

Eye Care Centers of America, Inc. and Subsidiaries

Consolidated Financial Statements

Years Ended December 28, 2002, December 27, 2003 and January 1, 2005 with Report of Independent Registered Public Accounting Firm

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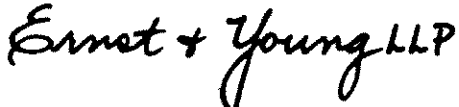
Report of Independent Registered Public Accounting Firm

The Board of Directors and Shareholders
Eye Care Centers of America, Inc.
San Antonio, Texas

We have audited the accompanying consolidated balance sheets of Eye Care Centers of America, Inc. as of January 1, 2005 and December 27, 2003, and the related consolidated statements of operations, shareholders' deficit, and cash flows for each of the fiscal years ended January 1, 2005, December 27, 2003 and December 28, 2002. Our audit also includes the attached financial statement schedule listed in the index to the consolidated financial statements. 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 the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. We were not engaged to perform an audit of the Company's internal controls over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Eye Care Centers of America, Inc. at January 1, 2005 and December 27, 2003, and the consolidated results of their operations and their cash flows for each of the fiscal years ended January 1, 2005, December 27, 2003 and December 28, 2002 in conformity with accounting principles generally accepted in the United States. Also, in our opinion, the related financial statement schedule, when considered in relation to the basic financial statements taken as a whole, presents fairly in all material respects the information set forth therein.



San Antonio, Texas
March 1, 2005

EYE CARE CENTERS OF AMERICA, INC.

CONSOLIDATED BALANCE SHEETS

(Dollar amounts in thousands unless indicated otherwise)

	December 27,	January 1,
	2003	2005
	<hr/>	<hr/>
Assets		
Current assets:		
Cash and cash equivalents	\$ 3,809	\$ 3,098
Accounts receivable, less allowance for doubtful accounts of \$4,076 in fiscal 2003 and \$3,189 in fiscal 2004	11,117	10,455
Inventory, less reserves of \$596 in fiscal 2003 and \$708 in fiscal 2004	25,120	28,558
Deferred income taxes, net	570	2,313
Prepaid expenses and other	3,696	7,552
Total current assets	<hr/> 44,312	<hr/> 51,976
Property and equipment, net of accumulated depreciation and amortization of \$141,351 in fiscal 2003 and \$157,159 in fiscal 2004	51,715	46,440
Goodwill	107,423	107,423
Other assets	8,631	5,945
Deferred income taxes, net	13,445	13,765
Total assets	<hr/> <hr/> \$ 225,526	<hr/> <hr/> \$ 225,549
Liabilities and Shareholders' Deficit		
Current liabilities:		
Accounts payable	\$ 21,360	\$ 21,991
Current portion of long-term debt	18,980	19,628
Deferred revenue	5,743	5,198
Accrued payroll expense	5,429	5,874
Accrued interest	3,213	1,914
Other accrued expenses	8,334	8,422
Total current liabilities	<hr/> 63,059	<hr/> 63,027
Long-term debt, less current maturities	219,845	204,285
Deferred rent	4,719	4,614
Deferred gain	1,532	1,296
Total liabilities	<hr/> 289,155	<hr/> 273,222
Commitments and contingencies		
Shareholders' deficit:		
Common stock, par value \$.01 per share; 20,000,000 shares authorized, 7,397,689 shares issued and outstanding in fiscal 2003 and fiscal 2004	74	74
Preferred stock, par value \$.01 per share, 300,000 shares authorized, issued and outstanding in fiscal 2003 and fiscal 2004	62,169	70,825
Additional paid-in capital	28,259	18,713
Accumulated deficit	(154,131)	(137,285)
Total shareholders' deficit	<hr/> (63,629)	<hr/> (47,673)
	<hr/> <hr/> \$ 225,526	<hr/> <hr/> \$ 225,549

The accompanying notes are an integral part of these consolidated financial statements.

EYE CARE CENTERS OF AMERICA, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS

(Dollar amounts in thousands unless indicated otherwise)

	Fiscal Year Ended		
	December 28, 2002	December 27, 2003	January 1, 2005
Revenues:			
Optical sales	\$ 360,266	\$ 366,531	\$ 396,092
Management fees	3,401	3,321	3,376
Net revenues	363,667	369,852	399,468
Operating costs and expenses:			
Cost of goods sold	112,471	114,578	125,489
Selling, general and administrative expenses	212,779	218,702	231,615
Amortization of intangibles:			
Noncompete and other intangibles	1,865	165	-
Total operating costs and expenses	327,115	333,445	357,104
Income from operations	36,552	36,407	42,364
Interest expense, net	21,051	20,200	20,216
Net income before income taxes	15,501	16,207	22,148
Income tax expense (benefit)	1,258	(9,600)	5,302
Net income	14,243	25,807	16,846
Less preferred stock dividends	6,569	7,466	8,656
Net income available to common shareholders	\$ 7,674	\$ 18,341	\$ 8,190

The accompanying notes are an integral part of these consolidated financial statements.

EYE CARE CENTERS OF AMERICA, INC.
CONSOLIDATED STATEMENTS OF SHAREHOLDERS' DEFICIT
(Dollar amounts in thousands unless indicated otherwise)

	Common Stock		Additional	Preferred Stock	Accumulated Deficit	Total Shareholders' Deficit
	Shares	Amount	Paid-In Capital			
	Balance at December 29, 2001	7,407,289	\$ 74			
Dividends accrued on preferred stock	-	-	(6,569)	6,569	-	-
Interest receivable on loan to shareholder	-	-	(90)	-	-	(90)
Distribution to affiliated OD	-	-	(675)	-	-	(675)
Stock buyback	(9,600)	-	(100)	-	-	(100)
Net income	-	-	-	-	14,243	14,243
Balance at December 28, 2002	<u>7,397,689</u>	<u>74</u>	<u>36,040</u>	<u>54,703</u>	<u>(179,938)</u>	<u>(89,121)</u>
Dividends accrued on preferred stock	-	-	(7,466)	7,466	-	-
Interest receivable on loan to shareholder	-	-	(90)	-	-	(90)
Distribution to affiliated OD	-	-	(225)	-	-	(225)
Net income	-	-	-	-	25,807	25,807
Balance at December 27, 2003	<u>7,397,689</u>	<u>74</u>	<u>28,259</u>	<u>62,169</u>	<u>(154,131)</u>	<u>(63,629)</u>
Dividends accrued on preferred stock	-	-	(8,656)	8,656	-	-
Interest receivable on loan to shareholder	-	-	(90)	-	-	(90)
Distribution to affiliated OD	-	-	(800)	-	-	(800)
Net income	-	-	-	-	16,846	16,846
Balance at January 1, 2005	<u><u>7,397,689</u></u>	<u><u>\$ 74</u></u>	<u><u>\$ 18,713</u></u>	<u><u>\$ 70,825</u></u>	<u><u>\$ (137,285)</u></u>	<u><u>\$ (47,673)</u></u>

The accompanying notes are an integral part of these consolidated financial statements.

EYE CARE CENTERS OF AMERICA, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS

(Dollar amounts in thousands unless indicated otherwise)

	Fiscal Year Ended		
	December 28, 2002	December 27, 2003	January 1, 2005
Cash flows from operating activities:			
Net income	\$ 14,243	\$ 25,807	\$ 16,846
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation	18,761	16,653	15,907
Amortization of intangibles	1,865	165	-
Amortization of debt issue costs	1,901	2,007	2,628
Deferrals and other	387	(635)	(879)
Gain on extinguishment of debt	(904)	-	-
Benefit for deferred taxes	-	(14,015)	(2,063)
Changes in operating assets and liabilities:			
Accounts and notes receivable	(1,899)	877	572
Inventory	605	(1,060)	(3,438)
Prepaid expenses and other	(203)	(1,143)	(3,855)
Deposits and other	-	(646)	(763)
Accounts payable and accrued liabilities	(393)	(598)	(134)
Net cash provided by operating activities	<u>34,363</u>	<u>27,412</u>	<u>24,821</u>
Cash flows from investing activities:			
Acquisition of property and equipment, (net of proceeds)	(10,668)	(10,971)	(10,639)
Net cash used in investing activities	<u>(10,668)</u>	<u>(10,971)</u>	<u>(10,639)</u>
Cash flows from financing activities:			
Payments on debt and capital leases	(23,708)	(15,857)	(14,961)
Distribution to affiliated OD and other	(775)	(225)	68
Proceeds from issuance of long-term debt	124,000	-	-
Payments on debt related to refinancing	(118,346)	-	-
Payments for refinancing fees	(4,788)	-	-
Net cash used in financing activities	<u>(23,617)</u>	<u>(16,082)</u>	<u>(14,893)</u>
Net (decrease) increase in cash and cash equivalents	78	359	(711)
Cash and cash equivalents at beginning of period	3,372	3,450	3,809
Cash and cash equivalents at end of period	<u>\$ 3,450</u>	<u>\$ 3,809</u>	<u>\$ 3,098</u>
Supplemental cash flow disclosures:			
Cash paid during the period for:			
Interest	\$ 19,401	\$ 17,232	\$ 19,216
Taxes	687	4,294	6,258
Noncash investing and financing activities:			
Dividends accrued on preferred stock	6,569	7,466	8,656
Additions of property and equipment	1,076	-	-

The accompanying notes are an integral part of these consolidated financial statements.

