1 800 CONTACTS INC
Form 10-Q
August 14, 2007

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

FORM 10-Q

(Mark one)

x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended June 30, 2007

or

o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from to .

Commission file number: 0-23633

1-800 CONTACTS, INC.

(Exact name of registrant as specified in its charter)

Delaware	**87-0571643**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
66 E. Wadsworth Park Drive, Draper, UT	**84020**
(Address of principal executive offices)	(Zip Code)

(801) 316-5000

(Registrant s telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days.

x Yes o No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer or a non-accelerated filer (as defined in Rule 12b-2 of the Exchange Act).

Large accelerated filer o   Accelerated filer x   Non-accelerated filer o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

o Yes x No

As of August 6, 2007, the Registrant had 14,082,594 shares of Common Stock, par value $0.01 per share, outstanding.

1-800 CONTACTS, INC.

INDEX

PART 1. FINANCIAL INFORMATION

Item 1. Financial Statements

1-800 CONTACTS, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(in thousands)
(unaudited)

	December 30, 2006	June 30, 2007
ASSETS		
CURRENT ASSETS:		
Cash	$ 75	$ 5,560
Marketable securities		3,865
Income tax receivable		11,772
Other receivables	1,825	2,155
Inventories	12,689	14,446
Deferred income taxes	1,886	2,849
Current assets of discontinued operations	19,682	4,648
Other current assets	1,009	983
Total current assets	37,166	46,278
PROPERTY AND EQUIPMENT, net	7,648	7,147
DEFERRED INCOME TAXES	898	1,071
GOODWILL	22,304	22,304
DEFINITE-LIVED INTANGIBLES, net	2,644	1,995
LONG-TERM ASSETS OF DISCONTINUED OPERATIONS	29,169	
OTHER ASSETS	696	830
Total assets	$ 100,525	$ 79,625
LIABILITIES AND STOCKHOLDERS EQUITY		
CURRENT LIABILITIES:		
Income taxes payable	722	
Accounts payable	8,266	13,816
Accrued liabilities	6,406	8,426
Unearned revenue	302	95
Current liabilities of discontinued operations	11,898	5,232
Total current liabilities	27,594	27,569
LONG-TERM LIABILITIES:		
Line of credit	29,970	
Long-term liabilities of discontinued operations	5,283	
Total long-term liabilities	35,253	
STOCKHOLDERS EQUITY		
Common stock, 13,424 and 13,644 issued, respectively	134	136
Additional paid-in capital	51,047	54,703
Treasury stock at cost, 8 and 25 shares, respectively	(133)	(524)
Accumulated deficit	(12,846)	(2,221)
Accumulated other comprehensive loss	(524)	(38)
Total stockholders equity	37,678	52,056
Total liabilities and stockholders equity	$ 100,525	$ 79,625

See accompanying notes to condensed consolidated financial statements.

1-800 CONTACTS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(in thousands, except per share amounts)
(unaudited)

	Quarter Ended July 1, 2006	June 30, 2007	Two Quarters Ended July 1, 2006	June 30, 2007
NET SALES	$ 57,734	$ 63,373	$ 116,907	$ 125,202
COST OF GOODS SOLD	34,960	36,962	70,509	73,962
Gross profit	22,774	26,411	46,398	51,240
SELLING, GENERAL AND ADMINISTRATIVE EXPENSES:				
Advertising	3,475	4,721	7,400	9,113
Legal and professional	975	2,386	1,945	3,937
Research and development			10	
Other selling, general and administrative	12,569	12,559	24,282	25,269
Total selling, general and administrative expenses	17,019	19,666	33,637	38,319
INCOME FROM OPERATIONS	5,755	6,745	12,761	12,921
OTHER EXPENSE, net	(319)	(392)	(638)	(862)
INCOME BEFORE PROVISION FOR INCOME TAXES AND DISCONTINUED OPERATIONS	5,436	6,353	12,123	12,059
PROVISION FOR INCOME TAXES	(2,401)	(3,366)	(5,527)	(5,789)
INCOME FROM CONTINUING OPERATIONS	$ 3,035	$ 2,987	$ 6,596	$ 6,270
DISCONTINUED OPERATIONS:				
Loss from discontinued operations (including loss on disposal of $2.8 million for 2007)	(4,837)	(7,834)	(6,848)	(11,892)
Income tax benefit (expense)	(236)	16,424	(605)	16,188
Gain (loss) on discontinued operations	(5,073)	8,590	(7,453)	4,296
NET INCOME (LOSS)	$ (2,038)	$ 11,577	$ (857)	$ 10,566
WEIGHTED AVERAGE SHARES OUTSTANDING:				
Basic	13,360	13,454	13,352	13,437
Diluted	13,473	13,637	13,457	13,635
PER SHARE INFORMATION:				
Basic net income (loss) per share:				
Continuing operations	$ 0.23	$ 0.22	$ 0.49	$ 0.47
Discontinued operations	(0.38)	0.64	(0.55)	0.32
	$ (0.15)	$ 0.86	$ (0.06)	$ 0.79
Diluted net income (loss) per share:				
Continuing operations	$ 0.23	$ 0.22	$ 0.49	$ 0.46
Discontinued operations	(0.38)	0.63	(0.55)	0.31
	$ (0.15)	$ 0.85	$ (0.06)	$ 0.77

See accompanying notes to condensed consolidated financial statements.

1-800 CONTACTS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)
(unaudited)

	Two Quarters Ended July 1, 2006	June 30, 2007
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income (loss)	$ (857)	$ 10,566
Net (income) loss from discontinued operations, net of tax	7,453	(4,296)
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	2,736	2,605
Amortization of debt issuance costs and discounts	66	53
Stock-based compensation	1,028	1,765
Tax benefits from share-based payment exercises	(27)	(42)
Loss on sale of property and equipment		5
Deferred income taxes	(112)	13
Changes in operating assets and liabilities:		
Accounts receivable, net	4	442
Inventories, net	2,786	(1,489)
Other current assets	(491)	(391)
Income taxes payable (receivable)	1,189	(13,542)
Accounts payable	836	5,447
Accrued liabilities	2,368	1,744
Unearned revenue	313	(621)
Net cash provided by continuing operating activities	17,292	2,259
Net cash provided by (used in) discontinued operations	(8,853)	9,996
Net cash provided by operations	8,439	12,255
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchase of property and equipment	(1,065)	(1,160)
Purchase of definite-lived intangible assets		(64)
Deposits and other	(631)	(36)
Net cash used in continuing investing activities	(1,696)	(1,260)
Net cash provided by (used in) discontinued investing activites	(2,653)	31,851
Net cash provided by (used in) investing activities	$ (4,349)	$ 30,591

