

Consolidated Financial Statements

Coastal Contacts Inc.

October 31, 2004

AUDITORS' REPORT

To the Shareholders of
Coastal Contacts Inc.

We have audited the consolidated balance sheet of **Coastal Contacts Inc.** as at October 31, 2004 and the consolidated statement of loss and deficit and cash flows for the year then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at October 31, 2004 and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

The financial statements as at October 31, 2003 and for the year then ended were audited by other auditors who expressed an opinion without reservation on those statements in their report dated December 23, 2003.

Ernst & Young LLP

Vancouver, Canada
January 14, 2005.

Chartered Accountants

Coastal Contacts Inc.

CONSOLIDATED BALANCE SHEET

As at October 31

	2004 \$	2003 \$
ASSETS [note 8]		
Current		
Cash	843,681	101,414
Short-term investments [note 2]	776,675	—
Accounts receivable [note 4]	3,043,140	94,552
Income taxes receivable	3,598	10,814
Inventory	3,997,434	1,416,520
Prepaid expenses	234,963	81,247
Due from related parties [note 11]	194,856	31,127
	9,094,347	1,735,674
Long-term receivable	13,713	—
Property, equipment and leasehold improvements [note 6]	841,506	64,276
Intangible assets [note 7]	5,041,909	39,465
Goodwill [note 5]	6,137,943	—
	21,129,418	1,839,415
LIABILITIES, SHARE CAPITAL AND DEFICIT		
Current		
Bank indebtedness	683,863	434,274
Accounts payable and accrued liabilities [note 4]	5,215,624	1,381,343
Income taxes payable	99,552	—
Deferred revenue	307,067	—
Due to related parties [note 11]	38,733	1,747
Current portion of lease inducement	24,337	—
Current portion of long-term debt [note 8]	610,408	184,100
	6,979,584	2,001,464
Long-term lease inducement	133,853	—
Long-term debt [note 8]	409,242	396,786
Future income tax liability [note 10]	1,415,911	—
	8,938,590	2,398,250
Commitments [note 13] and contingencies [note 14]		
Share capital and deficit		
Share capital [note 9]		
Authorized:		
Unlimited common shares without par value		
Unlimited Class A preferred shares without par value		
Issued and outstanding:		
33,874,860 common shares [2003 - 12,280,000]	11,569,500	77,000
Shares to be issued [note 9]	1,762,560	—
Contributed surplus [note 9b]	105,898	—
Cumulative foreign currency translation adjustment	(71,745)	—
Deficit	(1,175,385)	(635,835)
	12,190,828	(558,835)
	21,129,418	1,839,415

See accompanying notes

On behalf of the Board:

/s/ Roger V. Hardy
Director

/s/ Murray McBride
Director

Coastal Contacts Inc.

CONSOLIDATED STATEMENT OF LOSS AND DEFICIT

Year ended October 31

	2004	2003
	\$	\$
Sales	31,246,283	20,143,438
Cost of sales	25,536,880	16,338,181
Gross profit	5,709,403	3,805,257
Selling, general and administration expenses	5,934,077	4,393,151
Stock-based compensation	105,898	—
Amortization	195,323	34,060
Interest on long-term debt	87,673	40,732
Interest income	(14,626)	—
Loss before income taxes	(598,942)	(662,686)
Income tax recovery - current <i>[note 10]</i>	(21,347)	(5,704)
Income tax recovery - future <i>[note 10]</i>	(38,045)	—
Net loss	(539,550)	(656,982)
Retained earnings (deficit), beginning of year	(635,835)	21,147
Deficit, end of year	(1,175,385)	(635,835)
Basic and diluted loss per share	(.03)	(.05)
Basic and diluted weighted average number of common shares outstanding	21,218,334	12,123,123

See accompanying notes

Coastal Contacts Inc.

