

**Credit Opinion: [Eye Care Centers of America, Inc.](#)**

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*San Antonio, Texas, United States*

**Ratings**

<b>Category</b>	<b>Moody's Rating</b>
Outlook	Stable
Corporate Family Rating	B2
Sr Sec Bank Credit Facility	B2
Senior Subordinate	Caa1
Speculative Grade Liquidity	SGL-2

**Contacts**

<b>Analyst</b>	<b>Phone</b>
Richard Baldwin/New York	1.212.553.1653
Margaret Taylor/New York	
Angela Jameson/New York	

**Opinion**

**Company Profile**

Eye Care Centers of America, Inc. ("ECCA"), with headquarters in San Antonio, Texas, operates 385 optical retailing stores under EyeMasters and other regional trade names. The company is being acquired by HVHC Inc., a wholly-owned subsidiary of Highmark, Inc. (insurance financial strength rating of Baa1). Revenue for the twelve months ending April 1, 2006 was approximately \$414 million.

**Rating Rationale**

On June 12, 2006 Moody's concluded the rating review for Eye Care Centers by confirming the corporate family rating at B2, the bank loan rating at B2, and the senior subordinated notes at Caa1. This concludes the rating review that commenced on May 4, 2006. The review was prompted by the announcement that HVHC Inc., a wholly-owned subsidiary of Highmark Inc. (insurance financial strength rating of Baa1), intends to acquire complete ownership of ECCA. Confirmation of the long-term ratings reflects that, following the proposed transaction, ECCA's debt structure will not change and that ECCA will continue to be rated on a stand-alone basis without benefit of ownership by Highmark or HVHC.

ECCA's corporate family rating reflects that key quantitative and qualitative rating drivers are solidly non-investment grade. Weighting down the ratings are the company's relatively weak debt protection measures and substantial fixed charge burden relative to cash flow; competition in optical retailing including from much larger retailers; and the company's relatively small size for a rated retailer. However, supporting the company's ratings are the leading position of ECCA in the optical retailing industry in terms of geography, store count, and revenue; the modest cyclical and seasonality for optical product sales compared to many other retailing segments; and the favorable demographics for vision correction demand growth.

The key drivers and credit metrics (utilizing Moody's standard analytical adjustments) of Eye Care Center's ratings are as follows:

(1) Financial Policy

The substantial fixed charge burden for debt service, combined with the substantial level of capital investment for store count growth plus repair & maintenance, prompts the Ba score for this measure. The company has demonstrated a consistent history of slowly growing sales and cash flow, and annually repaying small amounts of debt. As of April 1, 2006, the company enjoys a good liquidity position with cash of \$33 million and \$22 million of availability under its \$25 million revolving credit facility (after \$3 million for letter of credit back up). ECCA is rated on a stand-alone basis because investment-grade Highmark, as a regulated insurance company, does not guarantee ECCA's obligations and would face high hurdles in supporting ECCA in the event of financial distress.

From the standpoint of ECCA, its debt agreements prohibit guarantees of affiliate obligations.

## (2) Credit Metrics

Most credit metrics are reasonably typical for the assigned corporate family rating of B2. Debt to EBITDA for the twelve months ending April 1, 2006 was about 5.2 times, EBIT covered interest expense by about 1.5 times, and free cash flow to net debt was about 4%. In line with healthy comparable store sales growth, good performance at newly developed stores, and eyeglass frame purchasing initiatives, operating margin has expanded over time to 11.3% in 2005 from 10.6% in 2004 and 9.8% in 2003. Free cash flow remains modest mostly because of capital investment in new store development and store repair & maintenance.