1-800 CONTACTS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (continued)
(in thousands)
(unaudited)

	Two Quarters Ended July 1, 2006	June 30, 2007
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from exercise of stock options	$ 105	$ 1,851
Restricted stock grant		1
Purchase of treasury stock		(391)
Excess tax benefits from share-based payment exercises	27	42
Debt issuance costs		(62)
Net repayments on line of credit	(4,267)	(29,970)
Net cash used in continuing financing activities	(4,135)	(28,529)
Net cash used in discontinued financing activities	(1,020)	(7,266)
Net cash used in financing activites	(5,155)	(35,795)
EFFECT OF FOREIGN EXCHANGE RATES ON CASH	(327)	(150)
NET INCREASE (DECREASE) IN CASH	(1,392)	6,901
CASH AT BEGINNING OF PERIOD	1,481	2,739
CASH RECLASSIFIED TO DISCONTINUED OPERATIONS	(27)	(4,080)
CASH AT END OF PERIOD	$ 62	$ 5,560
SUPPLEMENTAL CASH FLOW INFORMATION:		
Cash paid for interest	$ 815	$ 563
Cash paid for income taxes	5,045	2,450

SUPPLEMENTAL DISCLOSURES OF NONCASH INVESTING AND FINANCING ACTIVITIES:

Effective December 31, 2006, we adopted the provisions of Financial Account Standards Board (FASB) issued Interpretation No. 48, Accounting for Uncertainty in Income Taxes. As a result of the implementation of FIN 48, we recognized a $60 decrease to our liability for income taxes payable, and a corresponding decrease to our fiscal 2007 accumulated deficit beginning balance.

On June 30, 2007, in conjunction with the sale of ClearLab s manufacturing, distribution and related operations, a portion of the consideration received included 1,007,220 shares of Mi Gwang common stock valued at $4.2 million. The current portion of the investment ($3.9 million) has been designated as available for sale securites. The remainder of stock is included in other long term assets.

See accompanying notes to condensed consolidated financial statements.

1-800 CONTACTS, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

NOTE 1. PRESENTATION OF CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

We have prepared the accompanying condensed consolidated financial statements, without audit, pursuant to the rules and regulations of the Securities and Exchange Commission (the SEC). Certain information and disclosures normally included in financial statements prepared in accordance with U.S. generally accepted accounting principles have been condensed or omitted pursuant to such rules and regulations. These condensed consolidated financial statements reflect all adjustments (consisting only of normal recurring adjustments), which in the opinion of management, are necessary to present fairly the results of our operations for the periods presented. It is suggested that these condensed consolidated financial statements be read in conjunction with the audited financial statements and the notes thereto included in our Annual Report on Form 10-K for the year ended December 30, 2006.

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from these estimates.

During the second quarter of fiscal 2007, we closed the transactions for the sale of our ClearLab business. As a result of this sale, we no longer have any international operations. Our international operations are reflected as discontinued operations and, accordingly, are no longer reflected as a separate segment. As of June 30, 2007, we have one reportable segment; our domestic segment is represented by operations within the United States and is referred to as U.S. Retail . Results of operations, financial position and cash flows are separately reported for all periods presented.

NOTE 2. DISCONTINUED OPERATIONS

During the second quarter of fiscal 2007, we completed the sale of our ClearLab business. We sold ClearLab s flat pack technology and certain other intellectual property and we sold ClearLab s manufacturing, distribution and customer support operations in separate transactions as detailed below.

On June 15, 2007, we transferred certain intellectual property and other assets related to our flat pack technology to Menicon Co., Ltd. (Menicon) pursuant to an Asset Purchase Agreement dated May 24, 2007. The assets transferred to Menicon include patents and equipment. The consideration included $23 million in cash which was paid at closing; contingent consideration of $5 million, $3 million of which is due upon Menicon s launch of product sales in Japan using the flat pack technology and $2 million of which is due upon Menicon entering into a license agreement with a third party for sales of products using the flat pack technology in a market outside of Japan; and earn-out payments based on a percentage of Menicon s total sales of flat pack products and a percentage of the total consideration payable to Menicon pursuant to any license agreement for the flat pack and certain other products. The term of the earn-out payments commences upon the commercial launch of flat pack products anywhere in the world and continues through the fifteenth anniversary of the launch of flat pack products in Japan. As part of the agreement, we have terminated our previous license agreement with Menicon.

On June 30, 2007, we transferred certain assets related to ClearLab s manufacturing, distribution and related operations to a wholly-owned subsidiary of Mi Gwang Contact Lens Co., Ltd., a Korean-based contact lens manufacturer (Mi Gwang) pursuant to a Purchase Agreement dated May 25, 2007. The consideration included $9 million in cash which was paid at closing and 1,007,220 shares of Mi Gwang common stock valued at $4.2 million as of June 30, 2007. We are restricted from trading 929,742 shares of the Mi Gwang stock until twelve months after the closing and are restricted from trading the remaining 77,478 shares until eighteen months after the closing. The current portion of the investment has been designated as available-for-sale securities for purposes of SFAS 115 *Accounting for Certain Investments in Debt and Equity Securities.* The remainder of the restricted stock will be accounted for by the cost method and is included in other assets. The purchase price is subject to a post-closing adjustment of approximately $0.5 million based on the closing net working capital of the divested business, payable in cash by Mi Gwang.

We have accounted for the sale of the ClearLab business in accordance with SFAS No. 144. Accordingly, the results of operations for ClearLab for the quarter and two quarters ended July 1, 2006 and June 30, 2007 have been removed from continuing operations and classified as discontinued operations. The $2.8 million loss on disposal has been included in net income (loss) from discontinued operations.

We retained certain liabilities and have agreed to reimburse Mi Gwang for certain liabilities, including any remaining costs associated with the closure of the United Kingdom manufacturing operations and the consolidation in Singapore.