CONSOLIDATED STATEMENT OF CASH FLOWS

Year ended October 31

	2004	2003
	\$	\$
OPERATING ACTIVITIES		
Net loss	(539,550)	(656,982)
Non-cash items:		
Amortization	195,323	34,060
Accrued interest	(7,446)	—
Stock-based compensation	105,898	—
Shares issued for goods and services	350,000	—
Loss on disposal of short-term investment	67,844	—
Future income taxes	(38,045)	—
Changes in non-cash working capital:		
Accounts receivable	(1,016,847)	(86,698)
Inventory	(1,309,389)	(877,935)
Prepaid expenses	(6,775)	(35,133)
Accounts payable and accrued liabilities	2,422,234	826,197
Income taxes payable	(15,620)	(16,518)
Deferred revenue	307,067	—
Due from related parties	30,169	(31,127)
Lease inducements	158,190	—
Cash provided by (used in) operating activities	703,053	(844,136)
INVESTING ACTIVITIES		
Purchase of short-term investments	(4,909,519)	—
Sale of short-term investments	4,332,157	—
Business acquisition net of cash acquired	(5,878,869)	—
Acquisition of property, equipment and leasehold improvements	(478,956)	(36,941)
Advances to related parties	(156,912)	(33,147)
Acquisition of intangible assets	(111,910)	(23,784)
Cash used in investing activities	(7,204,009)	(93,872)
FINANCING ACTIVITIES		
Issuance of share capital	6,515,107	35,000
Proceeds received for shares to be issued	2,000,000	—
Bank indebtedness	146,354	434,724
Loan payments	(300,302)	(78,877)
Loan proceeds	—	480,000
Share issue costs	(1,110,045)	—
Cash provided by financing activities	7,251,114	870,847
Increase (decrease) in cash	750,158	(67,161)
Cash, beginning of year	101,414	168,575
Unrealized foreign exchange loss	(7,891)	—
Cash, end of year	843,681	101,414
Income taxes (recovered) paid in cash	(15,943)	5,704
Interest paid in cash	87,216	40,732

See accompanying notes

Coastal Contacts Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

October 31, 2004

1. NATURE OF OPERATIONS

Coastal Contacts Inc. ("the Company") is a global on-line retailer of contact lenses sold through internet sites created and operated by the Company. The Company has operations in North America and Europe.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Generally accepted accounting principles

These consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles.

Principles of consolidation

The consolidated financial statements include the accounts of the Company and its wholly owned Swedish subsidiary, Lensway AB ("Lensway"). All intercompany transactions and balances have been eliminated.

Revenue recognition

Revenue from product sales is recognized when the product has been shipped to the customer. At this point, the amount of sales revenue is determinable, no significant vendor obligations remain and the collection of the revenue is reasonably assured.

Deferred revenue includes revenue collected in advance of the product being shipped to the customer.

Foreign currency translation

The functional currency of the Company is the Canadian dollar. Monetary assets and liabilities denominated in foreign currencies are translated at the exchange rate prevailing at the balance sheet date. Revenues and expenses denominated in foreign currencies are translated at the date prevailing on the transaction date. Foreign currency translation gains or losses are recorded in income in the period in which they occur.

Coastal Contacts Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

October 31, 2004

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (cont'd.)

Translation of accounts of foreign subsidiaries

Lensway is classified as a self-sustaining foreign operation and their financial statements are translated into Canadian dollars using the current method as follows:

- a) Assets and liabilities are translated at the rate of exchange in effect at the balance sheet date.
- b) Revenue and expense items are translated at the average rate of exchange in effect for the period in which such items are recognized.
- c) Exchange gains or losses arising from translation are deferred in a separate component of shareholders' equity.

Short-term investments

Short-term investments consist of money market funds and fixed income securities and are carried at cost plus accrued interest. At October 31, 2004, their carrying value approximates their fair value.

Inventory

Inventory is valued at the lower of cost (determined on a first in first out basis) or net realizable value.

Property, equipment and leasehold improvements

Property, equipment and leasehold improvements are recorded at cost less accumulated amortization. Amortization is calculated over the estimated useful life of the assets at the following rates:

Leasehold improvements	Over the remaining term of the lease
Furniture and fixtures	20% declining balance
Computer hardware	30% declining balance
Computer software	100% declining balance
Customized ERP software	20% straight-line

Coastal Contacts Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

October 31, 2004

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (cont'd.)

Intangible assets

Finite life intangible assets are recorded at cost less accumulated amortization. Amortization is calculated over the estimated useful life of the assets at the following rates:

Website development	5 years straight-line basis
Lensway customer list	5 years straight-line basis

The Company intends to keep the Lensway name and brand intact. All future sales and marketing efforts in Europe will be conducted using the Lensway name. As a result, the trade name is considered to have an indefinite life and will not be amortized. The value will be reviewed for possible impairment annually or more frequently if events or changes in circumstances indicate possible impairment, based on the profitability and cash flows of Lensway. Based on this testing the Company has determined that no impairment charge is required as at October 31, 2004.

