

Management's Discussion and Analysis of Financial Condition and Results of Operations March 9, 2007

The following management's discussion and analysis should be read in conjunction with Coastal Contacts Inc.'s (the "Company, our, we, us or Coastal") unaudited interim consolidated financial statements for the fiscal quarter ended January 31, 2007. We prepare our consolidated financial statements in accordance with Canadian generally accepted accounting principles.

Forward-looking statements

All statements made in this report, other than statements of historical fact, are forward-looking statements. The words "anticipate," "believe," "estimate," "expect," "intend," "may," "plan," "will," "would," "should," "guidance," "potential," "continue," "project," "forecast," "confident," "prospects," and similar expressions typically are used to identify forward-looking statements.

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, our ability to implement our business strategies, competition, general economic conditions, limited suppliers, inventory risk, disruption in our distribution facilities, foreign exchange, fluctuations, regulatory requirements, demand for contact lenses, competition and dependence on the internet and other risks detailed in our filings with the Canadian Securities authorities. Reference should be made to the section entitled "Risk Factors" contained in the Annual Information Form dated January 29, 2007 for a detailed description of the risks and uncertainties relating to the business of the Company. 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

With operations and distribution hubs in North America, Europe and Asia, we are among the largest and fastest growing vision care providers in the world. We have shipped over 2.2 million orders since inception, shipped over 248,000 orders in the 3 months ended January 31, 2007 and continue to strengthen the Coastal Contacts brand through the compelling value proposition of savings and convenience. We leverage the internet and global purchasing to sell directly to the consumer efficiently and cost effectively. We believe we can maintain a competitive advantage by combining these efficiencies with our global operations.

Our revenue has grown from \$2.5 million in 2001 to \$81.0 million in 2006 representing a compound annual growth rate of 79% over six years. Our revenues were \$23.6 million in the first quarter of fiscal 2007.

We are focused on achieving consistent and sustainable growth through the continued development of our core business and our strategically selected business acquisitions. Our internal growth initiatives include the expansion into new markets through existing distribution hubs and the expansion of market share within existing markets.

Selected Quarterly Information

Quarter ended (\$000's)	Jan. 31, 2007	Oct. 31, 2006	July 31, 2006	Apr. 31, 2006	Jan. 31, 2006	Oct. 31, 2005	July 31, 2005	Apr. 31, 2005
Sales	23,605	23,344	21,657	17,603	18,410	20,819	19,818	14,855
Gross profit	6,300	6,768	4,630	4,288	4,619	5,163	5,656	1,077
Net income (loss)	681	469	(2,143)	100	237	217	1,200	436
Income tax expense (recovery) - current	160	142	195	154	89	(171)	520	55
Income tax expense (recovery) - future	(29)	85	83	183	20	233	(314)	(10)
Income (loss) before taxes	812	696	(1,865)	437	346	279	1,406	481
Depreciation and amortization	504	428	332	290	260	257	229	172
Interest on long-term debt ⁽²⁾	13	11	4	14	16	18	22	23
Interest income	(252)	(258)	(304)	(285)	(86)	(80)	(77)	(45)
Stock-based compensation	106	182	40	19	27	29	30	98
EBITDA ⁽¹⁾	1,183	1,059	(1,793)	475	563	503	1,610	729

(1) EBITDA is defined as earnings from operations before interest, income taxes, depreciation, amortization and share based compensation. The Company reports its results in accordance with Canadian GAAP; however, although this is a non-GAAP measure, the Company presents EBITDA in its filings because it believes its current and potential investors use EBITDA to make investment decisions about the Company. Investors should not consider EBITDA to be an alternative to net income, nor to cash provided by operating activities nor any other indicator of performance or liquidity which has been determined in accordance with Canadian GAAP. The Company's method of calculating EBITDA may differ from the methods used by other companies.

(2) Includes interest on current portion of long-term debt.

Results of Operations – Three months ended January 31, 2007 compared to the three months ended January 31, 2006

Revenues increased 28% in the quarter ended January 31, 2007 to \$23.6 million from \$18.4 million in the same quarter of 2006. Revenues grew \$1.2 million as a result of favorable foreign exchange rates, \$3.7 million as a result of the inclusion of a full quarter of revenue from the MyLenses and AsianZakka businesses that we acquired in the fourth quarter of 2006 and \$1.7 million as a result of an increase in organic sales, offset by a \$1.4 million decrease in bulk sales in 2007.

We shipped 248,489 orders for the first fiscal quarter of 2007, an increase of 66,979 orders or 37% over the first quarter of fiscal 2006. The first quarter orders include 38,706 orders related to businesses acquired in the fourth quarter of 2006. Reorders represented 52% of the orders in the first quarter of 2007 compared to 57% of the orders in the first quarter of fiscal 2006.

Gross margin increased to 27% in the quarter ended January 31, 2007 from 25% in the first quarter of fiscal 2006. The improvement in the first quarter was due primarily to improvements in pricing and product costs, which were partially offset by increases in shipping and packing costs.

Selling, general and administrative expenses (SG&A) increased by \$1.5 million to \$5.8 million in the quarter ended January 31, 2007, as compared with \$4.3 million in the quarter ended January 31, 2006. The increase is a result of the higher employee, marketing and professional costs to support our increase in business and expansion of our global operations.

In the quarter ended January 31, 2007 we recognized foreign currency exchange gains on the translation of our monetary assets of \$0.7 million compared to a gain of \$0.3 million in the same period of the previous year. Our foreign exchange gains are related, almost in their entirety, to the translation of intercompany loans denominated in currencies other than the functional currency. We do not hold any financial instruments for the purposes of hedging exposure to foreign currency or interest rate fluctuations.