## (3) Business Risk and Cash Flow Volatility

Moody's believes that this attribute has low investment grade / high non-investment grade characteristics. In Moody's opinion, in spite of steady demand for vision correction, eyeglass dispensing is a segment of retailing with moderate business risk because of the fashion element associated with vision correction. Thus far, the wide availability of surgical vision correction has not prompted a reduction in sales of eyeglasses and contact lens. Stores operated by ECCA are scattered around many regions of the country (with California and New York as populous exceptions), with particular concentrations in Texas and Florida. HVHC operates Empire Vision Centers, a chain of optical vision retailers with substantial presence in New York. The seasonal nature of optical retailing, in which the first quarter accounts for a disproportionate share of sales and cash flow as employee-sponsored vision care plans are typically renewed in the new calendar year, also constrain the ratings.

## (4) Market Position

Moody's believes that this attribute has low Ba or high B characteristics. Holding down the score is the company's relatively small size among rated retailers in terms of revenue and store count. While recognizing that ECCA is the third largest optical retailer behind Wal-Mart (senior unsecured rating of Aa2) and Luxottica (unrated; owner of several banners including Lenscrafters and Pearle Vision), market share for ECCA is small in absolute terms in this highly fragmented sector of specialty retailing. Many smaller players compete in various price/service niches.

## (5) Execution Ability

The low investment grade / high non-investment score for this factor reflects several years of modest sales and cash flow growth both from average unit volume increases and annual development of several new stores, as well as the positive contribution from 96% of the company's stores. So far, ECCA has been able to take advantage of favorable demographic trends for vision correction as the U.S. population ages and third-party vision care payment plans become more widespread. The bankruptcy of Moulin, which operated eyeglass frame manufacturing facilities in Southern China, caused delays in the achievement of promised eyeglass frame purchasing efficiencies. Moody's expects that the company will obtain some of the expected synergies within the medium-term because of worldwide overcapacity in the production of eyeglass frames.

## Structural Considerations

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. The pending bank loan amendment will waive the event of default that would have occurred when the prior owner ceased to own a majority of ECCA. The bank loan places considerable limitations on restricted payments or incurrence of additional indebtedness. The notching relative to the corporate family rating recognizes that this bank loan comprises the majority of long-term debt in the company's capital structure. 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 so complete recovery would rely on the less easily predicted valuation for property, plant, and equipment and intangible assets. Moody's expects that the Revolving Credit Facility will largely be used to bridge temporary cash flow timing differences.

The Caa1 rating on the \$152 million issue of senior subordinated notes considers that, while this debt is guaranteed by the company's operating subsidiaries on a senior subordinated basis, it is contractually subordinated to significant amounts of more senior obligations. Senior obligations include the secured bank loan and about \$24 million of trade accounts payable. Noteholders declined to put their notes to the company per the change of control feature of the indenture when the former owners ceased to own a majority of ECCA. The notes first become callable in February 2010 at 105.375% of par. In a hypothetical default scenario, Moody's believes that recovery for this debt class would completely rely on residual enterprise value.

## Rating Outlook

Now that the Moulin issue is in the process of being resolved, the stable rating outlook reflects Moody's expectations that revenue and cash flow will continue to grow at least as fast as demographic factors and that the company will use a material portion of discretionary cash flow for prudent purposes such as repaying the term loan

ahead of schedule. An upgrade is unlikely within the medium-term. Given the nature of the company's business in which intangible assets provide most collateral value, Moody's will expect somewhat stronger credit metrics than for similarly-rated retailers.

### **What Could Change the Rating - Up**

Ratings are unlikely to increase for at least the next two years. However, Moody's believes that the Eye Care Centers is comfortably positioned within its rating category. Important components of an eventual upgrade would be further improvement in operating margins and improved credit metrics such as debt to EBITDA falling below 5 times, EBIT to interest greater than 2 times, and free cash flow to net debt in excess of 8%.

### **What Could Change the Rating - Down**

Factors that could lead Moody's to consider a negative rating action include a sustained reversal in the pattern of comparable store sales growth, inability to improve operating margins, or a reversal in debt protection measure improvements such as debt to EBITDA in excess of 6 times, EBIT to interest expense falling toward 1 time, or free cash flow to net debt permanently falling toward break-even.

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