Goodwill

Goodwill represents the excess of the purchase price over the fair value of the net assets acquired. Goodwill is not amortized and is reviewed for possible impairment annually or more frequently if events or changes in circumstances indicate possible impairment, based on the profitability and cash flows of Lensway. Based on this testing, the Company has determined that no goodwill impairment charge is required as at October 31, 2004.

Income taxes

Income taxes are accounted for using the liability method of tax allocation. Under this method future income tax assets and liabilities are recognized for the tax consequences of temporary differences by applying substantively enacted statutory tax rates applicable to future years to differences between the financial statement carrying amounts and the tax bases of existing assets and liabilities.

The effect on future taxes for a change in tax rates is recognized in income in the period that includes the substantive enactment. In addition, future tax assets are recognized to the extent their realization is more likely than not.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

October 31, 2004

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (cont'd.)

Use of estimates

The preparation of financial statements in conformity with Canadian 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 revenues and expenses during the reporting period. Actual results could differ from these estimates.

Financial instruments

The Company's financial instruments consist of cash, bank indebtedness, accounts receivable, short-term investments, accounts payable, loans, amounts due to and from related parties and income taxes receivable and payable. The fair value of these financial instruments approximate their carrying value. It is management's opinion that the Company is not exposed to significant interest, currency or credit risk arising from these financial instruments.

Financial risk to the Company's earnings arises from fluctuations in foreign exchange rates and the volatility of these rates. The Company has not used derivative instruments to reduce its exposure to currency risk. Purchases from U.S. suppliers offset sales in U.S. dollars in the normal course of business and consequently, significantly reduce the Company's exposure to currency risk.

3. ADOPTION OF NEW ACCOUNTING POLICIES

Stock-based compensation

Effective November 1, 2003, the Company prospectively adopted the new recommendations of the Canadian Institute of Chartered Accountants ("CICA") Handbook Section 3870, *Stock-Based Compensation and Other Stock Based Payments* which requires the use of the fair value method of accounting for all stock options granted or modified on or after the date of adoption.

Coastal Contacts Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

October 31, 2004

3. ADOPTION OF NEW ACCOUNTING POLICIES (cont'd.)

Earnings per share

Effective November 1, 2003, the Company retroactively adopted the recommendations of CICA Handbook Section 3500, *Earnings per Share*. Under this standard, the Company calculates basic earnings per share using the weighted average number of common shares outstanding during the period. Diluted earnings per share are calculated by the treasury stock method. Under the treasury stock method, the weighted average number of common shares outstanding for the calculation of diluted earnings per share assumes that the proceeds to be received on the exercise of dilutive stock options and warrants are applied to repurchase common shares at the average market price for the period. Stock options and warrants are dilutive when the Company has income from continuing operations and when the average market price of the common shares during the period exceeds the exercise price of the options and warrants.

4. ACCOUNTS RECEIVABLE, ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

Accounts receivable

	2004	2003
	\$	\$
Accounts receivable	2,469,536	72,308
Allowance for doubtful accounts	(598,161)	—
Value added tax receivable	1,171,765	22,244
	3,043,140	94,552

Accounts payable and accrued liabilities

	2004	2003
	\$	\$
Accounts payable - trade	3,948,782	1,196,206
Accrued liabilities	1,019,471	185,137
Value added tax payable	247,371	—
	5,215,624	1,381,343

Coastal Contacts Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

October 31, 2004

5. ACQUISITION OF LENSWAY

On July 26, 2004, the Company completed the acquisition of all of the shares of Lensway, a European retailer of contact lenses. The consideration paid included \$5,655,000 in cash and 13,195,000 restricted common shares of the Company. The shares are subject to a pooling agreement for a period of 36 months after the closing date of July 26, 2004. Forty percent of the pooled shares will be released 12 months after closing and 15% of the shares will be released every six months thereafter (all shares will be released as of 36 months after the closing date).

