Moody's Investors Service

Global Credit Research
Issuer Comment
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Issuer Comment: Eye Care Centers of America, Inc.

MOODY'S AFFIRMS BANK LOAN, SENIOR SUB NOTES, AND LIQUIDITY RATING OF EYE CARE CENTERS OF AMERICA AT B2, Caa1, AND SGL-4, RESPECTIVELY

Approximately $340 Million of Debt Affected.

Moody's Investors Service affirmed all long-term ratings of Eye Care Centers of America ("ECCA") and updated the rationale for the Speculative Grade Liquidity rating of SGL-4. The rating outlook remains negative.

The following ratings are affirmed:

$190 million senior secured bank loan at B2,

$152 million 10.75% senior subordinated notes (2015) at Caa1,

Corporate family rating at B2, and the

Speculative grade liquidity rating at SGL-4.

The poor liquidity rating of SGL-4 is prompted by the pending liquidation of the company's Hong Kong-based controlling shareholder Moulin International Holdings Ltd. ("Moulin") and Moody's concern that the existing debt amortization schedule would accelerate if all rated debt were put to the company per change of control provisions in the bank agreement and bond indenture. Moody's notes that the liquidators of Moulin have asked for Chapter 15 protection under U.S. bankruptcy code in which Moulin's creditors would be prevented from moving against ECCA while Moulin is restructuring in a foreign court. There has been no public update regarding the potential change of control at ECCA, including clarification of the uncertain timing, since Moody's last comment in October 2005.

The negative rating outlook considers that long-term ratings would decline if the ownership issue is not satisfactorily resolved from the perspective of ECCA's creditors including if the likely change of control does not occur in an orderly manner. The inability to immediately repay the bank loan and senior subordinated notes, in the event that this becomes necessary, would cause all ratings to be lowered to default levels. Aside from satisfactory resolution of the ownership issue and cost-effective replacement of Moulin as an eyeglass frame supplier, the rating outlook could stabilize as leverage (using by Moody's standard analytical adjustments) falls below 6 times, EBIT to interest expense exceeds 1.5 times while the system profitably expands both from new store development and comparable store sales growth. Leverage is expected to slightly improve to about 6 times in 2006.

ECCA's long-term ratings reflect the high financial leverage, weak fixed charge coverage, and the relatively low operating margins for a specialty retailer. Moody's believes that competitive pressures will remain strong as larger competitors such as Wal-Mart (senior unsecured rating of Aa2) and Luxottica (unrated; owner of Lenscrafters and Pearle Vision) compete in various price/service niches. The seasonal nature of optical retailing, in which the first quarter accounts for a disproportionate share of sales and cash flow, also constrain the ratings. The potential for Golden Gate Capital, the other major shareholder of ECCA, to put its preferred stock to Moulin (or presumably its successor) in March 2009 could eventually become a concern.

However, the long-term ratings also recognize the potential economies of scale from the company's national position as the third-largest optical retailer, Moody's expectation that the company will use a portion of discretionary free cash flow to pay down debt, and the favorable demographic trends for vision correction as the U.S. population ages. Also benefiting the ratings are revenue diversity from operations in many geographies across the United States, the potential for increased traffic to the most important optical retailing chains as third-party vision care payment plans become more widespread, and the positive contribution from 96% of the company's stores.

The B2 rating of the senior secured credit facility (comprised of a $25 million revolving credit facility and a $165 million Term Loan B) recognizes the senior position of this debt class in the company's capital structure and considers that this debt is secured by substantially all of the company's assets. In a hypothetical default scenario, Moody's believes that the orderly liquidation value of easily monetizable assets such as accounts receivable and inventory would fall well below the existing bank loan commitment. Complete recovery would rely on the less

easily predicted valuation for property, plant, and equipment and intangible assets. As defined in the bank agreement, an event of default would occur if Moulin ceases to own a majority of ECCA. Moody's expects that the Revolving Credit Facility will mostly be used to bridge temporary cash flow timing differences. As of Dec. 31, 2005, all of the revolving credit facility was available except for $3 million reserved for Letters of Credit.

The Caa1 rating on the senior subordinated notes reflects the guarantees of the company's non-optometric practice operating subsidiaries, as well as the contractual subordination to significant amounts of more senior obligations which include the bank loan, $2 million of capital leases, and $20 million of trade accounts payable. As defined in the bond indenture, noteholders would have the option to put the notes back to ECCA if a change of control was to occur, including if Moulin, Golden Gate, and management collectively cease to own a majority of ECCA. In a hypothetical default scenario, Moody's believes that recovery for this debt class would completely rely on residual enterprise value.

Leverage equaled 6.3 times and EBIT to interest expense was about 1.4 times for the December 2005 fiscal year. Over the past several years, revenue has grown from a combination of healthy comparable store sales increases (up 3.0% in 2005) and a few new store openings. Moody's expects that store level operating performance and credit metrics will continue to steadily improve, and that the company will internally generate enough cash flow to support an increased pace of new store openings. However, the ratings and outlook acknowledge Moody's view that ECCA's long-term strategies are uncertain until the ownership issue is resolved.

Eye Care Centers of America, Inc., with headquarters in San Antonio, Texas, operates 380 optical retailing stores under EyeMasters and other regional trade names. Revenue for the twelve months ending Dec. 31, 2005 was approximately $406 million.

Contacts	**Phone**
Richard Baldwin/New York	201-915-8757
William L. Hess/New York	212-553-3837

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