EYE CARE CENTERS OF AMERICA, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollar amounts in thousands unless indicated otherwise)

1. Description of business and organization

Description of business

Eye Care Centers of America, Inc. (the Company) operates optical retail stores that sell prescription eyewear, contact lenses, sunglasses and ancillary optical products, and feature on-site laboratories. The Company's operations are located in 33 states, primarily in the Southwest, Midwest and Southeast, along the Gulf Coast and Atlantic Coast and in the Pacific Northwest regions of the United States.

2. Summary of significant accounting policies

Basis of presentation

The financial statements include the accounts of the Company, its wholly owned subsidiaries and certain private optometrists with practices managed under long-term practice management agreements by subsidiaries of the Company (the "ODs"). All significant intercompany accounts and transactions have been eliminated in consolidation. Certain reclassifications have been made to the prior period statements to conform to the current period presentation.

Use of estimates

In preparing financial statements in conformity with U.S. generally accepted accounting principles, management is required to make estimates and assumptions. These estimates and assumptions affect the reported amount of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements and revenues and expenses during the reporting period. Actual results could differ from these estimates.

Reporting periods

The Company uses a 52/53-week reporting format. Fiscal year 2002 ended December 28, 2002 ("Fiscal 2002") and Fiscal year 2003 ended December 27, 2003 ("Fiscal 2003") and each consisted of 52 weeks. Fiscal year 2004 ended January 1, 2005 ("Fiscal 2004") and consisted of 53 weeks.

Cash and cash equivalents

All short-term investments that mature in less than 90 days when purchased are considered cash equivalents for purposes of disclosure in the consolidated balance sheets and consolidated statements of cash flows. Cash equivalents are stated at cost, which approximates market value.

EYE CARE CENTERS OF AMERICA, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollar amounts in thousands unless indicated otherwise)

Accounts receivable

Accounts receivable are primarily from third-party payors related to the sale of eyewear and include receivables from insurance reimbursements, management fees, merchandise, rent and license fee receivables. Accounts receivable are stated at carrying value which approximates fair value. The Company's allowance for doubtful accounts requires significant estimation and primarily consists of amounts owed to the Company by third-party insurance payors. This estimate is based on the historical ratio of collections to billings. Management writes off receivable balances when they are deemed uncollectible. The Company's allowance for doubtful accounts was \$4.1 million at December 27, 2003, and \$3.2 million at January 1, 2005.

Inventory

Inventory consists principally of eyeglass frames, ophthalmic lenses and contact lenses and is stated at the lower of cost or market. Cost is determined using the weighted-average method, which approximates the first-in, first-out (FIFO) method. The Company's inventory reserves require significant estimation and are based on product with low turnover or deemed by management to be unsaleable as well as an estimate of shrinkage. The Company's inventory reserve was \$0.6 million at December 27, 2003 and \$0.7 million at January 1, 2005.

The Company uses several vendors to supply its lens and frame inventory. In Fiscal 2003, one vendor supplied approximately 43% of the Company's lens inventory and four vendors collectively supplied approximately 63% of the Company's frame inventory. In Fiscal 2004, two vendors supplied approximately 65% of the Company's lens inventory and four vendors collectively supplied approximately 67% of the Company's frame inventory. While such vendors supplied a significant share of the inventory used by the Company, lenses and frames are a generic product and can be purchased from a number of other vendors on comparable terms. The Company therefore does not believe that it is dependent on such vendors or any other single vendor for lenses or frames and that its relationships with its existing vendors are satisfactory and that significant disruption in the delivery of merchandise from one or more of its current principal vendors would not have a material adverse effect on the Company's operations because multiple vendors exist for all of the Company's products.

Property and equipment

Property and equipment is recorded at cost. For financial statement purposes, depreciation of building, furniture and equipment is calculated using the straight-line method over the estimated useful lives of the assets. Leasehold improvements are amortized on a straight-line method over the shorter of the life of the lease or the estimated useful lives of the assets. Depreciation of capital leased assets is included in

EYE CARE CENTERS OF AMERICA, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollar amounts in thousands unless indicated otherwise)

depreciation expense and is calculated using the straight-line method over the term of the lease.

Estimated useful lives are as follows:

Building	20 years
Furniture and equipment	3 to 10 years
Leasehold improvements	5 to 10 years

Maintenance and repair costs are charged to expense as incurred. Expenditures for significant betterments are capitalized.

Goodwill

Goodwill is the amount of excess purchase price over the market value of acquired net assets and identified intangibles. In July 2001, the Financial Accounting Standards Board (“FASB”) issued Statement of Financial Accounting Standards (SFAS) No.’s 141 and 142, “Business Combinations” and “Goodwill and Other Intangibles.” Under SFAS No. 141, goodwill is no longer subject to amortization over its estimated useful life. Rather, goodwill is subject to an annual assessment for impairment applying a fair-value based test. The Company adopted both statements on December 30, 2001. Additionally, an acquired intangible asset should be separately recognized if the benefit of the intangible asset is obtained through contractual or other legal rights, or if the intangible asset can be sold, transferred, licensed, rented, or exchanged, regardless of the acquirer’s intent to do so. All identified intangible assets have been fully amortized as of December 27, 2003. In accordance with SFAS No. 142, the Company has defined its reporting unit as the consolidated Company and performed its annual assessment of goodwill on a consolidated basis as of January 1, 2005, and based upon its analysis, the Company believes that no impairment of goodwill exists. There have been no indicators of impairment since this assessment.

Other assets

Other assets consist of deferred debt financing costs, deposits and a note receivable. The deferred debt financing costs are amortized into expense over the life of the associated debt. The note receivable consists of an original loan of \$1.0 million made during Fiscal 2003 to an optometrist owning the optometric practice Hour Eyes.

EYE CARE CENTERS OF AMERICA, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollar amounts in thousands unless indicated otherwise)

	December 27, 2003	January 1, 2005
Deferred financing costs	\$ 6,415	\$ 3,836
Deposits and other	1,380	1,374
Note receivable	836	735
	<u>\$ 8,631</u>	<u>\$ 5,945</u>

Long-lived assets

Long-lived assets consist primarily of store furnishings and lab equipment. Long-lived assets to be held and used and long-lived assets to be disposed of by sale are reviewed periodically for indicators of impairment. The Company believes no impairment of long-lived assets exists.

Deferred revenue—replacement certificates and warranty contracts

At the time of a frame sale, some customers purchase a warranty contract covering eyewear defects or damage during the 12-month period subsequent to the date of the sale. Revenue relating to these contracts is deferred and classified as deferred revenue on the accompanying balance sheet. Such revenue is recognized over the life of the warranty contract (one year) based on the Company's experience of the cost to fulfill the warranty obligation. Costs incurred to fulfill the warranty are expensed when incurred.

Prior to July 2003, certain frames purchased included a one-year warranty period without requiring the separate purchase of a warranty contract. Reserves are established for the expected cost of repair related to these frame sales. At the end of Fiscal 2003 the Company had established a reserve based on historical experience of approximately \$386 related to these warranties, which is included in other accrued expenses on the accompanying balance sheet. As of January 1, 2005, the reserve no longer existed as all of these warranties had expired.

Income taxes

The Company records income taxes under SFAS No. 109 using the liability method. Under this method, deferred tax assets and liabilities are determined based on differences between financial reporting and tax bases of assets and liabilities and are measured using the enacted tax rates and laws that will be in effect when the differences are expected to reverse.

EYE CARE CENTERS OF AMERICA, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollar amounts in thousands unless indicated otherwise)

Revenue recognition

Sales and related costs are recognized by the Company upon the sale of products at company-owned retail locations. Licensing fees collected from independent optometrists for using the Company's trade name "Master Eye Associates," insurance premiums and management fees are recognized when earned. Historically, the Company's highest sales occur in the first and third quarters.

