

Forward-looking statements

Some statements contained herein are forward-looking statements. Forward-looking statements include, but are not limited to, statements about our plans, objectives, expectations and intentions and other statements contained herein that are not historical facts. Many statements under the captions “Risk factors” and “Management’s discussion and analysis of financial condition and results of operations” are forward-looking statements. These forward-looking statements may relate to, among other things, our future performance generally, business development activities, strategy, projected synergies, future capital expenditures, financing sources and availability and the effects of regulation and competition. When used herein, the words “expect,” “anticipate,” “intend,” “plan,” “believe,” “seek,” “estimate,” “may,” “will” or “should” or, in each case, their negative and similar expressions are generally intended to identify forward-looking statements although not all forward-looking statements contain such identifying words.

You should not place undue reliance on these forward-looking statements, which reflect our management’s view and various assumptions only as of the date that we make them. Because these forward-looking statements involve risks and uncertainties, many of which are beyond our control, there are important factors that could cause actual results to differ materially from those expressed or implied by these forward-looking statements, including our assumptions, plans, objectives, expectations and intentions with respect to the following:

- our competitive environment;
- the cost and effect of legal, tax or regulatory proceedings;
- changes in general economic conditions;
- changes to our regulatory environment;
- our ability to maintain our relationships with optometrists;
- franchise claims by optometrists;
- our ability to build and maintain managed vision care plans;
- reduction of third-party reimbursement;
- technological advances in vision care;
- conflicts of interest between our controlling shareholders and noteholders;
- failure to realize anticipated cost savings;
- exposure to liability claims if we are unable to obtain adequate insurance;
- changes in general industry and market conditions and growth rates;
- loss of key management personnel;
- changes in accounting policies applicable to our business;
- the impact of unusual items resulting from the implementation of new business strategies, acquisitions and divestitures or future restructuring activities;

- our substantial indebtedness;
- restrictions imposed on our business by the terms of our indebtedness; and
- our ability to fund our capital requirements.

Some of these factors are discussed more fully under “Risk factors.” In light of these risks, uncertainties and assumptions, the forward-looking statements and events discussed herein might not occur. Unless required by law, we undertake no obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

Management’s discussion and analysis of financial condition and results of operations

The following discussion should be read in conjunction with our historical and pro forma consolidated financial statements and the notes thereto. The following discussion includes certain forward-looking statements. For a discussion of important factors, including the continuing development of our business, actions of regulatory authorities and competitors and other factors which could cause actual results to differ materially from the results referred to in the forward-looking statements, see “Forward-looking statements” and “Risk factors.”

Introduction

We are the third largest operator of optical retail stores in the United States as measured by revenue. We currently operate 377 stores in 33 states, including 313 directly-owned stores and 64 stores owned by an optometrist’s professional entity (an “OD PC”), which we manage under long-term management agreements. Our consolidated financial information includes the results of our 313 directly-owned stores, as well as the results of 52 of the 64 stores operated by an OD PC. The remaining 12 stores operated by an OD PC are not consolidated and we recognize as management fee revenue only the cash flows we earn pursuant to the terms of management agreements for those 12 OD PC-operated stores.

Our net revenues are comprised of optical sales, net of discounts and promotions, from our 365 consolidated stores as well as management fees from the 12 stores owned by OD PCs that are not consolidated in our results. Optical sales include sales of frames, lenses (including lens treatments), contact lenses and eyeglass warranties at all of our 365 consolidated stores, as well as the professional fees of the optometrists at 179 of the stores. These 179 stores include 84 stores where the optometrist is our employee or an independent contractor, the 52 stores operated by an OD PC that are consolidated in our results and the 43 stores with independent optometrists for whom we provide management services. The management fees from the 12 unconsolidated OD PC-operated stores are based on the performance of the stores.

Our operating costs and expenses are comprised of costs of goods sold and selling, general and administrative expenses. Cost of goods sold primarily includes the cost of eyeglass frames, ophthalmic lenses, contact lenses, lab manufacturing costs and buying, warehousing, distribution, shipping and delivery costs. Selling, general and administrative expenses primarily include retail payroll, doctor payroll, occupancy, overhead, advertising and depreciation. Occupancy, overhead and depreciation are less variable relative to sales levels than other components of selling, general and administrative expenses.

In this management’s discussion and analysis we use the terms “gross profit,” “gross margin,” “comparable store sales,” “comparable transaction volume” and “average ticket price” to compare our period-over-period performance. Gross profit is defined as optical sales less cost of goods sold in a period. Gross margin is defined as gross profit as a percentage of optical sales in a period. Comparable store sales is calculated by comparing net revenues for a period to net revenues of the equivalent prior period for all stores open at least twelve months during such prior period. Comparable transaction volume is based on the number of

comparable store sales in a period. Average ticket price is calculated by dividing net revenues by transaction volume in a period.