The following tables summarize the financial position and operating results of our discontinued international operations as of and for the quarter and two quarters ended on the dates indicated (in thousands):

	Quarter Ended		**Two Quarters Ended**	
	July 1, 2006	**June 30, 2007**	**July 1, 2006**	**June 30, 2007**
Discontinued operations				
Net Sales	$ 5,421	$ 5,787	$ 9,739	$ 11,379
Cost of Goods Sold	(5,563)	(5,593)	(9,027)	(11,642)
Gross Profit	(142)	194	712	(263)
Selling, General & Administrative Expenses	(5,366)	(4,730)	(8,863)	(8,452)
Loss from Discontinued Operations	(5,508)	(4,536)	(8,151)	(8,715)
Other Income (loss)	671	(498)	1,303	(377)
Loss on disposal		(2,800)		(2,800)
Income tax benefit (expense)	(236)	16,424	(605)	16,188
Net Income (Loss) from discontinued operations	$ (5,073)	$ 8,590	$ (7,453)	$ 4,296

Prior to the sale, we had undergone an extensive review of ClearLab s manufacturing operations. Based on this review, the board of directors authorized management to consolidate ClearLab operations in Singapore and we completed the closure of our manufacturing facility in the United Kingdom, other than lease termination commitments and disposal of surplus equipment, in the first quarter of fiscal 2007 prior to the sale of ClearLab in the second quarter of fiscal 2007. During fiscal 2006 and the first two quarters of fiscal 2007, we expensed approximately $1.0 million and $1.7 million, respectively, relating to these activities. As of June 30, 2007, we have accrued approximately $1.3 million for the estimated remaining expenses relating to the sale and disposal of these assets. The following is a rollforward of the accrual for such items as of December 30, 2006 and June 30, 2007:

Accrual at December 30, 2006	$ 1,020
Additions	1,510
Payments	(1,270)
Accrual at June 30, 2007	$ 1,260

NOTE 3. INVENTORIES

Inventories are recorded at the lower of cost (using the first-in, first-out method) or market value. Inventories consisted of purchased contact lenses and accessories totaling $12.7 million and $14.4 million at December 30, 2006 and June 30, 2007, respectively.

Provision is made to reduce excess and obsolete inventories to their estimated net realizable values. As of December 30, 2006 and June 30, 2007, reserves for excess and obsolete inventories for continuing operations were approximately $1.3 million and $0.8 million, respectively.

NOTE 4. NET INCOME (LOSS) PER COMMON SHARE

Basic net income (loss) per common share (Basic EPS) excludes dilution and is computed by dividing net income (loss) by the weighted-average number of common shares outstanding during the period. Diluted net income (loss) per common share (Diluted EPS) reflects the potential dilution that could occur if stock options or other common stock equivalents were exercised or converted into common stock using the treasury stock method. The computation of Diluted EPS does not assume exercise or conversion of securities that would have an antidilutive effect on net income (loss) per common share. We have not reflected performance based unvested restricted stock awards in Diluted EPS since the performance conditions were not satisfied as of June 30, 2007. For the quarter and two quarters ended July 1, 2006, options to purchase 76,653 and 86,527 shares of common stock, as well as 36,312 and 18,200 shares of unvested restricted stock; respectively, were included in the computation of Diluted EPS for both continuing operations and discontinued operations, although the effect is antidilutive for the discontinued operations and the consolidated operations. For the quarter and two quarters ended June 30, 2007, options to purchase 125,569 and 133,939 shares of common stock and 57,569 and 63,700 shares of unvested restricted stock; respectively, were included in the computation of Diluted EPS.

9

The following is a reconciliation of the numerator and denominator used to calculate Basic and Diluted EPS (in thousands, except per share amounts):

	Quarters Ended		Two Quarters Ended	
	July 1, 2006	**June 30, 2007**	**July 1, 2006**	**June 30, 2007**
Diluted earnings per share:				
Weighted-average shares for computation of basic earnings per share	13,360	13,454	13,352	13,437
Dilutive effect of stock options and restricted stock	113	183	105	198
Weighted average shares for computation of diluted earning per share	13,473	13,637	13,457	13,635

NOTE 5. COMPREHENSIVE INCOME (LOSS)

Comprehensive loss for the quarter and two quarters ended July 1, 2006 and June 30, 2007 consisted of the following components (in thousands):

	Quarter Ended		Two Quarters Ended	
	July 1, 2006	**June 30, 2007**	**July 1, 2006**	**June 30, 2007**
Net income (loss)	$ (2,038)	$ 11,577	$ (857)	$ 10,566
Foreign currency translation gain	112	551	111	486
Comprehensive gain (loss)	$ (1,926)	$ 12,128	$ (746)	$ 11,052

The foreign currency translation gain resulted primarily from changes in exchange rates relative to the U.S. dollar from the translation of our Singapore and United Kingdom subsidiaries financial statements.

NOTE 6. STOCK-BASED COMPENSATION

We account for share-based compensation in accordance with Statement of Financial Accounting Standards (SFAS) No. 123 (Revised 2004), Share-Based Payment, (SFAS No. 123R), which requires stock-based compensation to be measured based on the fair value of the award on the date of grant and recognized over the period during which service is required in exchange for the award.

SFAS No. 123R applies to all of our outstanding unvested share-based payment awards as of January 1, 2006 and all awards made thereafter. All of our stock-based awards, which are stock options and restricted stock awards, are classified as either equity instruments or liability-classified awards. Compensation cost recognized in fiscal 2006 and in fiscal 2007 for unvested options as of January 1, 2006 was based on the grant-date fair value, using the Black-Scholes model, estimated in accordance with the original provisions of SFAS No. 123.

Stock-based expense for the first two quarters of fiscal 2006 and 2007 includes expense, recognized over the applicable vesting periods, for new restricted stock share-based awards and for restricted stock and stock option share-based awards granted prior to, but not yet vested, as of January 1, 2006. Stock-based compensation expense for employees and non-employee directors for the quarter and two quarters ended June 30, 2007 were approximately $1.0 million and $1.8 million, respectively. Stock-based compensation expense for employees and non-employee directors for the quarter and two quarters ended July 1, 2006 were approximately $0.7 million and $1.0 million, respectively. The income tax deficit related to stock-based compensation expense during the quarter ended June 30, 2007, was approximately $4,000. The net income tax benefit related to stock-based expense during two quarters ended June 30, 2007, was approximately $42,000. The excess income tax benefit related to stock-based compensation expense during the quarter and two quarters ended July 1, 2006, was approximately $1,000 and $27,000, respectively.