Cost of goods sold

Cost of goods sold includes the cost of the actual product, buying, warehousing, distribution, shipping, handling, lab, and delivery costs.

Selling, general and administrative costs

Selling, general and administrative expenses consist of all retail and doctor payroll related expenses, advertising, occupancy, depreciation and miscellaneous store expenses not related to costs of goods sold.

Advertising costs

Advertising costs of the Company include costs related to broadcast and print media advertising expenses. The Company expenses production costs and media advertising costs when incurred. For Fiscal years ended 2002, 2003, and 2004, advertising costs amounted to approximately \$30,629, \$31,587, and \$33,651, respectively.

Stock Based Compensation

The Company grants stock options for a fixed number of shares to employees with an exercise price equal to the fair value of the shares at the date of grant. In accordance with SFAS No. 123, *Accounting for Stock-Based Compensation*, the Company has continued to account for stock option grants in accordance with APB Opinion No. 25, *Accounting for Stock Issues to Employees*, and, accordingly, recognized no compensation expense for the stock option grants.

Interest expense, net

Interest expense, net, consists of the following:

EYE CARE CENTERS OF AMERICA, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollar amounts in thousands unless indicated otherwise)

	Year-Ended		
	December 28, 2002	December 27, 2003	January 1, 2005
Interest expense	\$ 21,481	\$ 20,518	\$ 20,572
Interest income	(178)	(164)	(274)
Interest capitalized	(252)	(154)	(82)
Interest expense, net	\$ 21,051	\$ 20,200	\$ 20,216

New accounting pronouncements

In April 2002, SFAS 145, *Rescission of SFAS No. 4, 44 and 64, Amendment of SFAS No. 13, and Technical Corrections* was approved by the FASB. As a result, gains and losses from extinguishment of debt are classified as extraordinary items only if they meet the criteria in Accounting Principles Board Opinion No. 30. The Company adopted the statement on December 29, 2002. While the adoption of SFAS 145 resulted in the reclassification of extraordinary gain to ordinary gain, the adoption of SFAS 145 did not have a significant impact on the Company's results of operations or financial position.

In December 2002, SFAS 148, *Accounting for Stock-Based Compensation—Transition and Disclosure* was issued by the FASB. This statement amends SFAS 123 to provide alternative methods of transition for a voluntary change to the fair value method of accounting for stock-based employee compensation. In addition, this statement amends the disclosure requirements of SFAS 123 to require prominent disclosures in both annual and interim financial statements about the method of accounting for stock-based employee compensation and the effect of the method used on reported results. The Company adopted the statement on December 29, 2002 and continues to account for stock-based employee compensation under the intrinsic value method. As all options are granted at fair market value, the Company recorded no compensation expense for options granted in Fiscal years 2002, 2003, and 2004. For purposes of pro forma disclosures, the estimated fair value of the options is amortized to expense over the options' vesting period. As such, the impacts are not necessarily indicative of the effects on reported net income of future years. The Company's pro forma net income for Fiscal years 2002, 2003, and 2004 are as follows:

	Fiscal Year		
	2002	2003	2004
Net income	\$ 14,243	\$ 25,807	\$ 16,846
Fair value based method compensation expense	(121)	(115)	(162)
Pro forma net income	\$ 14,122	\$ 25,692	\$ 16,684

EYE CARE CENTERS OF AMERICA, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollar amounts in thousands unless indicated otherwise)

On December 16, 2004, the Financial Accounting Standards Board (FASB) issued FASB Statement No. 123 (revised 2004), Share-Based Payment, which is a revision of FASB Statement No. 123, *Accounting for Stock-Based Compensation*. Statement 123(R) supersedes APB Opinion No. 25, *Accounting for Stock Issued to Employees*, and amends FASB Statement No. 95, *Statement of Cash Flows*. Generally, the approach in Statement 123(R) is similar to the approach described in Statement 123. However, Statement 123(R) *requires* all share-based payments to employees, including grants of employee stock options, to be recognized in the income statement based on their fair values. Pro forma disclosure is no longer an alternative.

Statement 123(R) must be adopted no later than the beginning of the first interim period beginning after June 15, 2005. Early adoption will be permitted in periods in which financial statements have not yet been issued. We expect to adopt Statement 123(R) on July 3, 2005.

Statement 123(R) permits public companies to adopt its requirements using one of two methods:

1. A “modified prospective” method in which compensation cost is recognized beginning with the effective date (a) based on the requirements of Statement 123(R) for all share-based payments granted after the effective date and (b) based on the requirements of Statement 123 for all awards granted to employees prior to the effective date of Statement 123(R) that remain unvested on the effective date.
2. A “modified retrospective” method which includes the requirements of the modified prospective method described above, but also permits entities to restate based on the amounts previously recognized under Statement 123 for purposes of pro forma disclosures either (a) all prior periods presented or (b) prior interim periods of the year of adoption.

The company plans to adopt Statement 123(R) using the modified-prospective method.

As permitted by Statement 123, the Company currently accounts for share-based payments to employees using Opinion 25’s intrinsic value method and, as such, generally recognizes no compensation cost for employee stock options. Accordingly, the adoption of statement 123(R)’s fair value method will have an impact on our result of operations, although it will have no impact on our overall financial position. The impact of adoption of Statement 123(R) cannot be predicted at this time because it will depend on levels of share-based payments granted in the future. However, had we adopted Statement 123(R) in prior periods, the impact of that standard would have approximated the impact of Statement 123 as described in the disclosure of pro forma net income above. Statement 123(R) also requires the benefits of tax deductions in excess of recognized compensation cost to be reported as a financing cash flow, rather than as an operating cash flow as required under current literature. This requirement will reduce net operating cash flows and increase net financing cash flows in periods after adoption. The Company cannot estimate what those amounts will be in the future (because they depend on, among other

EYE CARE CENTERS OF AMERICA, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollar amounts in thousands unless indicated otherwise)

things, when employees exercise stock options) and there were no amounts recognized in prior periods for such excess tax deductions as there were no exercises of options.

In January 2003, the FASB issued Interpretation No. 46, *Consolidation of Variable Interest Entities*, an interpretation of ARB No. 51 (FIN 46). As a result, a variable interest entity is to be consolidated by a company if that company is subject to a majority of the risk of loss from the variable interest entity's activities or is entitled to receive a majority of the entity's residual returns or both. The interpretation also requires disclosures about variable interest entities that the company is not required to consolidate but in which it has a significant variable interest. On December 24, 2003, the FASB issued a revision to FIN 46, Revised Interpretation 46 (FIN 46R). FIN 46R codifies both the proposed modifications and other decisions previously issued through certain FASB Staff Positions and supersedes FIN 46 to include (1) deferring the effective date of the Interpretation's provisions for certain variable interests, (2) providing additional scope exceptions for certain other variable interests, (3) clarifying the impact of troubled debt restructurings on the requirement to reconsider (a) whether an entity is a variable interest entity or (b) which party is the primary beneficiary of a variable interest entity, and (4) revising Appendix B of FIN 46 to provide additional guidance on what constitutes a variable interest. The Company adopted FIN 46R on December 27, 2003 and the adoption did not have a significant impact on the Company's results of operations or financial position.

3. Self-insurance

The Company began maintaining its own self-insurance group health plan in June of Fiscal 2003. The plan provides medical benefits for participating employees. The Company has an employers' stop loss insurance policy to cover individual claims in excess of \$200 per employee. The amount charged to health insurance expense is based on estimates obtained from an actuarial firm. Management believes the accrued liability of approximately \$1.1 and \$1.0 million, which is included in other accrued expenses as of December 27, 2003 and January 1, 2005, respectively, is adequate to cover future benefit payments for claims that occurred prior to the period end.

4. Related party transactions

The Company and Thomas H. Lee Company (THL Co.), the primary shareholder, entered into a management agreement as of April 24, 1998 (as amended, the Management Agreement), pursuant to which (i) THL Co. received a financial advisory fee of \$6.0 million in connection with structuring, negotiating and arranging the recapitalization and structuring, negotiating and arranging the debt financing and (ii) THL Co. would receive \$500 per year plus expenses for management and other consulting services provided to the Company, including one percent (1%) of the gross purchase price for acquisitions for its participation in the negotiation and consummation of any such acquisition. As of December 31, 2000, the Management Agreement was amended to reduce the fees payable thereunder to \$250 per year plus expenses for management and other consulting services provided to the Company. However, the fees payable under the Management

EYE CARE CENTERS OF AMERICA, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollar amounts in thousands unless indicated otherwise)

Agreement may be increased by an additional \$250 annually depending upon the Company attaining certain leverage ratios. The Management Agreement continues unless and until terminated by mutual consent of the parties in writing, for so long as THL Co. provides management and other consulting services to the Company. The Company incurred \$500 for each of the Fiscal years ended 2002, 2003, and 2004 related to the Management Agreement.