We believe that the key driver of our performance is our ability to grow revenue without increasing costs at the same rate by (i) increasing comparable transaction volume by offering value and convenience, (ii) actively managing our store base in targeted markets and (iii) pursuing fee-for-service funded managed vision care relationships. Our performance is also affected by general economic conditions and consumer confidence.

We primarily grow optical sales by offering value and convenience to our customers. Since fiscal 2001, we have focused on our value strategy, which includes a promotion of two complete pairs of single vision eyewear for \$99. We believe our value strategy results in increased comparable transaction volume and also believe it encourages customers to purchase higher margin lenses, lens treatments and accessories, which increases average ticket price.

We also grow optical sales and leverage costs through selective store base expansion by opening new stores in targeted markets. Until a new store matures, its operating costs as a percentage of optical sales are generally higher than that of an established store. Accordingly, the expenses related to opening new stores adversely affects our results in that period. Over the longer term, opening a new store in an existing market allows us to leverage existing advertising, field management and overhead to mitigate margin pressure. When entering a new market, we seek to achieve sufficient market penetration to generate brand awareness and economies of scale in advertising, field management and overhead. Consistent with our strategic objectives, we believe the opportunity exists to open an average of 10 to 15 new stores per year over the next two years in existing and new markets. We also manage costs by closing stores that do not meet our performance expectations. Store openings and store closures affect period over period comparisons.

We have made a strategic decision to pursue fee-for-service funded managed vision care plans. Fee-for-service funded managed vision care plans consist of insurance relationships where we receive set fees for services provided to participants of a plan as opposed to capitated funded managed vision care plans where we receive a set fee per plan participant to provide any and all services requested by participants of such plan. Under a fee-for-service funded managed vision care plan we benefit from participants' utilization of the plan, whereas under a capitated funded managed vision care plan we bear risk related to the level at which participants utilize such plan. Substantially all of our current funded managed vision care plans are fee-for-service funded managed vision care plans. Our managed vision care plans also include discount managed vision care plans where participants receive a set discount on eye care products. We believe that participation in managed vision care plans will continue to benefit us and other large optical retail chains with strong local market shares, broad geographic coverage and sophisticated management information and billing systems. We expect that optical revenues derived from managed vision care plans will continue to account for approximately 30% of our net revenues, but that the percentage attributable to fee-for-service funded managed vision care plans will increase as revenues from discount managed vision care plans decline. While the average ticket price on products purchased under managed vision care plans is typically slightly lower than a non-managed vision care sale, managed vision care plan transactions generally earn comparable operating profit margins as they require less promotional spending and advertising support. We believe that the increased volume resulting from managed vision care plans also compensates for the lower average ticket price.

Upon completion of the acquisition by Moulin Global Eyecare Holdings, Ltd. and Golden Gate Capital, we became a party to a long-term supply agreement with Moulin pursuant to which Moulin supplies us with eyewear products and accessories. We believe that our ability to source products directly from a significant manufacturer and distributor like Moulin will reduce our cost of goods sold. The supply agreement provides that we receive pricing at least equal to the lowest price Moulin offers any of its other customers, provides us with semi-annual rebates based on the dollar volume of frames we purchase from Moulin and does not contain any minimum purchase volume requirements.

Results of operations

The following table sets forth the percentage relationship to net revenues of certain income statement data. The year-to-year comparisons of financial results are not necessarily indicative of future results.

	Fiscal year ended		
	December 28, 2002	December 27, 2003	January 1, 2005
Net revenues:			
Optical sales.....	99.1%	99.1%	99.2%
Management fees	0.9	0.9	0.8
Total net revenues.....	100.0%	100.0%	100.0%
Operating costs and expenses:			
Cost of goods sold(1).....	31.2	31.3	31.7
Selling, general and administrative(1)	59.1	59.7	58.5
Amortization of intangibles	0.5	—	—
Total operating costs and expenses	89.9	90.2	89.4
Income from operations	10.1	9.8	10.6
Interest expense, net.....	5.8	5.4	5.1
Income before income taxes	4.3	4.4	5.5
Income tax expense/(benefit).....	0.4	(2.6)	1.3
Net income	3.9	7.0	4.2

(1) Percentages based on optical sales only.

The following is a discussion of certain factors affecting our results of operations from fiscal 2002 through fiscal 2004 and our liquidity and capital resources. This discussion should be read in conjunction with our consolidated financial statements and notes thereto.