NOTE 3. INVENTORIES

Stock Based Award Plans

Stock Options. We have established a stock option plan that provides for the issuance of a maximum of 1,940,000 shares of common stock to officers, employees, directors and consultants. The plan allows for the issuance of incentive stock options, nonqualified stock options and restricted stock. Incentive and nonqualified stock options are granted at not less than 100 percent of the fair market value of the underlying common stock on the date of grant. As of June 30, 2007, 300,491 shares were available for future granting.

Prior to the establishment of the stock option plan, we issued nonqualified stock options to various key employees, a consultant and a director of the Company.

All options granted through January 1, 2000 vest equally over a three-year period and expire ten years from the date of grant.

Stock options remained outstanding under various plans as of January 1, 2006. No stock options were granted from these plans during fiscal 2006 or the two quarters ended June 30, 2007. Our stock option activity during the two quarters ended June 30, 2007 was as follows (in thousands, except option prices and years):

Two Quarters Ended June 30, 2007	**Number of Options**	**Weighted Average Exercise Price**	**Weighted Average Remaining Contractual Life (Years)**	**Aggregate Intrinsic Value**
Options outstanding at December 30, 2006	1,125	$ 20.96		
Exercised	(127)	14.57		
Forfeited	(124)	34.65		
Expired	(8)	29.11		
Options outstanding at June 30, 2007	866	$ 19.75	2.51	$ 5,005
Options vested and expected to vest at June 30, 2007	859	$ 19.71	2.51	$ 5,000
Options exercisable at June 30, 2007	820	$ 19.46	2.57	$ 4,973

The total intrinsic value of options exercised during the two quarters ended July 1, 2006 and June 30, 2007 totaled approximately $0.1 million and $1.1 million, respectively.

For the two quarters ended July 1, 2006 and June 30, 2007, stock option expense was recognized on a straight-line basis over the four year vesting period. Approximately $0.2 million and $0.4 million, respectively, were charged to expense for the quarter and two quarters ended June 30, 2007. Approximately $0.3 million and $0.6 million, respectively, were charged to expense in the quarter and two quarters ended July 1, 2006. We have applied a weighted average forfeiture assumption of approximately 15% in the calculation of such expense in each of the two quarters ended June 30, 2006 and July 1, 2007.

As of July 1, 2006 and June 30, 2007, there was approximately $1.1 million and $0.1 million, respectively, of unrecognized compensation cost related to non-vested stock options, which is expected to be recognized in full by the end of fiscal 2007.

Cash received from option exercises during the two quarters ended July 1, 2006 and June 30, 2007 was approximately $0.1 million and $1.8 million, respectively. The total tax benefit related to stock-based compensation expense during the quarter and two quarters ended July 1, 2006 was approximately $1,000 and $27,000, respectively and during the quarter and two quarters ended June 30, 2007 was approximately $1,000 and $25,000, respectively. These amounts were credited to additional paid-in capital.

Restricted Share Awards. During the first two quarters of fiscal 2006 and 2007, we granted 599,096 and 35,359 shares of restricted common stock, respectively, to various employees and executives of the Company. The restricted stock grants were valued at the closing stock price on the date of the grant, which was $13.14 for the 2006 grants and ranged from $16.28 to $23.70 for the 2007 grants. The restricted stock grants include both time-vesting and performance-vesting restricted shares. The time-vesting shares granted in 2006 vest 20% per year, beginning November 30, 2006 and ending November 30, 2010. All the restricted stock granted in the first quarter of fiscal 2007 were time-vesting shares that vest 20% per vesting period; 20% of the 10,500 shares of restricted stock granted in the first half of fiscal 2007 vested on February 25, 2007, and the balance of these vest 20% per year through February 25, 2011; 270 shares of the restricted stock granted in the first quarter of fiscal 2007 vest 20% per year beginning January 25, 2008 and ending January 25, 2012; and the remaining 14,684 shares of the restricted stock granted in the first quarter of fiscal 2007 vest 20% per year beginning February 25, 2008 and ending February 25, 2012. 9,905 shares of restricted stock were granted during the second quarter of fiscal 2007. These grants included both time-vesting and performance-vesting restricted shares. Of the 9,905 shares granted, 7,500 were performance-vesting. The remaining 2,405 shares of time-vesting restricted stock vest 20% per year. All performance-vesting shares vest upon achievement of certain operational milestones - such as obtaining sources for doctors only lenses on competitive terms, development of certain contact lens products and the achievement of an eight quarter cumulative financial target of at least $81 million consolidated earnings before taxes by or before the end of fiscal 2010. Both the time-vesting and the performance-vesting shares of restricted stock are subject to various change in control provisions involving us and our subsidiaries that will likely result in the accelerated vesting of unvested shares as well as conversion of unvested restricted shares into a cash amount at the time of the change in control.

During the first quarter of fiscal 2006 we also granted 50,000 shares of restricted common stock to our five non-employee directors. These grants vest equally over a three-year period; the vesting of these awards will be accelerated upon a change in control of the Company. The restricted share grants were also valued at the closing stock price on the date of the grant which was $13.14. An additional 2,500 shares of restricted common stock were granted to one non-employee director during the first quarter of fiscal 2006. This restricted share grant was valued at the closing stock price on the date of the grant, which was $13.28, and all of these shares vested on July 28, 2006.

Our activity relating to restricted share awards during the first two quarters of fiscal 2007 was as follows (in thousands, except fair values):

Two Quarters Ended June 30, 2007	**Number of Restricted Share Awards**		**Weighted Average Grant Date Fair Value Per Award**
Unvested at December 30, 2006	562		$ 14.20
Granted	35		18.02
Vested	(94	)	15.79
Forfeited and expired	(43	)	23.16
Converted to cash	(12	)	13.14
Unvested at June 30, 2007	448		$ 13.26

The sale of the ClearLab business triggered a change in control provision in one individual s restricted stock agreements, effective June 30, 2007. As a result of the change in control provisions, vesting was accelerated from five to two years and approximately 12,000 previously unvested shares of our restricted common stock were classified as liability-classified awards. The total amount due under this award is approximately $287,000, or $23.46 per share. The amount of previously recognized expense for these awards of approximately $15,000 was reclassified from additional paid-in-capital to accrued expenses. The remaining expense for these shares will be recognized

NOTE 3. INVENTORIES

quarterly as the award vests. The total amount due will be paid out in equal quarterly installments over the two-year period commencing on June 30, 2007.