During Fiscal 1998, Bernard Andrews, CEO at the time of the transaction, purchased \$1.0 million of the Company's Common Stock. Mr. Andrews paid for these shares by delivering a promissory note with an original purchase amount of \$1.0 million, which is accruing interest at a fixed rate equal to the Company's initial borrowing rate. The repayment of such note is secured by Mr. Andrews' shares of Common Stock.

The \$1.0 million note receivable and related accrued interest receivable of \$434, \$524 and \$614 at December 28, 2002, December 27, 2003 and January 1, 2005, respectively, is netted against additional paid-in capital on the accompanying balance sheets.

5. Prepaid Expenses and Other

Prepaid expenses and other consists of the following:

	December 27, 2003	January 1, 2005
	<hr/>	<hr/>
Prepaid rentals	\$ 88	\$ 4,298
Prepaid advertising	1,477	1,377
Prepaid store supplies	943	868
Prepaid insurance	780	641
Other	408	368
	<hr/>	<hr/>
	\$ 3,696	\$ 7,552
	<hr/> <hr/>	<hr/> <hr/>

EYE CARE CENTERS OF AMERICA, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollar amounts in thousands unless indicated otherwise)

6. Property and Equipment

Property and equipment, net, consists of the following:

	December 27, 2003	January 1, 2005
	<u> </u>	<u> </u>
Building	\$ 2,240	\$ 2,240
Furniture and equipment	123,672	130,056
Leasehold improvements	67,154	71,303
	<u>193,066</u>	<u>203,599</u>
Less accumulated depreciation and amortization	(141,351)	(157,159)
Property and equipment, net	<u>\$ 51,715</u>	<u>\$ 46,440</u>

7. Other Accrued Expenses

Other accrued expenses consists of the following:

	December 27, 2003	January 1, 2005
	<u> </u>	<u> </u>
Payroll & sales/use tax	\$ 1,211	\$ 1,823
Insurance	1,312	1,389
Store expenses	1,194	1,351
Other	943	1,303
Property taxes	549	885
Advertising	328	747
Income tax payable	669	679
Professional fees	198	153
Third party liability	225	92
Construction	1,319	-
Warranties	386	-
	<u>\$ 8,334</u>	<u>\$ 8,422</u>

EYE CARE CENTERS OF AMERICA, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollar amounts in thousands unless indicated otherwise)

8. Long-term debt

Credit facilities

In April 1998, the Company entered into a credit agreement which provided for \$55.0 million in term loans, \$100.0 million in acquisition facilities, and \$35.0 million in revolving credit facilities (Old Credit Facility). On December 23, 2002, the Company entered into a credit agreement which consists of (i) the \$55.0 million term loan facility (the Term Loan A); (ii) the \$62.0 million term loan facility (the Term Loan B); and (iii) the \$25.0 million revolving credit facility (the Revolver and together with the Term Loan A and Term Loan B, the New Facilities). The proceeds of the New Facilities were used to (i) pay long-term debt outstanding under the Old Credit Facility, (ii) redeem \$20.0 million face value of subordinated debt at a cost of \$17.0 million, and (iii) pay fees and expenses incurred in connection with the New Facilities. Thereafter, the New Facilities are available to finance working capital requirements and general corporate purposes.

Borrowings made under the New Facilities accrue interest at the Company's option at the Base Rate or the LIBOR rate, plus the applicable margin. Base Rate shall mean a floating rate equal to the higher of (i) the Fleet prime rate and (ii) the overnight Federal Funds Rate plus 1/2%. Pricing for the Revolver will be at LIBOR plus 4.50% (Base Rate plus 3.50%), Term Loan A will be at LIBOR plus 4.25% (Base Rate plus 3.25%), and Term Loan B will be at LIBOR plus 4.75% (Base Rate plus 3.75%). The amortization on Term Loan A began on March 31, 2003 and amortizes as follows: \$15.0 million of the principal amount amortized during Fiscal 2003, \$20.0 million of the principal amount amortized during Fiscal 2004 and the remaining \$20.0 million of the principal amount will amortize during Fiscal 2005. The Term Loan B shall have no payments until 2006 when quarterly payments will commence in annual principal amounts of \$20.0 million and \$42.0 million, for Fiscal 2006 and 2007, respectively. The terms of the agreement allow for voluntary prepayments without premium or penalty. The Revolver provides for borrowings up to \$25.0 million less outstanding letters of credit which were \$2.4 million as of January 1, 2005.

In connection with the borrowings made under the New Facilities, the Company incurred approximately \$4.8 million in debt issuance costs. These amounts are classified within other assets in the accompanying balance sheets and are being amortized over the life of the New Facilities. The unamortized amount of debt issuance costs related to the New Facilities as of December 27, 2003 and January 1, 2005 was \$3.5 million and \$1.6 million, respectively.

The New Facilities are collateralized by all tangible and intangible assets, including the stock of the Company's subsidiaries. In addition, the Company must meet certain financial covenants including minimum EBITDA, interest coverage, leverage ratio and capital expenditures. Also, the New Facilities prohibit the payment of dividends to shareholders. Any event of default under the terms of the Exchange Notes (defined

EYE CARE CENTERS OF AMERICA, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollar amounts in thousands unless indicated otherwise)

herein) is considered an event of default for the New Facilities. As of January 1, 2005, the Company was in compliance with the financial covenants.

On April 24, 1998, the Company completed a debt offering consisting of \$100.0 million aggregate principal amount of its 9¹/₈% Senior Subordinated Notes due 2008 (the Fixed Rate Notes) and \$50.0 million aggregate principal amount of its Floating Interest Rate Subordinated Term Securities due 2008 (the Floating Rate Notes and, together with the Fixed Rate Notes, the Initial Notes). The Floating Rate Notes bear interest at a rate per annum, reset semiannually, and equal to LIBOR plus 3.98%. In connection with the New Facilities, the Company redeemed \$20.0 million of the Floating Rate Notes on December 23, 2002. The Company filed a registration statement with the Securities and Exchange Commission with respect to an offer to exchange the Initial Notes for notes which have terms substantially identical in all material respects to the Initial Notes, except such notes are freely transferable by the holders thereof and are issued without any covenant regarding registration (the Exchange Notes). The registration statement was declared effective on January 28, 1999. The exchange period ended March 4, 1999. The Exchange Notes are the only subordinated notes of the Company which are currently outstanding.

The Exchange Notes are senior uncollateralized obligations of the Company and rank *pari passu* with all other indebtedness of the Company that by its terms other indebtedness is not subordinate to the Exchange Notes. The Company may redeem the Notes, at its option, in whole at any time or in part from time to time. The redemption prices for the Fixed Rate Notes are set forth below for the 12-month periods beginning May 1 of the year set forth below, plus in each case, accrued interest to the date of redemption:

<u>YEAR</u>	<u>REDEMPTION PRICE</u>
2004	103.042%
2005	101.521%
2006 and thereafter	100.000%

In connection with the issuance of the Exchange Notes, the Company incurred approximately \$11.2 million in debt issuance costs. These amounts are classified within other assets in the accompanying balance sheets and are being amortized over the life of the Exchange Notes. The unamortized amount of debt issuance costs related to the Exchange Notes as of December 27, 2003 and January 1, 2005 was \$2.9 million and \$2.2 million, respectively.

The Exchange Notes contain various restrictive covenants which apply to both the Company and the Guarantor Subsidiaries (defined herein), including limitations on additional indebtedness, and sale of assets other than in the normal course of business. The failure to pay at final maturity the principal amount of the New Facilities is an event of default under the terms of the Exchange Notes indenture. The Exchange Notes restrict the payment of dividends if an event of default has occurred if the Company is restricted

EYE CARE CENTERS OF AMERICA, INC.
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from incurring additional indebtedness or the sum of dividends exceeds a specified amount.