Fiscal 2004 compared to fiscal 2003

Net revenues. Fiscal 2004 was a 53-week year compared to a 52-week fiscal year for 2003. Net revenues increased to \$399.5 million in fiscal 2004 from \$369.9 million in fiscal 2003, as a result of the addition of seven new stores since the end of fiscal 2003, four of which were opened in the Atlanta market, and an increase in comparable store sales. The opening of these seven new stores was partially offset by the closing of one store during fiscal 2004. Net revenues attributable to the new stores opened in fiscal 2004 were \$3.2 million. The increase in net revenues attributable to the full year effect of stores opened in fiscal 2003 being open all of fiscal 2004 was \$4.8 million. Comparable store sales increased by 4.9%. We believe incremental net revenues from the fifty-third week contributed approximately 1.9% to comparable store sales. Comparable transaction volume increased by 0.7%, and average ticket prices increased by 2.3% in fiscal 2004 compared to fiscal 2003. We believe the increases in comparable store sales and comparable transaction volume was primarily the result of an overall improvement in the retail optical market and increased promotional activity in fiscal 2004. The increase in average ticket prices was largely the result of the increase in the sales mix of branded frames which carry higher prices than non-branded frames. Approximately 30.2% of our optical revenues were derived from managed vision care plans in fiscal 2004 compared to 31.6% in fiscal 2003. A decline in our participation in managed vision care plans and the shift of managed vision care participants to our retail value promotions in fiscal 2004 was largely offset by growth in existing fee-for-service funded managed vision care plans, sales under which increased by 5.5% for fiscal 2004.

Gross profit. Gross profit increased to \$270.6 million in fiscal 2004 from \$252.0 million in fiscal 2003, primarily as a result of an increase in optical sales. Gross margin decreased to 68.3% in fiscal 2004 from 68.7% in fiscal 2003. This decrease was largely due to an increase in the volume of branded frames, which are lower margin products, sold in the period as well as higher lab manufacturing costs.

Selling, general & administrative expenses (SG&A). SG&A increased to \$231.7 million in fiscal 2004 from \$218.7 million in fiscal 2003, which is consistent with the increase in sales. SG&A as a percentage of optical sales decreased to 58.5% in fiscal 2004 from 59.7% in fiscal 2003. This percentage decrease was

primarily due to an increase in optical sales while certain components of SG&A remained relatively stable compared to fiscal 2003. In connection with our proposed initial public offering of investment units, the Company incurred \$0.6 million in expenses. The offering was not completed, the registration statement filed with the SEC was withdrawn on December 10, 2004 and all related expenses were written off during fiscal 2004.

Amortization expense. There was no amortization expense for fiscal 2004 compared to \$0.2 million of amortization expense for fiscal 2003. Our amortizable intangible balances have been fully amortized.

Net interest expense. Net interest expense remained flat at \$20.2 million for fiscal 2004 from \$20.2 million for fiscal 2003.

Income tax benefit. Income tax expense was \$5.3 million in fiscal 2004 compared to a benefit of \$9.6 million in fiscal 2003. This increase was primarily due to utilization of the Company's net operating loss for tax purposes during fiscal 2003, as well as the removal of the valuation allowance on deferred tax assets in fiscal 2003.

Net income. Net income decreased to \$16.8 million in fiscal 2004 from \$25.8 million in fiscal 2003, as a result of the factors described above.

Fiscal 2003 compared to fiscal 2002

Net revenues. Net revenues increased to \$369.9 million in fiscal 2003 from \$363.7 million in fiscal 2002, largely the result of the addition of 10 new stores since the end of fiscal 2002, nine of which were opened in the Atlanta market. The opening of these 10 new stores was partially offset by the closing of two stores during fiscal 2003. Net revenues attributable to the new stores opened in fiscal 2003 were \$4.2 million. The increase in net revenues attributable to the full year effect of stores opened in fiscal 2002 being open all of fiscal 2003 was \$4.1 million. Comparable store sales decreased by 0.3% and comparable transaction volume decreased by 0.4%, while average ticket prices increased by 0.2% in fiscal 2003 compared to fiscal 2002. We believe this relatively flat performance was largely the result of the lack of overall growth in the optical retail market and a sluggish economy for the majority of fiscal 2003. Approximately 31.6% of our optical revenues were derived from managed vision care plans in fiscal 2003 compared to 39.4% in fiscal 2002. The decline was primarily due to (i) our decision to discontinue participation in certain discount managed vision care plans and (ii) the shift of managed vision care participants to our retail value promotion. This decline was partly offset by increased participation in fee-for-service funded managed vision care plans, sales under which increased by 6.2% for fiscal 2003.

Gross profit. Gross profit increased to \$252.0 million in fiscal 2003 from \$247.8 million in fiscal 2002, primarily as a result of an increase in optical sales. Gross margin decreased to 68.7% in fiscal 2003 from 68.8% in fiscal 2002. This relatively flat trend was due to an increase in professional fees as a percentage of optical sales offset by an increase in the volume of contact lens sales, which typically have lower gross margins. Non-branded frames have lower wholesale purchase prices than branded frames resulting in higher margins.