For the first two quarters ended July 1, 2006 and June 30, 2007, approximately $0.4 million and $1.4 million, respectively, were charged to expense relating to the amortization of the time-vested restricted share awards. At June 30, 2007, unrecognized compensation expense, including estimated forfeitures related to time-vested restricted share awards totaled approximately $2.7 million and will be recognized over a weighted average period of approximately 3.3 years, respectively. The fair value of restricted share awards that vested during the quarter and two quarters ended July 1, 2006 totaled approximately $26,000 and $82,000, respectively. The fair value of restricted share awards that vested during the quarter and two quarters ended June 30, 2007 totaled approximately $1.2 million and $1.6 million, respectively. Total tax benefit generated from vested restricted share awards for the two quarters ended June 30, 2007 was approximately $21,000, which was credited to additional paid-in capital. There was no tax benefit generated from vested restricted share awards for the quarter ended June 30, 2007.

Expense related to performance-vesting shares of restricted stock will be recognized once it is determined probable that the operational milestones will be met. At the time the achievement of these operational milestones are considered probable , we will record a cumulative catch-up for the amount of expense that should have been recognized from the date of the grant to the date it was determined achievement was probable and recognize the remaining expense on a straight-line basis through the estimated date of achievement. Total gross compensation expense, excluding any estimate of forfeitures related to the outstanding performance-vesting shares of restricted stock, will be approximately $2.8 million. As of June 30, 2007, we do not believe that the achievement of the operational milestones is probable.

On June 3, 2007, we entered into a definitive agreement and plan of merger with Alta Parent Corp. and Alta Acquisition Corp., affiliates of Fenway Partners Capital Fund III, L.P (the Merger Agreement). See Note 11. Proposed Merger. Upon completion of the transactions contemplated by the Merger Agreement, outstanding stock options, vested and unvested, will be canceled and option holders will receive the excess, if any, of $24.25 per share over the option exercise price for each share subject to the option. In addition, restricted stock that is vested and restricted stock that is unvested but which will vest as a result of the transactions contemplated by the Merger Agreement will be canceled and holders will receive $24.25 per share. Any unvested shares of restricted stock that do not vest as a result of the transactions contemplated by the Merger Agreement will be canceled and holders will receive $24.25 per share at such times as are set forth in the applicable restricted stock grant agreements.

NOTE 7. DEBT OBLIGATIONS

We have a loan agreement with a U.S. bank providing for a revolving credit facility that matures on June 1, 2009. The loan agreement provides for borrowings of up to $40 million and for letters of credit up to a maximum of $15 million outstanding or payable at any time. The amount of any letters of credit outstanding is deducted from the amount available for borrowing. There were outstanding letters of credit of $1.5 million as of June 30, 2007 that reduce the total amount available under the loan agreement to $38.5 million. We may reduce the maximum available advance amount or terminate the loan at any time.

Outstanding borrowings on the revolving credit facility bear interest at a floating rate equal to the lender s prime interest rate plus a margin, or the lender s LIBOR rate plus a margin. The interest rate is adjusted quarterly and ranges between prime minus 0.75 percent and prime minus 1.25 percent or between the applicable LIBOR rate plus 1.75 percent and the applicable LIBOR rate plus 2.25 percent, depending on our maximum leverage ratio, as defined in the loan agreement. As of June 30, 2007, the prime rate margin is minus 1.00 percent and the LIBOR rate margin is 2.00 percent. Interest is payable monthly. As of June 30, 2007, we have no outstanding borrowings on our revolving credit facility. We used the proceeds from the sale of our international operations and certain intellectual property and other assets related to ClearLab s flat pack technology to repay the borrowings on our revolving credit facility. The facility requires the quarterly payment of an unused credit fee which ranges from 0.25 percent to 0.38 percent, depending on our maximum leverage ratio.

If there are outstanding balances on the revolving credit facility, they are secured by substantially all of our U.S. assets, subsidiary debt instruments, 100 percent ownership interests in all domestic subsidiaries and 65 percent ownership interests in foreign subsidiaries owned directly by us. The loan agreement includes various financial covenants including a capital expenditure limit, a maximum leverage ratio and a minimum fixed charge coverage ratio. The loan agreement does not permit us or our subsidiaries to dissolve, sell, dispose or merge all of their assets or acquire all of the assets of any entity without the written consent of the U.S. bank, unless the transaction meets the definition of a Permitted Acquisition Basket, as defined in the loan agreement. The loan agreement also places a limit on the amount we can loan to any entity, outside the normal course of business. Additionally, the loan agreement allows us to declare or pay cash dividends, to repurchase our stock or to perform other similar equity transactions if such transactions would not exceed $15 million in any fiscal year and subject to other terms. This agreement defines several customary events of default including any material adverse change or any event that occurs which may cause a material adverse change in our or our subsidiaries condition.

NOTE 8. COMMITMENTS AND CONTINGENCIES

Legal and Regulatory Matters

The sale and delivery of contact lenses are governed by both federal and state laws and regulations, including the federal Fairness to Contact Lens Consumers Act (FCLCA). The FCLCA requires a seller, prior to selling contact lenses to a consumer, to either (i) obtain an actual copy of the consumer s prescription or (ii) verify the consumer s prescription by direct communication with the customer s prescriber. Consistent with this requirement, we require all customers to provide either a valid copy of their prescription or the contact information for their prescriber so that we can verify their prescription by direct communication with their prescriber. If we do not have a valid copy of the customer s prescription, we directly communicate to the customer s prescriber the precise prescription information received from the customer and, in accordance with the FCLCA, inform the prescriber that we will proceed with the sale based on this prescription information unless the prescriber advises us within eight business hours that such prescription information is expired or otherwise invalid. If the prescriber properly advises us within this time period that the customer s prescription is expired or otherwise invalid, we cancel the customer s order. On the other hand, if the prescriber either advises us that the prescription is valid or fails to respond properly within the required time period, we complete the sale based on the prescription information communicated to the prescriber, as expressly permitted by the FCLCA. We retain copies of the written prescriptions that we receive and maintain records of our communications with the customer s prescriber. The FCLCA provides for several means of direct communication with eye care practitioners, and we may alter our prescription verification procedures from time to time in keeping with the FCLCA and FTC guidelines.

We are involved in legal proceedings generally incidental to our business. It is the opinion of management, after discussion with legal counsel, that the ultimate dispositions of all of these matters will not have a material impact on our financial position, liquidity, or results of operations.