Gain on extinguishment of debt

On December 23, 2002, the Company retired \$20.0 million face value of subordinated debt at a cost of \$17.0 million and \$0.5 million of related capitalized loan costs resulting in a gain of \$2.5 million. In addition, the Company wrote-off \$1.6 million of capitalized loan costs related to the Old Credit Facility resulting in a loss of \$1.6 million. As a result, the Company recognized a gain net of tax of \$0.9 million in its financial statements.

Capital leases

The Company has an agreement whereby it leases equipment and buildings at various operating locations. The Company has accounted for the equipment and property leases as capital leases and has recorded the assets and the future obligations on the balance sheet as follows:

	<u>December 27, 2003</u>	<u>January 1, 2005</u>
Buildings and equipment, assets	\$ 3,591	\$ 3,591
Accumulated depreciation	(1,524)	(1,922)
Buildings and equipment, assets- net	<u>\$ 2,067</u>	<u>\$ 1,669</u>
Buildings and equipment, future obligations	<u>\$ 2,287</u>	<u>\$ 2,116</u>

The Company's scheduled future minimum lease payments as of January 1, 2005 for the next five years under the property and equipment capital leases are as follows:

2005	\$ 962
2006	932
2007	833
2008	833
2009	345
Beyond 2009	53
Total minimum lease payments	<u>3,958</u>
Amounts representing interest	1,842
Present value of minimum lease payments	<u>\$ 2,116</u>

EYE CARE CENTERS OF AMERICA, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollar amounts in thousands unless indicated otherwise)

Long-term debt outstanding, including capital lease obligations, consists of the following:

	December 27, 2003	January 1, 2005
Exchange Notes, face amount of \$130,000 net of unamortized debt discount of \$212 and \$163, respectively	\$ 129,788	\$ 129,837
New Facilities	105,750	83,960
Capital lease and other obligations	2,287	2,116
Revolver	1,000	8,000
	238,825	223,913
Less current portion	(18,980)	(19,628)
	\$ 219,845	\$ 204,285

Future principal maturities as of January 1, 2005 for long-term debt and capital lease obligations are as follows:

2005	\$ 19,628
2006	25,217
2007	48,264
2008	130,445
2009	308
Beyond 2009	51
Total future principal payments on debt	\$ 223,913

As of December 27, 2003 and January 1, 2005, the fair value of the Company's Exchange Notes was approximately \$130.0 and the fair value of the capital lease obligations was approximately \$2.3 and \$2.1 million, respectively. The estimated fair value of Exchange Notes is based primarily on quoted market prices for the same or similar issues and the estimated fair value of the capital lease obligation is based on the present value of estimated future cash flows. The carrying amount of the variable rate credit facility approximates its fair value.

9. Condensed consolidating information

The Exchange Notes described in Note 8 were issued by the Company and are guaranteed by all of the subsidiaries of the Company (the Guarantor Subsidiaries) but are not guaranteed by the ODs. The Guarantor Subsidiaries are wholly owned by the Company and the guarantees are full, unconditional and joint and several. The following condensed consolidating financial information presents the financial position, results of operations and cash flows of (i) the Company, as parent, as if it accounted for its subsidiaries on the equity method, (ii) the Guarantor Subsidiaries, and (iii) ODs. Separate financial statements of the Guarantor Subsidiaries are not presented herein as management does not believe that such statements would be material to investors.

EYE CARE CENTERS OF AMERICA, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollar amounts in thousands unless indicated otherwise)

Consolidating Statements of Operations
For the Year Ended December 28, 2002

	Parent	Guarantor Subsidiaries	ODs	Eliminations	Consolidated Company
Revenues:					
Optical sales	\$ 175,733	\$ 114,834	\$ 69,699	\$ -	\$ 360,266
Management fees	554	22,319	-	(19,472)	3,401
Investment earnings in subsidiaries	6,251	-	-	(6,251)	-
Net revenues	182,538	137,153	69,699	(25,723)	363,667
Operating costs and expenses:					
Cost of goods sold	58,914	39,535	14,022	-	112,471
Selling, general and administrative expenses	96,547	81,138	54,566	(19,472)	212,472
Amortization of noncompete and other intangibles	-	1,865	-	-	1,865
Total operating costs and expenses	155,461	122,538	68,588	(19,472)	326,808
Income from operations	27,077	14,615	1,111	(6,251)	36,859
Interest expense, net	12,495	8,548	8	-	21,051
Income before income taxes	14,582	6,067	1,103	(6,251)	15,808
Income tax expense	339	419	500	-	1,565
Net income	\$ 14,243	\$ 5,648	\$ 603	\$ (6,251)	\$ 14,243

EYE CARE CENTERS OF AMERICA, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollar amounts in thousands unless indicated otherwise)

Consolidating Statement of Cash Flows
For the Year Ended December 28, 2002

	Parent	Guarantor Subsidiaries	ODs	Eliminations	Consolidated Company
Cash flows from operating activities:					
Net income	\$ 14,243	\$ 5,648	\$ 603	\$ (6,251)	\$ 14,243
Adjustments to reconcile net income to net cash provided by operating activities:					
Depreciation	11,363	7,398	-	-	18,761
Amortization of intangibles	-	1,865	-	-	1,865
Amortization of debt issue costs	1,901	-	-	-	1,901
Deferrals and other	44	149	194	-	387
(Gain) loss on extinguishment of debt	(1,290)	386	-	-	(904)
Changes in operating assets and liabilities:					
Accounts and notes receivable	(13,311)	(6,932)	(811)	19,155	(1,899)
Inventory	656	256	(307)	-	605
Prepaid expenses and other	(166)	(35)	(2)	-	(203)
Accounts payable and accrued liabilities	(7,045)	24,854	954	(19,156)	(393)
Net cash provided by operating activities	6,395	33,589	631	(6,252)	34,363
Cash flows from investing activities:					
Acquisition of property and equipment (net of proceeds)	(7,765)	(2,903)	-	-	(10,668)
Investment in subsidiaries	(6,252)	-	-	6,252	-
Net cash used in investing activities	(14,017)	(2,903)	-	6,252	(10,668)
Cash flows from financing activities:					
Payments on debt related to refinancing	(88,346)	(30,000)	-	-	(118,346)
Proceeds from issuance of long-term debt	124,000	-	-	-	124,000
Payments on debt and capital leases	(23,345)	(363)	-	-	(23,708)
Payments for refinancing fees	(4,788)	-	-	-	(4,788)
Distribution to affiliated OD	(100)	-	(675)	-	(775)
Net cash provided by (used in) financing activities	7,421	(30,363)	(675)	-	(23,617)
Net increase (decrease) in cash and cash equivalents	(201)	323	(44)	-	78
Cash and cash equivalents at beginning of period	755	2,209	408	-	3,372
Cash and cash equivalents at end of period	<u>\$ 554</u>	<u>\$ 2,532</u>	<u>\$ 364</u>	<u>\$ -</u>	<u>\$ 3,450</u>

EYE CARE CENTERS OF AMERICA, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollar amounts in thousands unless indicated otherwise)

Consolidating Balance Sheet
For the Year Ended December 27, 2003

	Parent	Guarantor Subsidiaries	ODs	Eliminations	Consolidated Company
ASSETS					
Current assets:					
Cash and cash equivalents	\$ 67	\$ 3,501	\$ 241	\$ -	\$ 3,809
Accounts and notes receivable	166,924	48,875	2,847	(207,529)	11,117
Inventory	-	22,941	2,179	-	25,120
Deferred income taxes, net	570	-	-	-	570
Prepaid expenses and other	-	3,648	48	-	3,696
Total current assets	167,561	78,965	5,315	(207,529)	44,312
Property and equipment	-	51,715	-	-	51,715
Intangibles	166	107,195	87	(25)	107,423
Other assets	6,414	2,217	-	-	8,631
Deferred income taxes, net	13,445	-	-	-	13,445
Investment in subsidiaries	(6,952)	-	-	6,952	-
Total Assets	<u>\$ 180,634</u>	<u>\$ 240,092</u>	<u>\$ 5,402</u>	<u>\$ (200,602)</u>	<u>\$ 225,526</u>
LIABILITIES AND SHAREHOLDERS' DEFICIT					
Current liabilities:					
Accounts payable	\$ 341	\$ 221,829	\$ 6,719	\$ (207,529)	\$ 21,360
Current portion of long-term debt	18,750	230	-	-	18,980
Deferred revenue	512	4,785	446	-	5,743
Accrued payroll expense	-	5,027	402	-	5,429
Accrued interest	3,213	-	-	-	3,213
Other accrued expenses	246	6,889	1,199	-	8,334
Total current liabilities	23,062	238,760	8,766	(207,529)	63,059
Long-term debt, less current maturities	217,789	2,056	-	-	219,845
Deferred rent	-	4,570	149	-	4,719
Deferred gain	1,213	319	-	-	1,532
Total liabilities	<u>242,064</u>	<u>245,705</u>	<u>8,915</u>	<u>(207,529)</u>	<u>289,155</u>
Shareholders' deficit:					
Common stock	74	-	-	-	74
Preferred stock	62,169	-	-	-	62,169
Additional paid-in capital	30,458	25	(2,199)	(25)	28,259
Accumulated deficit	(154,131)	(5,638)	(1,314)	6,952	(154,131)
Total shareholders' deficit	<u>(61,430)</u>	<u>(5,613)</u>	<u>(3,513)</u>	<u>6,927</u>	<u>(63,629)</u>
	<u>\$ 180,634</u>	<u>\$ 240,092</u>	<u>\$ 5,402</u>	<u>\$ (200,602)</u>	<u>\$ 225,526</u>

