

Management's Discussion and Analysis of Financial Condition and Results of Operations for the quarter ended July 31, 2008

September 11, 2008

This Management's Discussion and Analysis of Financial Condition and Results of Operations ("MD&A") is dated as of September 11, 2008 and should be read in conjunction with Coastal Contacts Inc.'s (the "Company", our, we, us or "Coastal Contacts") unaudited interim consolidated financial statements, and corresponding notes thereto, for the fiscal quarter ended July 31, 2008 and the year ended October 31, 2007. We prepare our consolidated financial statements in accordance with Canadian generally accepted accounting principles ("GAAP") and use Canadian dollars as our reporting currency.

Forward-looking statements

All statements made in this management's discussion and analysis, other than statements of historical fact, are forward-looking statements. The words "may", "would", "could", "will", "intend", "plan", "anticipate", "believe", "estimate", "expect", "goal", "target", "should," "likely," "potential," "continue," "project," "forecast," "prospects," and similar expressions typically are used to identify forward-looking statements. Persons reading this MD&A are cautioned that such statements or information are only predictions, and that our actual future results or performance may be materially different. Readers should therefore not place undue reliance on forward-looking statements and information, which are qualified in their entirety by this cautionary statement.

Forward-looking statements are based on the then-current expectations, beliefs, assumptions, estimates and forecasts about our business and the industry and markets in which we operate. These statements are not guarantees of future performance and involve risks, uncertainties and assumptions which are difficult to predict. Therefore, actual outcomes and results may differ materially from what is expressed or implied by these forward-looking statements due to a number of factors, including but not limited to, changes in the market, potential downturns in economic conditions, consumer credit risk, our ability to implement our business strategies, competition, limited suppliers, inventory risk, disruption in our distribution facilities, mergers and acquisitions, foreign exchange fluctuations, regulatory requirements, demand for contact lenses and related vision care products, competition and dependence on the internet and other risks detailed in our filings with the Canadian securities regulatory authorities. Reference should be made to the section entitled "Risk Factors" contained in our Annual Information Form dated January 2, 2008 for a detailed description of the risks and uncertainties relating to our business. These risks, as well as others, could cause actual results and events to vary significantly. We expressly disclaim any intent or obligation to update these forward-looking statements, unless we specifically state otherwise.

Overview

Coastal Contacts is a leading worldwide direct to consumer retailer of vision care products, with customers in North America, Europe and the Asia Pacific region. Coastal has created a leading multinational optical business designed to provide significant savings to consumers and enhanced service levels when compared with traditional sources of vision care products, such as retail optical stores or directly from eye care practitioners.

Since our inception in 2000, our business has grown to over one million shipments representing over \$102 million in revenues in the 2007 fiscal year. Initially we focused on the North American market. However in recent years we have successfully executed on our strategy of global market diversification, achieving the largest market share of any direct to consumer contact lens retailer in many global markets. We are focused on achieving consistent and sustainable growth through the continued development of our core business. Our growth initiatives include the expansion into new markets through existing distribution hubs, the expansion of market share within existing markets and the introduction of new products.

Results of Operations – three and nine months ended July 31, 2008 compared to the three and nine months ended July 31, 2007

(\$000's)	For the three months ended July 31,		For the nine months ended July 31,	
	2008	2007	2008	2007
Sales	32,725	27,310	86,731	75,517
Gross profit	8,950	7,538	23,442	20,463
Earnings (loss) before taxes	608	594	(611)	2,077
Net earnings (loss)	211	374	(1,184)	1,368
Adjusted EBITDA ¹	1,340	1,087	2,182	3,264

¹ Adjusted EBITDA is a non-GAAP measure that does not have standardized a meaning prescribed by Canadian GAAP and is therefore unlikely to be comparable to similar measures presented by other companies. See *Supplemental Non-GAAP Measures* for further information and a reconciliation of net earnings to Adjusted EBITDA.

Revenues increased by \$5.4 million or 20% in the third quarter of 2008 to \$32.7 million from \$27.3 million in the same quarter of 2007. Revenues increased by \$11.2 million or 15% in the first nine months of 2008 to \$86.7 million from \$75.5 million in the same period of 2007. We operate globally, and sell products in many currencies, some of which, including the Swedish Krona and U.S. dollar, have varied relative to the Canadian dollar over the last year. Excluding the effect of foreign exchange rates, revenues grew \$4.3 million or 16%, and \$13.3 million or 18% during the three and nine month periods ended July 31, 2008, respectively compared to the same periods in 2007, as a result of an increase in organic sales and the introduction of our prescription eyeglass business.