Advertising Commitments

As of June 30, 2007, we had entered into certain noncancelable commitments with various advertising companies that will require us to pay approximately $7.7 million during the remainder of 2007. With respect to additional commitments and contingencies, reference should be made to our consolidated financial statements and disclosures thereto included in our Form 10-K for the fiscal year ended December 30, 2006.

NOTE 9. INCOME TAXES

On December 31, 2006, we adopted the provisions of FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes (FIN 48), which clarifies the accounting for uncertainty in income tax positions. This interpretation requires us to recognize in the consolidated financial statements only those tax positions determined to be more-likely-than-not of being sustained upon examination, based on the technical merits of the positions as of the reporting date. If a tax position is not considered more-likely-than-not to be sustained based solely on its technical merits, no benefits of the position are recognized. This is a different standard for recognition than was previously required. The more-likely-than-not threshold must continue to be met in each reporting period to support continued recognition of a benefit. At adoption, companies must adjust their financial statements to reflect only those tax positions that are more-likely-than-not to be sustained as of the adoption date. Any necessary adjustment is recorded directly to opening retained earnings in the period of adoption and reported as a change in accounting principle. As a result of the adoption of FIN-48, we recognized a decrease of $60,000 in the liability recorded for unrecognized tax benefits, which was accounted for as a decrease to the Fiscal 2007 beginning accumulated deficit balance. We do not have any unrecognized tax benefits that, if recognized, would affect our effective tax rate. We recognize interest and potential penalties accrued related to unrecognized tax benefits in our provision for income taxes. We had approximately $63,000 accrued for the payment of interest as of June 30, 2007, which is netted against the income tax receivable on the balance sheet.

We have not been notified of intent to audit, nor are we currently undergoing an income tax audit in any jurisdiction. The tax years that remain subject to examination by significant jurisdiction are as follows:

U.S. Federal	2003 through the current period
Utah	2003 through the current period
Singapore	2002 through the current period

NOTE 10. RECENTLY ISSUED ACCOUNTING STANDARDS

On February 15, 2007, the Financial Accounting Standards Board issued SFAS No.159, The Fair Value Option for Financial Assets and Financial Liabilities (FAS 159). FAS 159 allows companies to elect to follow fair value accounting for certain financial assets and liabilities in an effort to mitigate volatility in earnings without having to apply complex hedge accounting provisions. FAS 159 is applicable only to certain financial instruments and is effective for fiscal years beginning after November 15, 2007, the fiscal year beginning December 30, 2007 for the Company. We have not yet completed our assessment of what impact, if any, the adoption of FAS 159 will have on our financial statements.

In September 2006, the FASB issued Statement of Financial Accounting Standard No. 157, Fair Value Measurements (FAS 157). FAS 157 provides a definition of fair value, establishes acceptable methods of measuring fair value and expands disclosures for fair value measurements required under other accounting pronouncements, but does not change existing guidance as to whether or not an instrument is carried at fair value. FAS 157 is effective for fiscal years beginning after November 15, 2007, the fiscal year beginning December 30, 2007 for the Company. We have not yet completed our assessment of what impact, if any, the adoption of FAS 157 will have on our financial statements.

NOTE 11. PROPOSED MERGER

On June 3, 2007, we entered into a definitive agreement and plan of merger with Alta Parent Corp. (Parent) and Alta Acquisition Corp. (Acquisition), affiliates of Fenway Partners Capital Fund III, L.P. (the Merger Agreement). The Merger Agreement provides that, upon the terms and subject to the conditions set forth in the Merger Agreement, Acquisition will merge with and into the Company, with the Company as the surviving corporation of the merger (the Merger). As a result of the Merger, the Company will become a wholly owned subsidiary of Parent and each outstanding share of the Company s common stock (other than dissenting shares) will be converted into the right to receive $24.25 in cash, without interest. Options to acquire common stock, whether vested or unvested, will be canceled and option holders will receive the excess, if any, of $24.25 per share over the option exercise price for each share subject to the option, less any applicable withholding taxes. In addition, restricted stock that is vested and restricted stock that is unvested but whose vesting will accelerate as a result of the transactions contemplated by the Merger Agreement will be canceled and holders will receive $24.25 per share, less any applicable withholding taxes. Any unvested shares of restricted stock that do not vest as a result of the transactions contemplated by the Merger Agreement will be canceled and holders will receive $24.25 per share at such times as are set forth in the applicable restricted stock grant agreements. A transactions committee comprised of independent directors and our board of directors approved the Merger Agreement, and our board of directors recommended that stockholders vote to approve and adopt the Merger Agreement.

Certain members of our senior management and board of directors, investment funds affiliated with one of our directors and investment funds affiliated with one of our unaffiliated stockholders will exchange some of their equity interests in the Company for equity interests in a newly formed Delaware limited partnership holding all of the capital stock of Parent.

We may terminate the Merger Agreement if we receive a takeover proposal that our board of directors determines in good faith constitutes a superior proposal and its failure to terminate the Merger Agreement would be inconsistent with its fiduciary duties. In connection with such a termination, or if the Merger Agreement is terminated under certain other specified circumstances, we must pay Parent a termination fee equal to $10,330,550.

If the Merger Agreement is terminated by us under certain specified circumstances (including because Parent and Acquisition fail to obtain the proceeds of debt financing arrangements), Parent will be required to pay or cause to be paid to us a fee of $10,330,550, except such fee will be increased to $13,774,000 in the event that Parent or Acquisition willfully breaches any of its representations, warranties, covenants or other agreements set forth in the Merger Agreement.

Fenway Partners Capital Fund III, L.P. has delivered to us a guaranty of Parent s obligation to pay such termination fee under the Merger Agreement, up to a maximum amount equal to $13,774,000. Consummation of the Merger is subject to customary closing conditions, including approval of the Merger Agreement by our stockholders and the absence of certain legal impediments to the consummation of the Merger. As previously announced, we will hold a special meeting of stockholders on September 6, 2007. Holders of record as of August 6, 2007 will be entitled to vote on the Merger Agreement. If approval of the Merger is obtained at the special meeting, we expect the Merger to close promptly thereafter. The Merger is not subject to a financing condition. At the effective time of the Merger, we will cease to be an independent public company, and our common stock will no longer be traded on the Nasdaq Global Market.

On June 3, 2007, Parent and Acquisition entered into a support agreement with Jonathan C. Coon, our Chairman and Chief Executive Officer, John F. Nichols, our Vice President, Trade Relations and one of our directors, and investment funds affiliated with Frank LaGrange Johnson, one of our directors, who collectively have the power to vote approximately 40% of the fully diluted shares of our common stock. Pursuant to and subject to the terms of the support agreement, these stockholders have agreed to vote their shares in favor of the Merger and not to transfer such shares prior to the completion of the Merger.