Selling, general & administrative expenses (SG&A). SG&A increased to \$218.7 million in fiscal 2003 from \$212.8 million in fiscal 2002. SG&A as a percentage of optical sales increased to 59.7% in fiscal 2003 from 59.1% in fiscal 2002. This increase was due to a change in the structure of our doctor relationships in eight of our markets, which resulted in increased doctor payroll expenditures, as well as new store openings which resulted in an increase in initial store opening, payroll and occupancy expenditures in fiscal 2003.

Amortization expense. Amortization expense decreased to \$0.2 million for fiscal 2003 from \$1.9 million in fiscal 2002 as the related intangible asset was fully amortized.

Net interest expense. Net interest expense decreased to \$20.2 million for fiscal 2003 from \$21.1 million for fiscal 2002. This decrease was primarily due to lower outstanding debt balances during fiscal 2003.

Income tax benefit. Income tax benefit increased to \$9.6 million in fiscal 2003 from a \$1.3 million expense in 2002, due to the increase in the related deferred tax asset of \$14.0 million. The recognition of the deferred tax asset is the result of the removal of the valuation allowance on deferred tax assets because of our history of taxable income and high probability of future taxable income.

Net income. Net income increased to \$25.8 million in fiscal 2003 from \$14.2 million in fiscal 2002, primarily as a result of the tax benefit realized in fiscal 2003 and increased net revenues.

Liquidity and capital resources

Sources of capital

Our short-term and long-term liquidity needs will arise primarily from: (i) interest payments primarily related to our new senior credit facility and the notes; (ii) capital expenditures, including those for opening new stores; and (iii) working capital requirements as may be needed to support our business. We intend to fund our operations, interest expense, capital expenditures and working capital requirements principally from cash from operations. We are a holding company with no direct operations. Our principal assets are the equity interests we hold in our subsidiaries. As a result, we are dependent upon dividends and other payments from our subsidiaries to generate the cash necessary to fund our operations, interest expense, capital expenditures and working capital requirements. There are currently no restrictions on the ability of our subsidiaries to transfer funds to us.

Cash flows from operating activities provided net cash for fiscal 2004, 2003 and 2002 of \$24.8 million, \$27.4 million and \$34.4 million, respectively. Our other sources of capital are cash on hand and funding from our revolving credit facility. As of January 1, 2005 we had \$3.1 million of cash available to meet our obligations. On a pro forma basis, after giving effect to the consummation of the transactions, we would have had \$25.0 million of borrowings available under the \$25.0 million revolving portion of our new senior credit facility, excluding \$2.4 million letters of credit outstanding.

Payments on debt and issuance of debt have been our principal financing activities. Cash flows used in financing activities for fiscal 2004, 2003 and 2002 were \$14.9 million, \$16.1 million and \$23.6 million, respectively.

Our working capital primarily consists of cash and cash equivalents, accounts receivable, inventory, accounts payable and accrued expenses and was a deficit of \$11.1 million as of January 1, 2005. Our level of working capital has remained relatively stable since December 28, 2002.

Capital expenditures for fiscal 2004, 2003 and 2002 were \$10.6 million, \$11.0 million and \$10.7 million, respectively, and were and are our principal uses of cash for investing activities. The table below sets forth the components of these capital expenditures for fiscal 2002, 2003 and 2004.

(Dollars in millions)	Fiscal year ended		
	December 28, 2002	December 27, 2003	January 1, 2005
Expenditure category:			
New stores.....	\$ 2.9	\$ 3.7	\$ 2.7
Information systems.....	1.8	1.4	1.5
Lab equipment.....	1.4	2.4	1.4
Store maintenance and remodeling.....	4.4	3.3	4.9
Other.....	0.2	0.2	0.1
Total capital Expenditures.....	\$ 10.7	\$ 11.0	\$ 10.6

Capital expenditures for fiscal 2005 are projected to be approximately \$11.0 million.

In 1998, we issued \$100.0 million aggregate principal amount of our 9½% Senior Subordinated Notes due 2008 and \$50.0 million aggregate principal amount of our Floating Interest Rate Subordinated Term Securities due 2008. In connection with entering into our old credit facility in December 2002, we redeemed \$20.0 million principal amount of our Floating Interest Rate Subordinated Term Securities. On March 1, 2005, we paid \$129 million to purchase retired notes tendered pursuant to the tender offer. On March 4, 2005, we delivered a notice of redemption to redeem on and as of May 2, 2005 all of our outstanding 9½% Senior Subordinated Notes due 2008 that were not tendered in the tender offer in the amount of \$8.3 million, which includes accrued and unpaid interest up to but not including May 2, 2005.