We shipped 323,786 orders for the third fiscal quarter of 2008, an increase of approximately 16% over the third quarter of fiscal 2007. Orders shipped to customers we have sold to in the past, or “re-orders”, represented 65% to 69% of the orders in the third quarter of 2008.

During the three and nine months ended July 31, 2008, cost of sales increased from \$19.8 million and \$55.1 million to \$23.8 million and \$63.3 million respectively, a rate consistent with our sales growth. For the three and nine months ended July 31, 2008 gross margin remained constant at 27% when compared to the same period in 2007.

Selling, general and administrative expenses (“SG&A”) increased to \$7.7 million in the third quarter of 2008, as compared with \$6.3 million in the third quarter of 2007. During the nine months ended July 31, 2008, SG&A expenses increased to \$21.5 million, compared to \$17.9 million for the same period in 2007. Overall SG&A spending increased primarily as a result of an increase in marketing and advertising expenses for our contact lenses and prescription eyeglass business worldwide, as well as increased payroll costs and some additional costs related to customer receivables.

During the three and nine months ended July 31, 2008 we recognized a foreign currency exchange gain on the translation of our monetary assets of \$0.1 million and \$0.3 million, respectively, compared to a loss of \$0.2 million and a gain of \$0.7 million in the same periods of the previous year.

Amortization for the quarter ended July 31, 2008 increased by \$0.1 million over the same quarter of the previous year to \$0.7 million. Amortization increased by \$0.3 million during the nine months ended July 31, 2008 compared to the same period in 2007. The increase is due to continued capital expenditures relating to website development projects and certain leasehold improvements.

During the nine months ended July 31, 2008, we incurred certain restructuring charges associated with the consolidation of our Dutch and Asian operations totalling \$0.8 million. This one time charge was comprised of severance costs and other costs such as inventory and other asset revaluations and general and administrative costs related to the restructuring. These costs were incurred in the second quarter of 2008.

Our consolidated current income tax expense totaled \$0.5 million and \$0.7 million for the three and nine month periods ended July 31, 2008 compared with \$0.3 million and \$0.8 million for the three and nine month periods ended July 31, 2007. Operations in certain jurisdictions generate taxable income, while in other jurisdictions we have loss carry forwards

that can be applied against current and future taxable earnings to reduce our tax liability. As we are uncertain of realizing the future benefit of those losses, we have taken a valuation allowance against these future tax assets. Consequently, our consolidated tax expense, as a percentage of income before income taxes, will vary from quarter to quarter in line with the mix of net income within each taxable jurisdiction.

Liquidity and Capital Resources

At July 31, 2008 we had cash and cash equivalents of \$20.0 million, as compared to cash and cash equivalents of \$23.4 million and \$4.0 million short-term investments at October 31, 2007.

Net earnings for the current quarter, excluding non-cash items, resulted in cash inflows of \$0.9 million compared to \$1.4 million for the same period in the prior year. Net loss for the nine months ended July 31, 2008, excluding non-cash items, resulted in cash inflows of \$0.8 million, compared to cash inflows of \$2.6 million resulting from the net earnings for the same period in 2007. Working capital changes resulted in cash inflows of \$1.5 million during the three months ended July 31, 2008 compared to cash inflows of \$2.5 million for the same period in the prior year, and cash inflows of \$1.9 million for the nine months ended July 31, 2008, compared cash inflows of \$1.1 million in the nine months ended July 31, 2007.

We used \$0.2 million during the third quarter of the 2008 fiscal year to purchase equipment and leasehold improvements. In the same period of last year, we used \$0.5 million. For the nine months ended July 31, 2008, cash of \$2.7 million was provided by investing activities as short term investment maturities of \$4.0 million exceeded spending on property, equipment and website development. This compares to \$5.5 million of cash used in the same period of 2007 largely for the purchase of short term investments and the development of our websites.