The acquisition was accounted for using the purchase method whereby assets acquired and liabilities assumed were recorded at their fair market values as of the date of the acquisition. For purposes of computing the purchase price, the value of the restricted common shares was determined by taking the closing price of the Company's common stock as quoted on the TSX Venture Exchange for the two days before, the day of and the two days following the announcement of the signing of the letter of intent to acquire Lensway (June 24, 2004). This average price was then reduced by a 46% discount (as determined by a third party appraisal) due to the restriction provisions associated with the common shares issued.

The following sets forth the purchase price and its allocation to the tangible and intangible assets acquired.

	\$
Cash	5,655,000
Restricted common shares	5,500,000
Direct acquisition costs	773,953
Total consideration	11,928,953
Cash	550,084
Other current assets	3,656,208
Property and equipment	353,263
Lensway customer list	2,083,333
Lensway trade name	2,847,223
Website development	125,000
Current liabilities	(2,116,763)
Long-term debt	(280,776)
Future income taxes	(1,462,207)
Net assets acquired	5,755,365
Goodwill	6,173,588

Coastal Contacts Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

October 31, 2004

5. ACQUISITION OF LENSWAY (cont'd.)

Goodwill is not deductible for income tax purposes.

The results of operations of Lensway have been included in the accompanying financial statements since July 26, 2004. The fair values of the assets acquired, including goodwill, and liabilities assumed in the acquisition have been "pushed down" to Lensway resulting in foreign currency revaluation at each reporting date.

The unaudited pro forma information below sets forth summary results of operations as if the acquisition of Lensway had taken place at the beginning of fiscal 2003, after giving effect to certain adjustments, including amortization of intangibles, depreciation and elimination of intercompany sales. The following pro forma information for the fiscal year 2003 and 2004 have been prepared for comparative purposes only and do not purport to be indicative of what would have actually occurred had the acquisition occurred at the beginning of fiscal 2003 or of results which may occur in the future.

	2004	2003
	\$	\$
Sales	41,164,033	27,982,846
Net loss	(178,489)	(501,525)
Basic and diluted loss per share	(.01)	(.02)
Basic and diluted weighted average number of common shares outstanding	21,235,996	15,318,525

6. PROPERTY, EQUIPMENT AND LEASEHOLD IMPROVEMENTS

	2004	2003
	\$	\$
Leasehold improvements	355,314	—
Furniture and fixtures	199,404	24,220
Computer hardware	196,466	62,888
Computer software	11,525	8,519
Customized ERP software	223,408	—
	986,117	95,627
Accumulated amortization	(144,611)	(31,351)
Net book value	841,506	64,276

Coastal Contacts Inc.**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

October 31, 2004

7. INTANGIBLE ASSETS

	2004	2003
	\$	\$
Website development	303,050	66,181
Lensway trade name	2,830,783	—
Lensway customer list	2,071,306	—
	5,205,139	66,181
Accumulated amortization	(163,230)	(26,716)
Net book value	5,041,909	39,465

8. LONG-TERM DEBT

	2004	2003
	\$	\$
VanCity Capital		
Loan #1: Repayable in monthly instalments of \$7,381, blended principal and interest at prime (4.25%) plus 10.5%. The loan matures on March 15, 2005.	35,776	106,058
Loan #2: Repayable in monthly instalments of \$8,378, blended principal and interest at 13%. The loan matures on March 15, 2006.	232,759	294,828
Loan #3: Repayable in monthly instalments of interest only at an interest rate of 13%. Beginning November 15, 2003 monthly payments are \$26,250 blended principal and interest at a fixed interest rate of 13.0%. The loan matures on June 15, 2006.	127,560	180,000
Handelsbanken Loan: Repayable in monthly instalments of \$38,266, consisting of blended principal and interest at 7.45%. The loan is denominated in Swedish Krona (SEK 3,611,106) matures on February 28, 2006.	623,555	—
	1,019,650	580,886
Less current portion	610,408	184,100
	409,242	396,786

Coastal Contacts Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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8. LONG-TERM DEBT (cont'd.)

All three Van City loans are collateralized by a general security agreement over all the assets of the Company and certain personal guarantees by shareholders. These Van City loans are subordinate to any other loan facilities that the Company might obtain in the future. These loans also give VanCity the option of participating in equity offerings undertaken by the Company by converting the debt outstanding at the date of such offering into the equity offered.