Based upon current operations, we believe that our cash flows from operations, together with borrowings that are available under the \$25.0 million revolving credit facility portion of our new senior credit facility, will be adequate to meet our anticipated requirements for working capital, capital expenditures and scheduled principal and interest payments through the next twelve months. Our ability to satisfy our financial covenants under our new senior credit facility, meet our debt service obligations and reduce our debt will be dependent on our future performance, which in turn, will be subject to general economic conditions and to financial, business, and other factors, including factors beyond our control. We believe that our ability to repay amounts outstanding under our new senior credit facility and the notes at maturity will likely require additional financing, which may not be available to us on acceptable terms, if at all. A portion of our debt bears interest at floating rates; therefore, our financial condition is and will continue to be affected by changes in prevailing interest rates.

Commitments and contractual obligations

The following table discloses aggregate information about our contractual cash obligations as of January 1, 2005 and the periods in which payments are due:

(Dollars in thousands)	Payments due by period				
	Total	Less than 1 yr	1 to 3 yrs	3 to 5 yrs	More than 5 yrs
Long-term debt obligations(1)	\$221,797	\$19,301	\$72,659	\$129,837	\$ —
Capital lease obligations	2,116	327	822	916	51
Operating lease obligations(2)	146,982	31,859	52,905	37,737	24,481
Total future payments on contractual obligations	<u>\$370,895</u>	<u>\$20,487</u>	<u>\$74,386</u>	<u>\$168,490</u>	<u>\$24,532</u>

(1) Does not include interest that would have been payable on outstanding long-term debt obligations, including 9½% annual interest on \$130.0 million aggregate principal amount of notes and interest on approximately \$84.0 million of floating rate debt under our old senior credit facility.

(2) Our operating leases generally have a 10-year duration. We renew approximately 40 to 50 operating leases annually. Rental payments on leases to be renewed could be subject to change.

The following table discloses aggregate information about our contractual cash obligations as of January 1, 2005 after giving effect to the transactions and the periods in which payments are due:

(Dollars in thousands)	Payments due by period				
	Total	Less than 1 yr	1 to 3 yrs	3 to 5 yrs	More than 5 yrs
Long-term debt obligations(1)	\$317,000	\$ 825	\$ 3,300	\$ 3,300	\$309,575
Capital lease obligations	2,116	327	822	916	51
Operating lease obligations(2)	146,982	31,859	52,905	37,737	24,481
Total future payments on contractual obligations	<u>\$466,098</u>	<u>\$33,011</u>	<u>\$57,027</u>	<u>\$41,953</u>	<u>\$334,107</u>

(1) Does not include interest that would have been payable on outstanding long-term debt obligations after giving effect to the transactions, including 10.75% annual interest on \$152.0 million aggregate principal amount of notes and interest on approximately \$165.0 million of floating rate debt under our new senior credit facility. Does not include mandatory annual prepayments of the term loan facility based on defined excess cash flows.

(2) Our operating leases generally have a 10-year duration. We renew approximately 40 to 50 operating leases annually. Rental payments on leases to be renewed could be subject to change.

Off-balance sheet arrangements

As of January 1, 2005, our only off-balance sheet arrangements were letters of credit, in the amount of \$2.4 million, issued under our old credit facility primarily to insurance companies and remain outstanding under our new senior credit facility.

Critical accounting policies

Critical accounting policies are those that require us to make assumptions that are difficult or complex about matters that are uncertain and may change in subsequent periods, resulting in changes to reported results.

Our significant accounting policies are described in note 2 in our audited consolidated financial statements. The majority of these accounting policies do not require us to make difficult, subjective or complex judgments or estimates or the variability of the estimates is not material. However, the following policies could be deemed critical and require us to make judgments and estimates. We have discussed these critical accounting policies with the audit committee of the board of directors.

