO and CFO concluded that the design and operation of those disclosure controls and procedures were effective.

## **Internal Controls over Financial Reporting**

Management is responsible for certifying the design of the Company's internal control over financial reporting as required by National Instrument 52-109.

Our internal control over financial reporting is intended to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with applicable generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Management, including the CEO and CFO, carried out an evaluation of the design of our internal controls over financial reporting as at April 30, 2009. Management believes the design to be sufficient for the nature and size of the Company's business, to provide reasonable assurance

regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with Canadian generally accepted accounting principles.

During the second quarter of 2009, management did not make changes to its system of internal controls that materially affect internal controls over financial reporting.

### Supplemental Non-GAAP Measures

We report our results in accordance with Canadian GAAP, however, we present Adjusted EBITDA and the number of orders shipped, reorders and the reorder rate, which is defined as the percentage of orders in the quarter shipped to customers that we estimate have ordered from us in the past. We believe that our investors may use these figures to make more informed investment decisions about us.

Adjusted EBITDA is a non-GAAP measure that does not have any standardized meaning prescribed by Canadian GAAP and is therefore unlikely to be comparable to similar measures presented by other companies. Adjusted EBITDA should be considered in addition to, and not as a substitute for, net income, cash flows and other measures of financial performance and liquidity reported in accordance with Canadian GAAP.

Adjusted EBITDA is a measure we believe is useful in assessing performance and highlighting trends on an overall basis. Adjusted EBITDA differs from the most comparable GAAP measure, net income, primarily because it does not include interest, income taxes, amortization and share-based compensation expense.

The following table provides a reconciliation of net income to Adjusted EBITDA:

(\$000's)	For the three months ended April 30,		For the six months ended April 30,	
	2009	2008	2009	2008
<b>Net income</b>	<b>528</b>	<b>(692)</b>	<b>1,496</b>	<b>(1,393)</b>
Depreciation and amortization	604	669	1,218	1,269
Interest income, net	(14)	(155)	(56)	(387)
Income tax expense	160	72	497	174
Share-based compensation	148	179	296	334
Restructuring cost	-	844	-	844
<b>Adjusted EBITDA</b>	<b>1,426</b>	<b>917</b>	<b>3,451</b>	<b>841</b>

### Additional Information

Additional information relating to the Company, including the Company's most recently filed annual information form, dated January 29, 2009, can be found on SEDAR at [www.sedar.com](http://www.sedar.com).