On October 16, 2006, the Toronto Stock Exchange accepted our notice of intention to make a Normal Course Issuer Bid (“NCIB”) for up to approximately 4.9 million of our common shares. Shares were purchased at the market price for the common shares at the time of acquisition and were cancelled after purchase. The bid was terminated on October 17, 2007.

On October 24, 2007, we initiated a second NCIB for up to approximately 4.6 million of our common shares. Shares acquired have been and will be purchased at the market price for the common shares at the time of acquisition and cancelled after purchase. As at July 31, 2008, 1,154,700 shares had been purchased for cash of \$1.3 million, and subsequently cancelled.

On January 16, 2008 we announced an offer to purchase for cancellation up to 7,000,000 of our common shares through a modified “Dutch auction” issuer bid. On February 25, 2008, we acquired 6,837,344 common shares at \$1.25 per share, for total consideration of \$8.5 million.

During the third quarter of the 2008 fiscal year we did not purchase any of our common shares for cancellation compared to the third quarter of 2007 when we used \$0.5 million to purchase common shares for cancellation. For the nine months ended July 31, 2008, we used \$10 million to buy back our common shares, compared to \$2.6 million of cash used during the nine months ended July 31, 2007 for the same purpose.

On June 19, 2008, we made an offer to purchase for cash 5,000,000 common shares for \$1.00 per share. On August 1, 2008, we purchased and subsequently cancelled 5,000,000 common shares tendered by shareholders for a total of \$5,000,000.

We believe that available cash, together with cash flow from operating activities will be sufficient to support our operations through to the end of fiscal 2009.

We are actively expanding our product offerings, purchasing our common shares for cancellation and seeking strategic acquisitions. While our foreign subsidiaries hold a minority of our cash balances they generate our cash flows from earnings. We may incur additional tax costs transferring funds from these subsidiaries to our parent company. We may seek additional sources of funds for accelerated growth, common share purchases, acquisitions of companies or assets or other activities, and there can be no assurance that such funds will be available on satisfactory terms. Failure to obtain such financing could delay or prevent our planned growth, which could adversely affect our business, financial condition and results of operations.

Critical Accounting Estimates

We prepare our consolidated financial statements in accordance with GAAP. The preparation of consolidated financial statements in conformity with GAAP 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 as well as the reported amounts of revenues and expenses during the reporting period. Estimates are based upon historical experience and other assumptions that are believed to be reasonable under the circumstances. These estimates are evaluated on an on-going basis and form the basis for making decisions regarding the carrying value of assets and liabilities and the reported amount of revenues and expenses. Actual results may differ from these estimates under different assumptions.

We have identified the following as critical accounting estimates, which are defined as those that are reflective of significant judgments and uncertainties, are the most pervasive and important to the presentation of our financial condition and results of operations and could potentially result in materially different results under different assumptions and conditions.

Accounting for Long-lived Assets

The ability to realize long-lived assets which are primarily comprised of customer lists and website creation costs are evaluated periodically as events or circumstances indicate a possible inability to recover their carrying amount. Such evaluation is based on assessment of reorder rates and various analyses, including undiscounted cash flow and profitability projections that incorporate, as applicable, the impact on the existing business. The analyses necessarily involve significant management judgment. Any impairment loss, if indicated, is measured as the amount by which the carrying amount of the asset exceeds the estimated fair value of the asset.

Accounting for Goodwill and Intangible Assets with Indefinite Lives

Goodwill represents the excess of the purchase price over the fair value of the net assets acquired. Goodwill is not amortized and we perform an annual impairment test of our recorded goodwill. In addition, we test our other indefinite-lived intangible assets for impairment. These impairment tests can be significantly altered by estimates of future performance, long-term discount rates used or market price valuation multiples. The analyses necessarily involve significant management judgment. These estimates will likely change over time. Goodwill and intangible assets with indefinite lives totaled \$16.9 million and \$14.9 million at July 31, 2008 and October 31, 2007, respectively.