- Accounts receivable are primarily from third-party payors related to the sale of eyewear and include receivables from insurance reimbursements, optometrist management fees, credit card companies, merchandise, rent and license fee receivables. Our allowance for doubtful accounts requires significant estimation and primarily consists of amounts owed to us by third party insurance payors. This estimate is based on the historical ratio of collections to billings and adjustments to estimates of contractual reimbursement arrangements from third-party payors. Our allowance for doubtful accounts was \$3.2 million at January 1, 2005. Revenues from third-party payors under managed vision care plans include estimated adjustments based on historical experience under the terms of the payor contracts with such third-party payors.
- 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. Our inventory reserves require significant estimation and are based on product with low turnover or deemed by us to be unsaleable and an estimate of shrinkage, which is the variance between the expected balance and the actual physical counts of inventory. Our inventory reserve was \$0.7 million at January 1, 2005.
- All identified intangible assets have been fully amortized as of December 27, 2003. In accordance with SFAS No. 142, we have defined our reporting unit as the consolidated Company and performed our annual assessment of goodwill on a consolidated basis as of January 1, 2005, and based upon our analysis, we believe that no impairment of goodwill exists. There have been no indicators of impairment since this assessment.
- Valuation allowances for deferred tax assets reduce deferred tax assets when it is deemed more likely than not that some portion or all of the deferred tax assets will expire before realization of the benefit or that future deductibility is not probable due to taxable losses. Although realization is not assured, due to historical taxable income and the probability of future taxable income, we believe it is more likely than not that all of the deferred tax asset will be realized.
- We maintain our own self-insurance group health plan. The plan provides medical benefits for participating employees. We have an employers' stop loss insurance policy to cover individual claims in excess of \$200,000 per employee. The amount charged to health insurance expense is based on estimates of future liabilities under the plan obtained from an independent actuarial firm. We believe the accrued liability of approximately \$1.0 million, which is included in other accrued expenses, as of January 1, 2005, is adequate to cover future benefit payments for claims that occurred prior to January 1, 2005.

Recent accounting pronouncements

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 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.

Inflation

The impact of inflation on our operations has not been significant to date. While we do not believe our business is highly sensitive to inflation, there can be no assurance that a high rate of inflation would not have an adverse impact on our operations.

Quantitative and qualitative disclosures about market risk

We are exposed to various market risks. Market risk is the potential loss arising from adverse changes in market prices and rates. We do not enter into derivative or other financial instruments for trading or speculative purposes.

Interest rate risk

Our primary market risk exposure is interest rate risk. All of our borrowing under our new senior credit facility bear interest at a floating rate. As of January 1, 2005, after giving effect to the transactions, we would have had approximately \$165.0 million of long-term floating-rate debt under our new senior credit

facility. Accordingly, our net income will be affected by changes in interest rates. Assuming a 1% increase in the interest rate under our new senior credit facility, our pro forma interest expense for the fiscal year ended January 1, 2005 would have increased by approximately \$1.7 million. In the event of changes in interest rates, we may take actions to mitigate our exposure by effectively fixing the interest rate on all or a portion of our floating rate debt. However, due to the uncertainty of the actions that would be taken and their possible effects, this analysis assumes no such actions.

Risk factors

Any of the following risks could materially and adversely affect our business, financial condition, results of operations and cash flow.

Risks relating to our business and the optical retail industry

The optical retail industry is highly competitive, and if we do not compete successfully our business will be adversely affected.

The optical retail market is highly competitive and is continuing to undergo consolidation. We compete directly with national, regional and local retailers, including other optical retail chains, warehouse clubs and mass merchandisers, and independent practitioners located in our markets. Many potential competitors for our products and services have substantial competitive advantages, including the following:

- greater name recognition;
- greater financial, technical, marketing and other resources;
- lower cost structure;
- more extensive knowledge of the optical retail business and industry; and
- well-established relationships with a larger base of current and potential customers, suppliers and managed vision care providers.

Some of our competitors are much larger than us. For example, LensCrafters and Cole Vision, which are owned by Luxottica Group SpA, had combined sales of approximately \$2.5 billion in 2003 and the optical outlets contained in Wal-Mart stores had sales of approximately \$968 million in 2003. These and other competitors have greater financial resources than we do and may be able to compete more effectively in an aggressive pricing environment. For example, when our major competitors offer significantly lower prices for their products we often adopt similar pricing strategies, which may reduce our revenues, gross margins and cash flows, and render us less able to compete with our largest competitors.

We may also encounter increased competition in the future from industry consolidation and from new competitors that enter our market. Increased competition could result in lower sales or downward price pressure on our products and services, which may adversely affect our revenues, gross margins and cash flows.

Adverse changes in economic conditions generally or in our markets, and changes in consumer tastes, could reduce demand for our products and services which could adversely affect our results of operations.

The optical retail industry may be affected by economic cycles. Downturns in general economic conditions or uncertainties regarding future economic prospects, which affect consumer disposable income, have historically adversely affected consumer spending habits in our principal markets. Therefore, future

economic downturns or uncertainties could reduce demand and have a material adverse effect on our revenues and cash flows.

The optical retail industry is also subject to rapidly changing consumer preferences. Such changes in consumer preferences could adversely affect us or the optical retail industry as a whole.

We are subject to extensive state, local and federal laws and regulations that govern our relationships with optometrists and affect the health care industry generally, and these laws and regulations may affect our ability to generate revenue or subject us to additional expenses.