The Handelsbanken loan is collateralized by a floating charge on the assets of Lensway, to a maximum of 7,500,000 krona (\$1,291,500), depending on the amount of outstanding loan.

Anticipated requirements to meet long term debt principal repayments over the next 5 years from November 1, 2004 are as follows:

	\$
2005	610,408
2006	409,242
	<u>1,019,650</u>

Under terms of the banks loan facilities with Van City Capital, there are certain covenants over working capital and effective net worth, as well as those restricting shareholder loans and capital expenditures. As at October 31, 2004, the Company had exceeded the covenant restricting annual capital expenditures to less than \$100,000 per annum. For the year ended October 31, 2004, the Company had incurred capital expenditures of \$73,644 in primarily computer and server purchases, along with \$109,607 in developing the Company's website. The Company also approved two loans to an Officer of the Company. These loans bear interest at 5% and are repayable on demand [see note 11]. The Company has obtained waivers from the lender in regards the above covenant restrictions.

Coastal Contacts Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

October 31, 2004

9. SHARE CAPITAL

[a] Issued and outstanding common shares

On December 23, 2003 the Company underwent a share subdivision issuing two new common shares for every one issued and outstanding common share. All common share and per share data included herein have been adjusted to reflect the two for one subdivision as if it had occurred at the beginning of the periods reflected.

	2004		2003	
	Number of Common Shares #	\$	Number of Common Shares #	\$
Balance - beginning of period	12,280,000	77,000	12,000,000	42,000
Issued in private placement	620,000	310,000	280,000	35,000
Issued on exercise of warrants	100,000	5,000	—	—
Issued for goods	700,000	350,000	—	—
Issued in initial public offering	6,000,000	5,127,395	—	—
Issued for services	375,000	—	—	—
Issued on exercise of options	264,960	1,325	—	—
Issued under greenshoe option	164,000	151,700	—	—
Issued under greenshoe option	50,900	47,080	—	—
Issued for services	125,000	—	—	—
Issued in purchase of Lensway	13,195,000	5,500,000	—	—
Balance - end of period	33,874,860	11,569,500	12,280,000	77,000

Between November 1, 2003 and December 15, 2003 the Company issued 1,420,000 common shares to non-related parties of the Company, of which 620,000 of the shares were issued for cash of \$310,000, 100,000 shares were issued on the exercise of warrants for cash of \$5,000 and 700,000 shares were issued in exchange for the settlement of accounts payable.

On March 29, 2004, the Company undertook an Initial Public Offering (IPO), issuing 6,000,000 common shares for proceeds of \$6,000,000, less share issue costs of \$872,605. There were a further 375,000 units issued to the underwriter. Each unit consists of one common share and one warrant exercisable at \$1.50 for a period of two years.

On April 7, 2004, employees of the Company exercised options for 264,960 shares, for proceeds of \$1,325.

Coastal Contacts Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

October 31, 2004

9. SHARE CAPITAL (cont'd.)

On April 23, 2004 and May 28, 2004, the underwriter exercised part of its rights under the greenshoe option granted in the IPO and 164,000 and 50,900 common shares were issued for proceeds of \$151,700, and \$47,080 respectively.

On July 22, 2004, the Company undertook a private placement issuing 2,500,000 shares for proceeds of \$2,000,000, less share issue cost of \$237,440. These shares were issued on November 23, 2004. Each of the 2,500,000 shares includes a share purchase warrant entitling the holder to purchase one share per warrant at an exercise price of \$1.00 for a period of two years. There were a further 125,000 units comprising one common share and one purchase warrant issued to the underwriter. Each warrant is exercisable into one common share at \$0.80 for a period of two years. Underwriting fees also included 250,000 agent's warrants exercisable at \$0.80 for a period of 2 years.

On July 26, 2004, the Company issued 13,195,000 common shares in connection with the purchase of Lensway [see note 5].