Allowance for Doubtful Accounts

We offer credit to most of our customers. These customers do not have to pay for the order until the goods are received – generally estimated to be less than 15 days. The majority of the individual receivable balances are small amounts of less than \$150 and there are a large number of records. Given the composition of the receivable portfolio, using a specific balance approach to determine an allowance for doubtful accounts for the bulk of the receivables is not feasible. Consequently, management estimates an allowance for doubtful accounts based on the aging of the receivable portfolio. The analyses necessarily involve significant judgment. These analyses can be significantly altered by estimates of the probability of future collection or changes in payment patterns of customers. The allowance for doubtful accounts was \$0.9 million and \$0.6 million at July 31, 2008 and October 31, 2007, respectively.

Share-based Compensation

The fair value of each share purchase option grant is estimated on the date of the grant using the Black-Scholes option-pricing model. The amount of share-based compensation associated with any share purchase options that are granted will be estimated and expensed, based on the vesting schedule, using assumptions involving the estimated dividend yield, expected volatility, the risk-free interest rate and the expected lives of the share purchase options.

Income Taxes

We account for income taxes using the liability method of accounting. Under the liability method, future income tax assets and liabilities are determined based on differences between the carrying amounts of balance sheet items and their corresponding tax values. The determination of the income tax provision requires management to interpret regulatory requirements and to make certain judgements. While income tax filings are subject to audits and assessments, management believes that adequate provision has been made for all income tax obligations. However, changes in the interpretations or judgements may result in an increase or decrease in our income tax provision in the future. The amount of any such increase or decrease cannot be reasonably estimated.

Change in Accounting Policies

Effective November 1, 2007, we adopted the new accounting standards related to financial instruments and capital disclosures that were issued by the Canadian Institute of Chartered Accountants. These accounting policy changes were adopted on a prospective basis with no restatement of prior period financial statements. The new standards and accounting policy changes are as follows:

Capital Disclosures (Section 1535)

This standard requires disclosure of an entity's objectives, policies and processes for managing capital, quantitative data about what the entity regards as capital and whether the entity has complied with any capital requirements and, if it has not complied, the consequences of such non-compliance.

Financial instruments – Disclosure (Section 3862) and Presentation (Section 3863)

These standards replace CICA 3861, Financial Instruments – Disclosure and Presentation. It increases the disclosures currently required, which will enable users to evaluate the significance of financial instruments for an entity's financial position and performance, including disclosures about fair value. In addition, disclosure is required of qualitative and quantitative information about exposure to risks arising from financial instruments, including specified minimum disclosures about credit risk, liquidity risk and market risk. The quantitative disclosures must provide information about the extent to which the entity is exposed to risk, based on information provided internally to the entity's key management personnel.

New accounting pronouncements not yet adopted:

Inventories (Section 3031)

This standard replaces CICA 3030, Inventories, and will harmonize accounting for inventories under Canadian GAAP and International Financial Reporting Standards ("IFRS"). This standard requires that inventories should be measured at the lower of cost and net realizable value, and includes guidance on the determination of cost, including allocation of overheads

and other costs. The standard also requires the reversal of previous write downs to net realizable value when there is a subsequent increase in the value of inventories. The new Section is effective for interim and annual financial statements relating to fiscal years beginning on or after January 1, 2008. We are currently evaluating the impact of this new standard.

Goodwill and Intangible Assets (Section 3064)

This standard replaces existing Section 3062, Goodwill and Other Intangible Assets and Section 3450 Research and Development Costs and will harmonize accounting for goodwill and intangible assets under Canadian GAAP and IFRS. This Section establishes the standards for the recognition, measurement and disclosure of goodwill and intangible assets, including internally generated intangible assets. The new Section is effective for interim and annual financial statements relating to fiscal years beginning on or after October 1, 2008. We are currently evaluating the impact of this new standard.

Common Shares

As at July 31, 2008, we had 63,430,443 common shares and 3,176,271 options outstanding. Of these securities, 1,211,143 common shares are subject to voluntary pooling agreements and 2,220,404 options have not yet vested as of July 31, 2008.