Our relationships with optometrists are subject to state optometric laws that generally prohibit us from “controlling” the practice of optometry or from practicing optometry. Accordingly, we have adopted different contractual arrangements with optometrists to comply with the various regulations in the states in which we operate. For example, we sublease 64 of our stores pursuant to contracts with professional corporations or other entities controlled by optometrists, which we refer to as OD PCs. The OD PCs own the optical dispensary and the professional eye examination practice and employ the optometrists. We manage the OD PC stores under long-term management agreements, including management of the professional practice and optical retail business. Notwithstanding our efforts to comply with applicable law, a court or regulatory authority could conclude that any of our contractual arrangements with optometrists, including our long-term management agreements with OD PCs, subleases and trademark license agreements, and our day-to-day operational practices in managing these relationships, result in the improper control of an optometric practice or otherwise do not comply with applicable laws and regulations. A finding that we are in violation of these laws and regulations may result in censure or delicensing of optometrists, substantial civil or criminal damages and penalties, including double and triple monetary damages and penalties, and, in the case of violations of federal laws and regulations, exclusion from the Medicare and Medicaid programs, or other sanctions. In addition, a determination in any state that we are controlling an optometric practice or engaged in the corporate practice of medicine or any unlawful fee-splitting arrangement could render any sublease, management or service agreement between us and optometrists located in such state unenforceable or subject to modification, or, for example, could necessitate a buy-out of an OD PC. Each of these events could adversely impact our revenues and cash flows.

The Health Insurance Portability and Accountability Act of 1996 (“HIPAA”) covers a variety of subjects which impact our businesses and the business of the optometrists, including the privacy and security of patient health care information and the standardization of electronic data transactions for purposes of medical billing. We have devoted, and continue to devote, resources to implement operating procedures within the stores and our corporate office to ensure compliance with HIPAA regulations which became effective in 2003. Penalties under HIPAA, if applied to us, or a determination that we or any affiliated optometrists or OD PCs are not in compliance with such laws, could have a material adverse effect on our results of operations.

Regulation of the healthcare industry is constantly changing, which affects our opportunities, competition and other aspects of our business. Future developments or changes to the regulatory environment could adversely impact our operations, our compliance costs, our relationships with optometrists and the implementation of our business plan.

Any events resulting in a change in our relationship with the optometrist located in or adjacent to our stores could have a material adverse effect on our business.

The location of optometrists within or adjacent to our stores is an important part of our operating strategy. No assurances can be given as to the likelihood of events adversely affecting the relationship with these optometrists or our ability to locate optometrists within or adjacent to our stores including, without limitation (i) a dispute with an optometrist or group of optometrists controlling multiple practice locations, (ii) a government or regulatory authority challenging our operating structure or our relationship with the optometrists or (iii) other changes to applicable laws or regulations (or interpretations of the same), resulting in changes to our operating structures. Any of these events affecting our relationships with optometrists

could affect our ability to attract and retain customers, and thus may have a material adverse effect on our business.

While most of these optometrists operate one practice location, seven optometrists operate an aggregate of 106 locations, which includes OD PCs. Due to this concentration of locations operated by these optometrists, disputes or regulatory issues with any of these optometrists could have a greater impact on our business.

We could be subject to franchise claims by optometrists that could limit our ability to conduct our business in the manner we deem appropriate.

We sublease office space to certain optometrists who enter into Trademark License Agreements with Enclave Advancement Group, Inc., one of our subsidiaries (“Enclave”). In the past we have been, and in the future may be, subject to claims that this leasing of space from us, coupled with the license from Enclave of trademarks, constitutes a franchise and thereby gives the tenant optometrists rights as franchisees. No assurance can be given that a claim, action or proceeding will not be brought against us or Enclave asserting that a franchise exists or that the success of any such claim would not impair the way in which we currently structure our relationships with optometrists.

Our future success will depend in part on our ability to build and maintain managed vision care relationships, most of which are not subject to contractual arrangements.

As an increasing percentage of patients enter into health care coverage arrangements with managed vision care payors, we believe that our success will be, in part, dependent upon our ability to participate in the managed vision care plans of employer groups and other private third party payors. Our existing managed vision care plans are, for the most part, not contractual and may be terminated with little or no notice. Currently, we participate in a managed vision care network that we anticipate being removed from in fiscal 2005, which presently accounts for approximately \$5.0 million in annual revenues. We may not be able to establish or maintain satisfactory relationships with managed vision care and other third party payors, many of which have existing provider structures in place and may not be able or willing to change their provider networks. Some states have adopted, and others are considering, legislation that requires managed vision care payors to include any provider who is willing to abide by the terms of the managed vision care payor’s contracts and/or prohibit termination of providers without cause. These types of laws limit our ability to develop effective managed vision care provider networks in such states. This could adversely affect our ability to implement our business plan. Our inability to maintain our current relationships or enter into such arrangements in the future could have a material adverse effect on our revenue and cash flows.

We rely on third-party reimbursement, including government programs, for a portion of our net revenues, the future reduction of which could adversely affect our results of operations.