[b] Stock options

The following table contains information with respect to stock options:

	#	\$
Options outstanding, October 31, 2002	9,929,200	.005 - .125
Granted	1,205,500	.125 - .275
Options outstanding, October 31, 2003	11,134,700	.005 - .275
Granted	432,501	.005 - 1
Exercised	(264,960)	.005 - .125
Options outstanding, October 31, 2004	11,302,241	.005 - 1

Coastal Contacts Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

October 31, 2004

9. SHARE CAPITAL (cont'd.)

The following table summarizes information about share options outstanding as at October 31, 2004:

Options Outstanding			Options Exercisable	
Shares #	Weighted Average Contractual Life	Exercise Price \$	Shares #	Exercise Price \$
9,334,000	4.08 yrs	0.005	9,334,000	0.005
1,280,240	3.60 yrs	0.125	1,280,240	0.125
345,500	2.62 yrs	0.175	345,500	0.175
110,000	2.25 yrs	0.275	110,000	0.275
232,501	4.79 yrs	1.000	—	1.000
11,302,241	3.99 yrs	0.040	11,069,740	0.040

On December 15, 2003, the Company issued 200,000 options to a consultant of the Company, which resulted in \$99,000 of stock-based compensation expense being recorded in the year ended October 31, 2004.

On October 17, 2004 the Company issued 232,501 options to employees of the Company. These options are exercisable at \$1 each and vest equally on March 31, 2005, 2006 and 2007. Using the Black-Scholes option-pricing model, the Company estimates the fair value of this option grant to be \$69,750. Compensation of \$6,898 has been recognized as expense in the year ended October 31, 2004, with \$46,223 to be recognized in 2005, \$13,563 in 2006 and \$3,875 in 2007.

The following pro forma financial information presents the loss for the year had the Company recognized stock-based compensation using a fair value method for all stock awards granted, modified or settled prior to November 1, 2003:

	2004 \$	2003 \$
Loss - as reported	(539,550)	(656,982)
Add: stock-based compensation cost as reported	105,898	—
Less: pro forma stock-based compensation cost	(105,898)	(94,850)
Loss - pro forma	(539,550)	(751,832)
Loss per share - as reported	(0.03)	(0.05)
Loss per share - pro forma	(0.03)	(0.06)

Coastal Contacts Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

October 31, 2004

9. SHARE CAPITAL (cont'd.)

The fair value of each option grant is estimated on the date of the grant using the Black-Scholes option-pricing model with the following weighted average assumptions:

	2004	2003
Dividend yield	0%	0%
Expected volatility	70%	70%
Risk free interest rate	3.24%	3.72%
Expected lives	3 years	4 years

[c] Warrants

The following table contains information with respect to all warrants:

	#	\$
Warrants outstanding, October 31, 2003	—	—
Granted	3,971,490	.05 - 1.50
Exercised	(100,000)	.05
Warrants outstanding, October 31, 2004	3,871,490	0.80 - 1.50

The following table summarizes information about warrants outstanding as at October 31, 2004:

Warrants Outstanding			Warrants Exercisable	
Shares #	Average Life	Weighted Average Price \$	Shares #	Weighted Average Price \$
375,000	2 yrs	0.80	375,000	0.80
3,121,490	2 yrs	1.00	3,121,490	1.00
375,000	2 yrs	1.50	375,000	1.50
3,871,490	2 yrs	1.03	3,871,490	1.03

Coastal Contacts Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

October 31, 2004

10. INCOME TAXES

Future income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Significant components of the Company's future tax liabilities are as follows:

	2004	2003
	\$	\$
Future tax assets		
Non-capital loss carryforwards	402,416	218,062
Net book value of capital assets in excess of tax value	(37,700)	(432)
Deferred income recognized for tax purposes	56,347	—
Share issue costs	451,675	—
Other	630	677
Total future tax assets	873,368	218,307
Valuation allowance	(873,368)	(218,307)
Total future tax assets	—	—
Future tax liabilities		
Foreign income tax reserves	39,266	—
Carrying value of intangible assets in excess of tax basis	1,376,645	—
	1,415,911	—

The potential income tax benefits relating to the future tax assets have not been recognized in the consolidated financial statements as their realization did not meet the requirements of "more likely than not" under the liability method of tax allocation. Accordingly, no future tax assets have been recognized as at October 31, 2004 and 2003.