Quarterly Financial Information

(in \$000's, except per share amounts)

Quarter ended	July 31, 2008	Apr. 30, 2008	Jan. 31, 2008	Oct. 31, 2007	July 31, 2007	Apr. 30, 2007	Jan. 31, 2007	Oct. 31, 2006
Sales	32,725	28,632	25,375	26,657	27,310	24,602	23,605	23,344
Net Earnings (loss)	211	(692)	(701)	257	374	313	681	469
Weighted Average # of shares - Basic	63,430	65,092	71,275	72,015	72,454	72,974	74,339	71,250
Weighted Average # of shares - Diluted	63,535	65,353	71,275	72,194	73,031	73,457	74,869	73,882
Basic Earnings (Loss) per share	0.00	(0.01)	(0.01)	0.00	0.01	0.00	0.01	0.01
Diluted Earnings (Loss) per share	0.00	(0.01)	(0.01)	0.00	0.01	0.00	0.01	0.01

Seasonality may impact our revenue distribution throughout the year. Our sales are generally stronger during the spring, summer and fall months. Our industry generally experiences lower sales during the winter as customers choose to divert discretionary funds towards holiday purchases.

Related Party Balances

The following amounts were due from related parties:

(\$000's)	July 31, 2008	October 31, 2007
Promissory notes receivable	355	342
Advances to officers	12	6
	367	348

As at July 31, 2008, there were seven promissory notes receivable from officers ranging in value from \$0.01 million to \$0.1 million and totaling \$0.36 million. These loans are payable on demand and bear interest at a rate of 5% per annum.

Contractual Obligations

We are committed to minimum annual payments, primarily related to lease costs on our premises, as follows:

	\$000's
2008	1,260
2009	1,179
2010	750
2011 and thereafter	189
	3,378

Operating costs on leases have been excluded. We have no obligations for annual payments related to long-term debt or capital lease obligations.

Contingent Liabilities

In the ordinary course of our business, inquiries are made periodically by regulatory authorities and assertions are made. We review these and respond to them in due course. To date, no reservation or provision has been made in the financial statements in connection with these matters.

Off-Balance Sheet Arrangements

We do not have any off-balance sheet arrangements as defined by applicable securities regulations in Canada at July 31, 2008 that have, or are reasonably likely to have, a current or future material effect on our results of operations or financial condition.

Critical Suppliers

We purchase significant amounts of inventory from three major suppliers. We believe that alternative suppliers are available should those suppliers be unable to provide us with product.

Subsequent events

On June 19, 2008, we made an offer to purchase for cash 5,000,000 common shares of the Company for \$1.00 per share. On August 1, 2008, we purchased and subsequently cancelled 5,000,000 common shares tendered by shareholders for a total of \$5,000,000.

Subsequent to July 31, 2008, we filed a statement of claim against the College of Opticians of British Columbia (the “Opticians”) relating to certain public statements made by the Opticians which we are asking the Opticians to retract as a part of our claim.

Management Assessment of Internal Controls

During the most recent interim quarter ending July 31, 2008, there have not been any changes in the design of our internal controls over financial reporting that have materially affected, or are reasonably likely to materially affect, our internal controls over financial reporting.

Supplemental Non-GAAP Measures

We report our results in accordance with Canadian GAAP; however, we present Adjusted EBITDA and the number of orders shipped and the reorder rate in our filings because we believe our investors use these figures to make investment decisions about us.

Adjusted EBITDA is a non-GAAP measure that does not have any standardized meaning prescribed by Canadian GAAP and is therefore unlikely to be comparable to similar measures presented by other companies. Adjusted EBITDA should be considered in addition to, and not as a substitute for, net income, cash flows and other measures of financial performance and liquidity reported in accordance with Canadian GAAP.

Adjusted EBITDA is a measure we believe is useful in assessing performance and highlighting trends on an overall basis. Adjusted EBITDA differs from the most comparable GAAP measure, net income, primarily because it does not include interest, income taxes, amortization, restructuring cost and share-based compensation expense.

The following table shows a reconciliation of net earnings to Adjusted EBITDA:

(\$000's)	For the three months ended July 31,		For the nine months ended July 31,	
	2008	2007	2008	2007
Net earnings	211	374	(1,184)	1,368
Depreciation and amortization	663	537	1,931	1,498
Interest income, net	(91)	(176)	(477)	(626)
Income tax expense – current	460	268	668	813
Income tax recovery – future	(63)	(48)	(95)	(104)
Share-based compensation	160	132	495	315
Restructuring cost	----	----	844	----
Adjusted EBITDA	1,340	1,087	2,182	3,264

Additional Information

Additional information relating to the Company, including the Company's most recently filed annual information form, dated January 2, 2008, can be found on SEDAR at www.sedar.com.