A significant portion of medical care in the United States is funded by government and private insurance plans, including managed vision care plans. For fiscal year ended January 1, 2005, approximately 30% of our net revenues were derived from managed vision care plans. The health care industry is experiencing a trend toward cost-containment with government and private insurance plans seeking to impose lower reimbursement, utilization restrictions and risk-based compensation arrangements. Payments made under such programs may not remain at levels comparable to the present levels or be sufficient to cover the cost of the services we provide to plan beneficiaries. In addition, many private insurance plans may base their reimbursement rates on the government rates. Private insurance plans are also developing increasingly sophisticated methods of controlling health care costs through redesign of benefits and explorations of more cost-effective methods of delivering health care. Accordingly, reimbursement for purchase and use of eye care services may be limited or reduced, thereby adversely affecting our revenues and cash flows. Furthermore, government or private insurance plans may retrospectively and/or prospectively adjust payments to us in amounts which would have a material adverse effect on our cash flows and financial condition.

Our controlling shareholders have the ability to direct our operations and their interests may conflict with the interests of noteholders.

We are controlled by Moulin and Golden Gate. This control could be exercised in a manner that may be in conflict with the interests of noteholders. In addition, Moulin and Golden Gate have made and may, in the future, make significant investments in other companies, some of which may be competitors. Furthermore, under agreements to which Golden Gate and Moulin are parties, in certain circumstances, Golden Gate can force a sale of Eye Care Centers of America, Inc. to a third party. In addition, we are a party to a long-term supply agreement pursuant to which Moulin supplies us with, ophthalmic frames, reading glasses, sunglasses and other eyewear products and accessories. Moulin's interests as a supplier under such agreement may conflict with the interests of noteholders.

We expect that our relationship with Moulin will result in benefits to us, but such benefits may not be realized to the extent anticipated, if at all.

We expect that we will realize significant cost savings through the long-term supply agreement with Moulin. These costs savings are based on projections and assumptions, all of which are subject to change. We may not realize any of the anticipated costs savings of our relationship with Moulin to the extent or in the timeframe anticipated, if at all. If

- Moulin is unable to effectively replicate our current private label frames and supply such frames to us with no significant differences in appearance, delivery or quality;
- we are unable to successfully market and sell the new brands of frames that we expect to purchase from Moulin in place of a portion of the brands that we currently sell;
- we are unable to purchase the volume of frames directly from Moulin in the time frame or in the amounts that we currently expect; or
- the prices at which we are entitled to purchase frames under the supply agreement are higher than we anticipate,

then we will not be able to achieve the anticipated cost savings. In addition, the supply agreement is subject to a five year term and may be terminated at the option of Moulin upon a sale of all of our capital stock or all or substantially all of our assets to a third party. In the event that the supply agreement is terminated, these cost savings may no longer be available to us.

Technological advances may reduce the demand for our products or allow other optical retailers to offer eyewear at a lower cost than we can, which could have a material adverse effect on our results of operations.

Corneal refractive surgery procedures such as radial-keratotomy, photo-refractive keratotomy, LASIK, and future drug development, may change the demand for our products. As traditional eyewear users undergo laser vision correction procedures or other vision correction techniques, the demand for certain contact lenses and eyeglasses will decrease. A decrease in customer demand for these products could have a material adverse effect on sales of prescription eyewear. In addition, technological developments such as wafer technology and lens casting may render our current lens manufacturing method uncompetitive or obsolete. Future medical advances and technological developments may have a material adverse effect on our business and results of operations.

We may be exposed to a significant risk from malpractice and other related claims if we are unable to obtain adequate insurance, at acceptable costs, to protect us against potential liability claims.

The provision of professional eye care services entails an inherent risk of professional malpractice and other related claims. As a result of the relationship between affiliated optometrists and us, we may become

subject to professional malpractice actions or claims under various theories relating to the professional services provided by these individuals. In addition, as a manufacturer of lenses, we are subject to claims for alleged defects in our products sold. Premiums for medical malpractice and other insurance may significantly increase which could adversely affect our results of operations and cash flows or force us to self insure against these potential claims. We may not be able to continue to obtain adequate liability insurance to cover claims asserted against us, in which event, our financial condition and results of operations could be adversely affected.

We depend on the ability and experience of certain members of our management team and their departure may have a material adverse effect on our results of operations.

To guide our operations, we rely on the skills of certain members of our senior management team, including our Chairman and Chief Executive Officer, David E. McComas, the loss of whom could have an adverse effect on our operations. Furthermore, other members of our senior management team have employment agreements with us that are terminable annually upon at least thirty days notice. Accordingly, key executives may not continue to work for us, and we may not be able to hire qualified replacements in a timely manner or at all, which could have a material adverse effect on our ability to implement our strategy and on our business operations.