Coastal Contacts Inc.**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

October 31, 2004

10. INCOME TAXES (cont'd.)

Significant components of the income tax expense attributable to continuing operations are as follows:

	2004	2003
	\$	\$
Current income tax recovery	(21,347)	(5,704)
Future income tax recovery relating to reversal of taxable temporary differences	(30,929)	—
Future income tax recovery relating to foreign tax reserves	(7,116)	—
	<u>(59,392)</u>	<u>(5,704)</u>

The reconciliation of income taxes attributable to continuing operations computed at the statutory income tax rates to income tax recovery, at the statutory tax rate of 35.95% [2003 - 37.95%] is as follows:

	2004	2003
	\$	\$
Recovery of tax at statutory tax rates	(215,319)	(251,489)
Expenses not deductible for income tax purposes	47,862	8,150
Financing costs deductible for income tax purposes	(113,965)	—
Non-capital losses generated	186,061	243,339
Amortization in excess of capital cost allowance for tax	19,722	—
Benefit of non-capital losses carried back to prior year	—	(5,704)
Foreign tax rate differential	16,247	—
	<u>(59,392)</u>	<u>(5,704)</u>

As at October 31, 2004, the Company has non-capital loss carryforwards of \$1,129,747 for Canadian income tax purposes that expire as follows:

	\$
2010	612,191
2011	517,556
	<u>1,129,747</u>

Coastal Contacts Inc.

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11. RELATED PARTY TRANSACTIONS

Due from related parties

	2004	2003
	\$	\$
Promissory notes receivable	115,000	—
Advances to officers	40,165	—
CMP Medical Inc.	39,691	31,127
	<u>194,856</u>	<u>31,127</u>

The amounts due from related parties includes (1) two promissory notes from an officer and a shareholder for \$100,000 and \$15,000 respectively. These loans are payable on demand and bear interest at 5% per annum; (2) Other advances to officers of the Company in the amount of \$40,165. These advances are non interest bearing with no fixed terms of repayment; and (3) \$39,691 from CMP Medical Inc., a company controlled by an officer and shareholder of the Company.

Due to related parties

	2004	2003
	\$	\$
Advances from officers	38,733	1,747

These advances are non interest bearing with no fixed terms of repayment.

All related party transactions are measured at their exchange amounts.

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12. SEGMENTED INFORMATION

The Company operates in one business segment, the sale of contact lenses. The Company's sales are in North America and Europe. Geographical information is based on the countries in which the Company sells contact lenses and accessories.

	United States and Canada \$	Sweden \$	Norway \$	Other \$	Intercompany Eliminations \$	Total \$
2004						
Sales	27,306,932	3,555,411	1,256,062	561,532	(1,433,654)	31,246,283
Property, equipment and leasehold improvements	494,261	347,245	—	—	—	841,506
Goodwill	—	6,137,943	—	—	—	6,137,943
2003						
Sales	20,143,438	—	—	—	—	20,143,438
Property, equipment and leasehold improvements	64,276	—	—	—	—	64,276

13. COMMITMENTS

The Company is committed to minimum annual lease payments on its premises, excluding operating costs as follows:

	\$
2005	186,000
2006	275,000
2007	311,000
2008	182,000
2009	156,000
2010 and thereafter	208,000
	<u>1,318,000</u>

Coastal Contacts Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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14. CONTINGENCIES

- [a] On December 11, 2002, Vision Direct Inc. filed a claim in the United States District Court for the Southern District of New York against the Company and WhenU.Com inc., which provided certain internet advertising services to the Company. The claim alleges copyright infringement against the Company in connection with certain content on the Company's website and additional copyright and trademark infringement and unfair competition claims against the Company and WhenU.com, resulting from WhenU.com's use of "pop-up" internet advertising. No amount has been accrued at October 31, 2004 in respect of this claim as the amount of loss, if any, cannot be reasonably estimated. The Company has retained counsel and intends to vigorously defend itself in this action. Pursuant to an agreement with WhenU.com, the Company will be indemnified by WhenU.com for all damages in excess of US \$15,000 for all claims related to advertising on the WhenU.com network. The indemnification agreement does not apply to claims unrelated to advertising on the WhenU.com network.
- [b] On March 18, 2004, 1-800-Contacts Inc. filed a legal action in the United States Federal Court for the District of Utah against the Company alleging trademark infringement, unfair competition, trademark dilution, copyright infringement, unfair trade practices and other related claims. This lawsuit was settled on November 15, 2004. The settlement involved no compensation.

15. COMPARATIVE FIGURES

Certain comparative figures have been reclassified to conform to the current year's presentation.