EYE CARE CENTERS OF AMERICA, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollar amounts in thousands unless indicated otherwise)

Consolidating Statements of Operations
For the Year Ended December 27, 2003

	Parent	Guarantor Subsidiaries	ODs	Eliminations	Consolidated Company
Revenues:					
Optical sales	\$ 62,864	\$ 228,982	\$ 74,685	\$ -	\$ 366,531
Management fees	480	23,711	-	(20,870)	3,321
Investment earnings in subsidiaries	12,242	-	-	(12,242)	-
Net revenues	75,586	252,693	74,685	(33,112)	369,852
Operating costs and expenses:					
Cost of goods sold	22,204	77,509	14,865	-	114,578
Selling, general and administrative expenses	36,414	145,691	57,467	(20,870)	218,702
Amortization of noncompete and other intangibles	-	165	-	-	165
Total operating costs and expenses	58,618	223,365	72,332	(20,870)	333,445
Income from operations	16,968	29,328	2,353	(12,242)	36,407
Interest expense, net	2,019	18,169	12	-	20,200
Income before income taxes	14,949	11,159	2,341	(12,242)	16,207
Income tax expense (benefit)	(10,858)	-	1,258	-	(9,600)
Net income	\$ 25,807	\$ 11,159	\$ 1,083	\$ (12,242)	\$ 25,807

EYE CARE CENTERS OF AMERICA, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollar amounts in thousands unless indicated otherwise)

Consolidating Statement of Cash Flows
For the Year Ended December 27, 2003

	Parent	Guarantor Subsidiaries	ODs	Eliminations	Consolidated Company
Cash flows from operating activities:					
Net income	\$ 25,807	\$ 11,159	\$ 1,083	\$ (12,242)	\$ 25,807
Adjustments to reconcile net income to net cash provided by operating activities:					
Depreciation	3,485	13,168	-	-	16,653
Amortization of intangibles	-	165	-	-	165
Amortization of debt issue costs	687	1,320	-	-	2,007
Deferrals and other	(5,933)	4,897	401	-	(635)
Benefit for deferred taxes	(14,015)	-	-	-	(14,015)
Changes in operating assets and liabilities:					
Accounts and notes receivable	(32,504)	(6,123)	398	39,106	877
Inventory	14,715	(15,450)	(325)	-	(1,060)
Prepaid expenses and other	3,789	(4,932)	-	-	(1,143)
Deposits and other	-	(646)	-	-	(646)
Accounts payable and accrued liabilities	34,682	5,181	(1,355)	(39,106)	(598)
Net cash provided by operating activities	30,713	8,739	202	(12,242)	27,412
Cash flows from investing activities:					
Acquisition of property and equipment, (net of proceeds)	(3,046)	(7,925)	-	-	(10,971)
Investment in subsidiaries	(12,242)	-	-	12,242	-
Net cash used in investing activities	(15,288)	(7,925)	-	12,242	(10,971)
Cash flows from financing activities:					
Payments on debt and capital leases	(15,912)	155	(100)	-	(15,857)
Distribution to affiliated OD	-	-	(225)	-	(225)
Net cash provided by (used in) financing activities	(15,912)	155	(325)	-	(16,082)
Net increase (decrease) in cash and cash equivalents	(487)	969	(123)	-	359
Cash and cash equivalents at beginning of period	554	2,532	364	-	3,450
Cash and cash equivalents at end of period	\$ 67	\$ 3,501	\$ 241	\$ -	\$ 3,809

EYE CARE CENTERS OF AMERICA, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollar amounts in thousands unless indicated otherwise)

Consolidating Balance Sheet
For the Year Ended January 1, 2005

	Parent	Guarantor Subsidiaries	ODs	Eliminations	Consolidated Company
ASSETS					
Current assets:					
Cash and cash equivalents	\$ 2,582	\$ 337	\$ 179	\$ -	\$ 3,098
Accounts and notes receivable	142,575	47,353	4,900	(184,373)	10,455
Inventory	-	26,663	1,895	-	28,558
Deferred income taxes, net	-	7,507	45	-	7,552
Prepaid expenses and other	2,313	-	-	-	2,313
Total current assets	147,470	81,860	7,019	(184,373)	51,976
Property and equipment	-	46,374	66	-	46,440
Intangibles	166	107,195	87	(25)	107,423
Other assets	6,415	(470)	-	-	5,945
Deferred income taxes, net	13,310	455	-	-	13,765
Investment in subsidiaries	15,973	-	-	(15,973)	-
Total Assets	<u>\$ 183,334</u>	<u>\$ 235,414</u>	<u>\$ 7,172</u>	<u>\$ (200,371)</u>	<u>\$ 225,549</u>
LIABILITIES AND SHAREHOLDERS' DEFICIT					
Current liabilities:					
Accounts payable	\$ 12	\$ 197,187	\$ 9,165	\$ (184,373)	\$ 21,991
Current portion of long-term debt	19,301	327	-	-	19,628
Deferred revenue	-	4,748	450	-	5,198
Accrued payroll expense	-	5,514	360	-	5,874
Accrued interest	3,584	(1,670)	-	-	1,914
Other accrued expenses	69	7,595	758	-	8,422
Total current liabilities	22,966	213,701	10,733	(184,373)	63,027
Long-term debt, less current maturities	202,495	1,790	-	-	204,285
Deferred rent	-	4,455	159	-	4,614
Deferred gain	1,213	83	-	-	1,296
Total liabilities	<u>226,674</u>	<u>220,029</u>	<u>10,892</u>	<u>(184,373)</u>	<u>273,222</u>
Shareholders' deficit:					
Common stock	74	-	-	-	74
Preferred stock	70,825	-	-	-	70,825
Additional paid-in capital	23,046	(1,084)	(3,224)	(25)	18,713
Accumulated deficit	(137,285)	16,469	(496)	(15,973)	(137,285)
Total shareholders' deficit	<u>(43,340)</u>	<u>15,385</u>	<u>(3,720)</u>	<u>(15,998)</u>	<u>(47,673)</u>
	<u>\$ 183,334</u>	<u>\$ 235,414</u>	<u>\$ 7,172</u>	<u>\$ (200,371)</u>	<u>\$ 225,549</u>

EYE CARE CENTERS OF AMERICA, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollar amounts in thousands unless indicated otherwise)

Consolidating Statements of Operations
For the Year Ended January 1, 2005

	Parent	Guarantor Subsidiaries	ODs	Eliminations	Consolidated Company
Revenues:					
Optical sales	\$ (495)	\$ 314,282	\$ 82,305	\$ -	\$ 396,092
Management fees	125	25,375	-	(22,124)	3,376
Investment earnings in subsidiaries	22,926	-	-	(22,926)	-
Net revenues	22,556	339,657	82,305	(45,050)	399,468
Operating costs and expenses:					
Cost of goods sold	-	109,101	16,388	-	125,489
Selling, general and administrative expenses	664	187,996	65,079	(22,124)	231,615
Total operating costs and expenses	664	297,097	81,467	(22,124)	357,104
Income from operations	21,892	42,560	838	(22,926)	42,364
Interest expense, net	(240)	20,452	4	-	20,216
Income before income taxes	22,132	22,108	834	(22,926)	22,148
Income tax expense (benefit)	5,286	-	16	-	5,302
Net income	\$ 16,846	\$ 22,108	\$ 818	\$ (22,926)	\$ 16,846

EYE CARE CENTERS OF AMERICA, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollar amounts in thousands unless indicated otherwise)