Item 2. ***Management s Discussion and Analysis of Financial Condition and Results of Operations***

Overview

We are a direct marketer of replacement contact lenses. We sell all of the popular brands of contact lenses, including those manufactured by Johnson & Johnson Vision Care, CIBA Vision, Bausch & Lomb and CooperVision. Prior to June 30, 2007, we were also a manufacturer, developer and distributor of our own branded and private label contact lenses through our ClearLab operations in Singapore and the United Kingdom. As discussed below, we have sold ClearLab, our international contact lens development, manufacturing and distribution business.

Discontinued Operations and Reduction in Indebtedness. During the second quarter of fiscal 2007, we finalized the transactions for the sale of our ClearLab business. In separate transactions as detailed below, we sold ClearLab s flat pack technology and certain other intellectual property and ClearLab s manufacturing, distribution and customer support operations. We used the proceeds from the completed transactions to repay all of our indebtedness.

On June 15, 2007, we transferred certain intellectual property and other assets related to our flat pack technology to Menicon Co., Ltd. (Menicon) pursuant to an Asset Purchase Agreement dated May 24, 2007. The assets transferred to Menicon include patents and equipment. The consideration included $23 million in cash which was paid at closing; deferred consideration of $5 million, $3 million of which is due upon Menicon s launch of product sales in Japan using the flat pack technology and $2 million of which is due upon Menicon entering into a license agreement with a third party for sales of products using the flat pack technology in a market outside of Japan; and earn-out payments based on a percentage of Menicon s total sales of flat pack products and a percentage of the total consideration payable to Menicon pursuant to any license agreement for the flat pack and certain other products. The term of the earn-out payments commences upon the commercial launch of flat pack products anywhere in the world and continues through the fifteenth anniversary of the launch of flat pack products in Japan. As part of the agreement, we have terminated our previous license agreement with Menicon.

On June 30, 2007, we transferred certain assets related to ClearLab s manufacturing, distribution and related operations to a wholly-owned subsidiary of Mi Gwang Contact Lens Co., Ltd., a Korean-based contact lens manufacturer (Mi Gwang) pursuant to a Purchase Agreement dated May 25, 2007. The consideration included $9 million in cash which was paid at closing and 1,007,220 shares of Mi Gwang common stock valued at $4.2 million as of June 30, 2007. We are restricted from trading 929,742 shares of the Mi Gwang common stock until twelve months after the date of closing and are restricted from trading the remaining 77,478 shares until eighteen months after the date of closing. The common stock that is subject to the one-year restriction has been designated as available-for-sale securities for purposes of SFAS No. 115 *Accounting for Certain Investments in Debt and Equity Securities.* The remainder of the common stock is accounted for under the cost method and is included in other assets. The purchase price is subject to a post-closing adjustment of approximately $0.5 million based on the closing net working capital of the divested business, payable in cash by Mi Gwang.

Prior to the sale, we were consolidating ClearLab operations in Singapore and we completed the UK site closure, except for lease termination commitments and disposal of surplus equipment, in the first quarter of fiscal 2007. During fiscal 2006 and the first two quarters of fiscal 2007, we expensed approximately $1.0 million and $1.7 million, respectively, relating to these activities. As of June 30, 2007, we have accrued approximately $1.3 million for the estimated remaining expenses relating to the sale and disposal of these assets.

The following is an estimate of total costs we expect in conjunction with the closure of the U.K site described above:

Description of Costs	Estimated Amount (in thousands)
Severance/retention costs (a)	$ 1,200
Termination of lease commitments (b)	1,200
Asset impairment (c)	3,605
Costs to relocate equipment to Singapore(b)	125
Other expenses (b)	100
Total estimated costs	***$ 6,230***

(a) Approximately $1,040 and $160 of these charges were included in our financial results for the fourth quarter of fiscal 2006 and the first two quarters of fiscal 2007, respectively.

(b) These charges were included in our financial results during the second quarter of fiscal 2007.

(c) These charges were included in our fiscal 2006 financial results. The asset impairment charge related to certain manufacturing and office equipment that was not relocated to Singapore, as well as leasehold improvements.

As of June 30, 2007, we have incurred cash expenditures associated with the closure and consolidation and disposal of ClearLab UK of approximately $1.3 million and anticipate future cash expenditures of approximately $1.5 million. These estimated future cash expenditures include the repayment of approximately $0.2 million of a regional development grant that is not included in the above table, as the repayment will not have an impact in our statement of operations.

Merger Agreement. On June 3, 2007, we entered into a definitive agreement and plan of merger with Alta Parent Corp. (Parent) and Alta Acquisition Corp. (Acquisition), affiliates of Fenway Partners Capital Fund III, L.P. (the Merger Agreement). The Merger Agreement provides that, upon the terms and subject to the conditions set forth in the Merger Agreement, Acquisition will merge with and into the Company, with the Company as the surviving corporation of the merger (the Merger). As a result of the Merger, the Company will become a wholly owned subsidiary of Parent and each outstanding share of the Company s common stock (other than dissenting shares) will be converted into the right to receive $24.25 in cash, without interest. Options to acquire common stock, whether vested or unvested, will be canceled and option holders will receive the excess, if any, of $24.25 per share over the option exercise price for each share subject to the option, less any applicable withholding taxes. In addition, restricted stock that is vested and restricted stock that is unvested but whose vesting will accelerate as a result of the transactions contemplated by the Merger Agreement will be canceled and holders will receive $24.25 per share, less any applicable withholding taxes. Any unvested shares of restricted stock that do not vest as a result of the transactions contemplated by the Merger Agreement will be canceled and holders will receive $24.25 per share at such times as are set forth in the applicable restricted stock grant agreements.

A transactions committee comprised of independent directors and our board of directors approved the Merger Agreement, and our board of directors recommended that stockholders vote to approve and adopt the Merger Agreement.

Certain members of our senior management and board of directors, investment funds affiliated with one of our directors and investment funds affiliated with one of our unaffiliated stockholders will exchange some of their equity interests in the Company for equity interests in a newly formed Delaware limited partnership holding all of the capital stock of Parent.