Consolidating Statement of Cash Flows
For the Year Ended January 1, 2005

	Parent	Guarantor Subsidiaries	ODs	Eliminations	Consolidated Company
Cash flows from operating activities:					
Net income	\$ 16,846	\$ 22,108	\$ 818	\$ (22,925)	\$ 16,847
Adjustments to reconcile net income to net cash provided by operating activities:					
Depreciation	-	15,907	-	-	15,907
Amortization of debt issue costs	49	2,579	-	-	2,628
Deferrals and other	(512)	(381)	14	-	(879)
Benefit for deferred taxes	(1,608)	(455)	-	-	(2,063)
Changes in operating assets and liabilities:					
Accounts and notes receivable	25,592	255	(2,119)	(23,156)	572
Inventory	-	(3,722)	284	-	(3,438)
Prepaid expenses and other	(1)	(3,857)	3	-	(3,855)
Deposits and other	-	(763)	-	-	(763)
Accounts payable and accrued liabilities	(135)	(24,895)	1,739	23,156	(135)
Net cash provided by operating activities	40,231	6,776	739	(22,925)	24,821
Cash flows from investing activities:					
Acquisition of property and equipment, (net of proceeds)	-	(10,639)	-	-	(10,639)
Investment in subsidiaries	(22,925)	-	-	22,925	-
Net cash used in investing activities	(22,925)	(10,639)	-	22,925	(10,639)
Cash flows from financing activities:					
Payments on debt and capital leases	(14,791)	(170)	-	-	(14,961)
Distribution to affiliated OD and other	-	869	(801)	-	68
Net cash provided by (used in) financing activities	(14,791)	699	(801)	-	(14,893)
Net increase (decrease) in cash and cash equivalents	2,515	(3,164)	(62)	-	(711)
Cash and cash equivalents at beginning of period	67	3,501	241	-	3,809
Cash and cash equivalents at end of period	\$ 2,582	\$ 337	\$ 179	\$ -	\$ 3,098

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10. Preferred Stock

During 1998, the Company issued 300,000 shares of preferred stock, par value \$.01 per share. Dividends on shares of Preferred Stock are cumulative from the date of issue (whether or not declared) and will be payable when and as may be declared from time to time by the Board of Directors of the Company. Such dividends accrue on a daily basis from the original date of issue at an annual rate per share equal to 13% of the original purchase price per share, with such amount to be compounded quarterly. Cumulative preferred dividends in arrears were \$32.2 million, and \$40.8 million as of December 27, 2003 and January 1, 2005, respectively. The Preferred Stock will be redeemable at the option of the Company, in whole or in part, at \$100 per share plus (i) the per share dividend rate and (ii) all accumulated and unpaid dividends, if any, to the date of redemption, upon occurrence of an offering of equity securities, a change of control or certain sales of assets. The Preferred Stock has no voting rights.

11. Shareholders' Deficit

1998 Executive Stock Option Plan

On April 25, 1998, the Company authorized a nonqualified stock option plan whereby key executives and senior officers may be offered options to purchase the Company's Common Stock. Under the plan, the exercise price set by the Board of Directors of the Company must at least equal the fair market value of the Company's Common Stock at the date of grant. The options begin vesting one year after the date of grant in four installments of 10%, 15%, 25% and 50% provided the optionee is an employee of the Company on the anniversary date and shall expire 10 years after the date of grant. Under certain specified conditions the vesting schedule may be altered. During Fiscal 2001, the Company entered into Option Cancellation Agreements (the Cancellation Agreements) with certain employees and directors (the Optionees) to cancel all outstanding options which were granted through the cancellation date under the Company's 1998 Stock Option Plan (the Plan) due to changes in the fair market value of the Company's common stock. The Company provided all of the Optionees with an option cancellation notice detailing the Company's offer for the Optionees to cancel and terminate their respective options in exchange for the commitment of the Company to grant new options under the Plan (the New Options), such new grant to be made no earlier than six months and a day after the effective date of the cancellation of the options and at an exercise price equal to the fair market value of the common stock as of the effective date of the grant of the New Options. The Cancellation Agreements provided that, in January 2002 (the Grant Date), the Company granted to each of the Optionees a New Option to purchase the number of shares of common stock subject to the options being terminated and cancelled and that such New Option will have an exercise price equal to the fair market value of the common stock as of the Grant Date. The vesting period for the New Options granted to employees was 40% on the Grant Date with an additional 20% to vest on each of the first, second and third anniversaries of the Grant Date. The exercise price at the Grant Date was \$5.00 per share. Subsequent grants of 131,000 options were made throughout the

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remainder of Fiscal 2002. Such grants begin vesting one year after the date of the grant in four installments of 10%, 15%, 25% and 50% and have an exercise price of \$5.00 to \$15.13 per share, based on the fair market value at the Grant Date. The weighted-average fair value per share for option grants was \$0.63, \$1.72, and \$1.82 for Fiscal 2002, 2003, and 2004, respectively. The following table presents information related to options outstanding and options exercisable at January 1, 2005 based on various exercise prices.

Options Outstanding			
Exercise Price Per Share (\$)	Number of Options	Weighted Average Remaining Contractual Life in Years	Options Exercisable
\$5.00	813,775	7.0	623,245
\$15.13	214,000	8.8	16,225
\$5.00 to \$15.13	1,027,775	7.4	639,470

Following is a summary of activity in the plan for Fiscal 2002, 2003, and 2004:

	Weighted Average Option Exercise Price Per Share(\$)	Options Outstanding	Weighted Average Option Exercise Price Per Share(\$)	Options Exercisable
December 29, 2001	\$ -	-	\$ -	-
Granted	5.76	988,775	-	-
Became exercisable	-	-	5.27	352,710
Canceled or expired	5.00	(41,000)	5.00	(27,200)
December 28, 2002	5.54	947,775	5.00	325,510
Granted	15.13	48,000	-	-
Became exercisable	-	-	5.30	173,155
Canceled or expired	5.29	(70,000)	5.00	(23,000)
December 27, 2003	6.06	925,775	5.10	475,665
Granted	15.13	135,500	-	-
Became exercisable	-	-	5.66	174,105
Canceled or expired	10.44	(33,500)	5.00	(10,300)
January 1, 2005	\$ 6.10	1,027,775	\$ 5.26	639,470

The Company grants certain directors options to purchase the Company's Common Stock from time to time. Options granted during Fiscal 2001 begin vesting on the date of grant in three installments of 50%, 25% and 25%, with such options expiring 10 years from the

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date of grant. All subsequent options granted begin vesting one year after the date of the grant in four installments of 25% each installment, with such options expiring 10 years from the date of grant. The weighted-average fair value per share for option grants was \$0.63, \$1.72, and \$2.24 for Fiscal 2002, 2003, and 2004, respectively. The following table presents information related to options outstanding and options exercisable at January 1, 2005 based on various exercise prices.

Options Outstanding			
Exercise Price Per Share (\$)	Number of Options	Weighted Average Remaining Contractual Life in Years	Options Exercisable
\$5.00	126,412	7.0	126,412
\$15.13	20,000	8.8	3,750
\$5.00 to \$15.13	146,412	7.3	130,162

Following is a summary of activity in the plan for Fiscal 2002, 2003, and 2004:

	Weighted Average Option Exercise Price Per Share(\$)	Options Outstanding	Weighted Average Option Fair Value Price Per Share(\$)	Options Exercisable
December 29, 2001	\$ -	-	\$ -	-
Granted	5.39	131,412	-	-
Became exercisable	-	-	5.00	63,206
Canceled or expired	-	-	-	-
December 28, 2002	5.39	131,412	5.00	63,206
Granted	15.13	5,000	-	-
Became exercisable	-	-	5.39	32,853
Canceled or expired	-	-	-	-
December 27, 2003	5.74	136,412	5.13	96,059
Granted	15.13	10,000	-	-
Became exercisable	-	-	5.74	34,103
Canceled or expired	-	-	-	-
January 1, 2005	\$ 6.38	146,412	\$ 5.29	130,162

The Company has elected to follow Accounting Principles Board Opinion No. 25 *Accounting for Stock Issued to Employees* (APB 25) and related interpretations in accounting for its employee stock options because, as discussed below, the alternative fair value accounting provided for under FASB Statement No. 123 *Accounting for Stock-*

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Based Compensation, requires use of option valuation models that were not developed for use in valuing employee stock options of privately held companies. Under APB 25, because the exercise price of the Company's employee stock options equals the estimated fair value of the underlying stock on the date of grant, no compensation expense is recognized.