We may terminate the Merger Agreement if we receive a takeover proposal that our board of directors determines in good faith constitutes a superior proposal and its failure to terminate the Merger Agreement would be inconsistent with its fiduciary duties. In connection with such a termination, or if the Merger Agreement is terminated under certain other specified circumstances, we must pay Parent a termination fee equal to $10,330,550.

NOTE 3. INVENTORIES

If the Merger Agreement is terminated by us under certain specified circumstances (including because Parent and Acquisition fail to obtain the proceeds of debt financing arrangements), Parent will be required to pay or cause to be paid to us a fee of $10,330,550, except such fee will be increased to $13,774,000 in the event that Parent or Acquisition willfully breaches any of its representations, warranties, covenants or other agreements set forth in the Merger Agreement.

Fenway Partners Capital Fund III, L.P. has delivered to us a guaranty of Parent s obligation to pay such termination fee under the Merger Agreement, up to a maximum amount equal to $13,774,000. Consummation of the Merger is subject to customary closing conditions, including approval of the Merger Agreement by our stockholders and the absence of certain legal impediments to the consummation of the Merger. As previously announced, we will hold a special meeting of stockholders on September 6, 2007. Holders of record as of August 6, 2007 will be entitled to vote on the Merger Agreement. If approval of the Merger is obtained at the special meeting, we expect the Merger to close promptly thereafter. The Merger is not subject to a financing condition. At the effective time of the Merger, we will cease to be an independent public company, and our common stock will no longer be traded on the Nasdaq Global Market.

On June 3, 2007, Parent and Acquisition entered into a support agreement with Jonathan C. Coon, our Chairman and Chief Executive Officer, John F. Nichols, our Vice President, Trade Relations and one of our directors, and investment funds affiliated with Frank LaGrange Johnson, one of our directors, who collectively have the power to vote approximately 40% of the fully diluted shares of our common stock. Pursuant to and subject to the terms of the support agreement, these stockholders have agreed to vote their shares in favor of the Merger and not to transfer such shares prior to the completion of the Merger.

Supplier Agreements. On January 31, 2007, we announced that we had recently signed long-term supply agreements with the three largest contact lens manufacturers/suppliers. We have purchased directly from the fourth largest manufacturer/supplier without a written agreement since 2001 and based on our longstanding relationship and recent discussions with this supplier, we do not expect this direct relationship to change. During the latter part of fiscal 2004, we decided to suspend sales of a specific brand of lens, as we were unable to obtain sufficient quantities of this lens from anyone other than the manufacturer, who refused to sell us this lens. With the signing of the long-term supply agreements, we recently began to sell this lens again in 2007, as well as other lenses previously not available to us.

We also have agreements with certain manufacturers/suppliers for improved pricing and marketing support. This support has come and will continue to come in the form of cooperative marketing and rebate programs designed to promote the manufacturer s products and build sales. As part of our ongoing relationship with our suppliers, we periodically review our specific marketing plan and negotiate our cooperative marketing programs and product pricing.

Regulatory Considerations

Fairness to Contact Lens Consumer Act. In November 2003, Congress passed the Fairness to Contact Lens Consumers Act (FCLCA), which establishes a national uniform standard for both eye care practitioners and direct marketers with regard to releasing and verifying consumer contact lens prescriptions as well as other requirements relating to the sale of contact lenses. The FCLCA became effective February 4, 2004, and now requires all eye care practitioners to give patients a copy of their prescription as soon as they have been fitted for contact lenses, whether the patients ask for it or not. It also directs contact lens sellers to contact eye care practitioners to request verification of consumer prescriptions before shipping all orders (if the prescription is not already on file), and it provides that a practitioner s failure to respond within eight business hours shall result in the prescription being presumed valid, thereby eliminating the ability of eye care practitioners to impede sales by direct marketers simply by ignoring or refusing to respond to their requests to verify prescriptions. The FCLCA also provides that prescriptions will be valid for a minimum of at least one year (absent some special medical reason justifying a shorter period). In addition, the FCLCA directed the Federal Trade Commission (FTC) to conduct a study examining the strength of competition in the market for contact lenses and to submit a report to Congress within twelve months of the FCLCA effective date. The FTC completed and published this study on February 15, 2005, with no recommendations for further changes in federal law.

To satisfy the prescription verification requirement of the FCLCA, a contact lens seller must either obtain a copy of the prescription or verify the prescription by direct communication with the prescriber. Consistent with this requirement, we require all customers to provide either a valid copy of their prescription or the contact information for their prescriber so that we can verify their prescription. If we do not have a valid copy of the customer s prescription, we directly communicate to the customer s prescriber the precise prescription information received from the customer and inform the prescriber that we will proceed with the sale based on this prescription information unless the prescriber advises us within eight business hours that such prescription information is expired or otherwise invalid. If the prescriber properly advises us within this time period that the customer s prescription is expired or otherwise invalid, we will cancel the customer s order. On the other hand, if the prescriber either advises us that the prescription is valid or fails to respond properly within the required time period, we will complete the sale based on the prescription information communicated to the prescriber, as expressly permitted by the FCLCA. We retain copies of the written prescriptions that we receive and maintain records of our communications with the customer s prescriber. The FCLCA provides for several means of direct communication with eye care practitioners, and we may alter our prescription verification procedures from time to time in keeping with the FCLCA and FTC guidelines.

20

Results of Operations

Our fiscal year consists of a 52/53-week period ending on the Saturday nearest to December 31. Fiscal 2007 is a 52-week year and will end on December 29, 2007.

During the second quarter of fiscal 2007, we closed the transactions for the sale of our ClearLab business. As a result of this sale, we no longer have any international operations. Our international operations are reflected as discontinued operations and, accordingly, are no longer reflected as a separate segment. As of June 30, 2007, we have one reportable segment represented by operations within the United States and referred to as U.S. Retail. Our international ClearLab operations are reflected as discontinued operations and, accordingly, are no longer reflected as a separate segment. Unless specifically indicated otherwise, all amounts and percentages presented in the notes below are exclusive of discontinued operations.

The following table presents our results of continuing operations expressed as a percentage of net sales for the periods indicated. All results of operations related to ClearLab have been classified as Income (Loss) from discontinued operations in the accompanying financial statements and are therefore excluded in the following discussion and analysis of results of operations for the quarter ended and the two quarters ended July 1, 2006 and June 30, 2007.

	Quarter Ended		Two Quarters Ended	
	July 1, 2006	**June 30, 2007**	**July 1, 2006**	**June 30, 2007**
NET SALES	100.0 %	100.0 %		