The fair value for these options was estimated at the date of the grant using the minimum value method with the following assumptions for Fiscal 2002, Fiscal 2003, and Fiscal 2004: risk-free interest rate of 3%, no dividend yield and a weighted-average expected life of the options of 4 years.

Option valuation models require the input of highly subjective assumptions. Because the Company's employee stock options have characteristics significantly different from those of traded options, and because changes in the subjective input assumptions can materially affect the fair value estimate, in management's opinion, the existing models do not necessarily provide a reliable single measure of the fair value of its employee stock options.

12. Income taxes

The provision (benefit) for income taxes is composed of the following:

	Year Ended		
	December 28, 2002	December 27, 2003	January 1, 2005
Current	\$ 1,258	\$ 4,415	\$ 7,365
Deferred	-	(14,015)	(2,063)
	<u>\$ 1,258</u>	<u>\$ (9,600)</u>	<u>\$ 5,302</u>

The reconciliation between the federal statutory tax rate and the Company's effective tax rate is as follows:

	Year Ended		
	December 28, 2002	December 27, 2003	January 1, 2005
Expected tax expense (benefit)	\$ 5,270	\$ 5,510	\$ 7,752
Provision to return adjustment	-	2,087	(172)
State taxes, net of federal benefit	-	1,320	1,923
Other	2,062	2,351	(1,789)
Change in effective tax rate	-	-	(2,412)
Change in valuation allowance	(6,074)	(20,868)	-
	<u>\$ 1,258</u>	<u>\$ (9,600)</u>	<u>\$ 5,302</u>

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The above reconciliation takes into account certain entities that are consolidated for financial accounting purposes but are not consolidated for tax purposes, therefore, the net operating loss carryforward cannot offset the income from the non-consolidated entities. Likewise, losses from these non-consolidated entities may not be utilized to offset consolidated entities' income or to increase the consolidated net operating loss.

The components of the net deferred tax assets are as follows:

	December 27, 2003	January 1, 2005
Total deferred tax assets, current	\$ 844	\$ 3,087
Total deferred tax liabilities, current	(274)	(774)
Net deferred tax asset, current	570	2,313
Total deferred tax assets, long-term	16,713	16,078
Total deferred tax liabilities, long-term	(3,268)	(2,313)
Net deferred tax assets, long term	\$ 13,445	\$ 13,765

The sources of the differences between the financial accounting and tax assets and liabilities which give rise to the deferred tax assets and deferred tax liabilities are as follows:

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	December 27, 2003	January 1, 2005
Deferred tax assets:		
Fixed asset depreciation differences	\$ 10,976	\$ 13,129
Net operating loss and credit carryforward	1,841	-
Gain on debt purchase	1,881	1,694
Allowance for bad debts	563	1,039
Other	869	1,265
Gain on asset disposals	465	349
Inventory basis differences	438	823
Accrued salaries	256	919
Deferred rent	187	1,294
Deferred revenue	81	1,155
	17,557	21,667
Deferred tax liabilities:		
Goodwill	2,197	4,361
Deferred financing costs	731	(132)
Other	320	424
Prepaid expense	273	912
Store pre-opening costs	21	24
	3,542	5,589
Total deferred tax liability	3,542	5,589
Net deferred tax assets	\$ 14,015	\$ 16,078

At December 27, 2003 and January 1, 2005, the Company had net operating loss carryforward for tax purposes of \$5,413 and \$0, respectively. Prior to 2003, utilization of the loss carryforwards was not assured due to historical taxable income and the probability of future taxable income. However, management believed it is more likely than not that all of the deferred tax asset would be realized. Accordingly the Company's valuation allowance was fully released in 2003.

13. Employee benefits

401(k) Plan

The Company maintains a defined contribution plan whereby substantially all employees who have been employed for at least six consecutive months are eligible to participate. Contributions are made by the Company as a percentage of employee contributions. In addition, discretionary contributions may be made at the direction of the Company's Board of Directors. Total Company contributions were approximately \$235 and \$248 for Fiscal 2003 and 2004, respectively.

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14. Leases

The Company is obligated as lessee under operating leases for substantially all of the Company's retail facilities as well as certain warehouse space. In addition to rental payments, the leases generally provide for payment by the Company of property taxes, insurance, maintenance, and its pro rata share of common area maintenance. These leases range in terms of up to 14 years. Certain leases also provide for additional rent in excess of the base rentals calculated as a percentage of sales.

The Company subleases a portion of substantially all of the stores to an independent optometrist or a corporation controlled by an independent optometrist. The terms of these leases or subleases are principally one to seven years with rentals consisting of a percentage of gross receipts, base rentals, or a combination of both. Certain of these leases contain renewal options.

Certain of the Company's lease agreements contain provisions for scheduled rent increases or provide for occupancy periods during which no rent payment is required. For financial statement purposes, rent expense is recorded based on the total rentals due over the entire lease term and charged to rent expense on a straight-line basis. The difference between the actual cash rentals paid and rent expenses recorded for financial statement purposes is recorded as a deferred rent obligation. At the end of Fiscal 2003 and 2004, deferred rent obligations aggregated approximately \$4.7 million and \$4.6 million, respectively.

Rent expense for all locations, net of lease and sublease income, is as follows. For the purposes of this table, base rent expense includes common area maintenance costs. Common area maintenance costs were approximately 21%, 22% and 23% of base rent expense for Fiscal 2002, 2003 and 2004 respectively.

	December 28, 2002	December 27, 2003	January 1, 2005
Base rent expense	\$ 40,364	\$ 41,483	\$ 42,643
Rent as a percent of sales	436	478	394
Lease and sublease income	<u>(4,435)</u>	<u>(3,326)</u>	<u>(3,197)</u>
Rent expense, net	<u>\$ 36,365</u>	<u>\$ 38,635</u>	<u>\$ 39,840</u>

Future minimum lease payments as of January 1, 2005 excluding common area maintenance costs, net of future minimum lease and sublease income under irrevocable operating leases for the next five years and beyond are as follows:

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	Operating Rental Payments	Lease and Sublease Income	Operating Lease, Net
2005	\$ 31,859	\$ (1,975)	\$ 29,884
2006	28,283	(793)	27,490
2007	24,622	(556)	24,066
2008	21,707	(381)	21,326
2009	16,030	(227)	15,803
Beyond 2009	24,481	(444)	24,037
Total minimum lease payments/(receipts)	<u>\$ 146,982</u>	<u>\$ (4,376)</u>	<u>\$ 142,606</u>

15. Commitments and contingencies

The Company is involved in various claims and legal actions arising in the ordinary course of business. In the opinion of management, the ultimate disposition of these matters will not have a material adverse effect on the Company's consolidated financial position or consolidated results of operations.

16. Merger agreement subsequent event

On December 2, 2004, the Company entered into an Agreement and Plan of Merger (the "Merger Agreement") made by and among the Company, ECCA Holdings Corporation, a newly formed Delaware corporation which is owned by Moulin International Holdings Limited and Golden Gate Private Equity, Inc., ("Parent"), and LFS-Merger Sub, Inc. ("Merger Sub"), a newly formed Texas corporation and a direct, wholly-owned subsidiary of Parent. The terms and conditions of the Merger Agreement provided that Merger Sub be merged with and into the Company, with the Company being the surviving corporation and becoming a wholly-owned subsidiary of Parent.

The transaction was approved by both the Company's and Parent's respective boards of directors as well as the shareholders of the Company and Moulin International Holdings Limited and the Merger Agreement was finalized on March 1, 2005. The aggregate merger consideration paid to the shareholders of the Company consisted of \$450.0 million in cash, less the aggregate amount of all outstanding indebtedness of the Company, including the Company's Exchange Notes.

On January 28, 2005, Merger Sub entered into a purchase agreement with several initial purchasers, pursuant to which it sold \$152.0 million aggregate principal amount of 10³/₄% senior subordinated notes due 2015 which were assumed by the Company at the time of the closing of the Merger Agreement.

Concurrently with the closing of the Merger Agreement, Merger Sub entered into a new senior credit facility with a syndicate of financial institutions and repaid its outstanding

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loans under the existing credit facility in full, plus accrued and unpaid interest, and terminated all commitments thereunder. The new senior credit facility is comprised of a \$165.0 million term loan facility, maturing in 2012, and a \$25.0 million revolving credit facility, maturing in 2010. The new senior credit facility is secured by substantially all of the assets of the Company, including its capital stock and the capital stock of its subsidiaries, and guaranteed by ECCA Holdings and all of its existing subsidiaries and any of its future domestic subsidiaries.