Amortization for the quarter ended January 31, 2007 increased by \$0.2 million from the same quarter of the previous year to \$0.5 million. The increase is due to expenditures on leasehold improvements, software development costs and intangible assets related to acquisitions made in the prior year.

Net interest income increased from \$0.1 million in the quarter ended January 31, 2006 to \$0.3 million in the quarter ended January 31, 2007 as we maintained higher cash and cash equivalent balances through out the quarter.

Our tax expense remained constant in the first quarter of 2007 compared to the first quarter of 2006. Our European operations generate taxable income, while in certain other jurisdictions we have incurred losses historically that can be applied against current and future taxable earnings to reduce our tax liability on those earnings. As we are uncertain of realizing the future benefit of those losses and expenditures, we have taken a valuation allowance against all future tax assets.

Liquidity and Capital Resources

At January 31, 2007 we had cash and cash equivalents of \$23.4 million as compared to \$24.2 million at October 31, 2006. Net income for the current quarter, excluding non-cash items, resulted in cash inflows of \$0.6 million compared to \$0.1 million for the same period in the prior year. Working capital requirements resulted in cash inflows of \$0.7 million during the first quarter of fiscal 2007 compared to a cash outflow of \$4.7 million for the same period in prior year.

Cash used in investing activities was \$0.7 million for the first quarter of 2007. During the prior year, the Company initiated a project to expand the capabilities of the websites used to service North America and Asia. Total spending on the project incurred as of January 31, 2007 was \$0.9 million, of which \$0.4 million was incurred in the quarter. Other investments were made primarily related to leasehold improvements. Cash used in investing activities was \$19.3 million for the first quarter of fiscal 2006 of which \$18.7 million relates to the purchase and sale of short term investments.

Cash of \$1.6 million was used in financing activities in the first quarter of the 2007 fiscal year compared to cash of \$21.9 million provided by financing activities in the quarter ended January 31, 2006.

On October 16, 2006, the Toronto Stock Exchange accepted our notice of intention to make a Normal Course Issuer Bid for up to approximately 4.9 million Coastal common shares through the facilities of the exchange. Effective, October 18, 2006, we began purchasing shares of our common shares. Any shares acquired have been and will be purchased at the market price for the common shares at the time of acquisition and will be cancelled. The Normal Course Issuer Bid will terminate on the earlier of the date determined by Coastal and October 17, 2007. During the quarter ended January 31, 2007, 1,458,600 shares were repurchased, for cash of \$1.5 million, of which 365,800 were cancelled in the quarter and 1,135,500 were cancelled in February 2007.

On January 31, 2006, we completed a private placement for the sale of 9,000,000 special warrants, at a price of \$2.50 per special warrant, for net proceeds of \$21.1 million. Each special warrant was exercised to acquire one common share of the Company for no additional consideration.

We believe that available cash, together with cash flow from operating activities will be sufficient to support current operations and organic growth at least through fiscal 2007.

The Company may seek additional sources of funds for accelerated growth, acquisitions of companies or assets or other accretive 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 the Company's planned growth, which could adversely affect the Company's business, financial condition and results of operations.

Critical Accounting Estimates

The Company prepares its financial statements in accordance with Canadian generally accepted accounting principles ("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.

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.

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 \$16.8 million and \$15.5 million at January 31, 2007 and October 31, 2006, respectively.

Allowance for doubtful accounts

The Company offers the "Invoice-Me-Later" option to most of its customers. Under this option, the customer does not have to pay for the order until the goods are received – generally estimated to be 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 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 \$0.7 million and \$0.6 million at January 31, 2007 and October 31, 2006, 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.

Change in Accounting Policies

Effective November 1, 2006, the Company adopted the new accounting standards related to financial instruments and comprehensive income that were issued by the Canadian Institute of Chartered Accountants in 2005. 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:

Financial instruments

All financial assets and liabilities are recorded on the balance sheet. Initial recognition of financial assets and liabilities is at fair value. Subsequent measurement of the financial assets and liabilities is determined as follows:

Cash is measured at fair value, with changes in fair value recorded in net income. The carrying amount approximates fair value.

Cash equivalents and short-term investments are comprised of guaranteed investment certificates. They are classified as held to maturity and reported at amortized cost.

Accounts receivable, classified as loans and receivables, and accounts payable, classified as other financial liabilities, are measured at fair value at inception, which, due to their short-term nature, approximates their amortized cost.

Promissory notes receivable, classified as loans and receivables, are measured at amortized cost, which approximates face value, with interest earned recorded in net income.

Advances to officers classified as loans and receivables, are measured at amortized cost, which approximates face value, with interest earned recorded in net income.

Comprehensive income

Comprehensive income includes net earnings and other comprehensive income. Other comprehensive income refers to changes in the net assets from certain transactions and events, other than transactions with shareholders. These changes are recorded directly as a separate component of shareholders' equity and excluded from net earnings. The Company's other comprehensive income includes the foreign currency translation adjustment for its foreign subsidiaries that do not use the Canadian dollar as their measurement currency.

Common Shares

As at March 9, 2007, we had 73,180,412 common shares and 1,551,772 options outstanding. Of these securities, 4,682,723 common shares and 671,754 options remain in escrow, are subject to a voluntary pooling agreement or have not yet vested as of March 9, 2007.

Earnings per Share Quarterly Information

(in 000's except per share amounts)

Quarter ended (\$000's)	Jan. 31, 2007	Oct. 31, 2006	July 31, 2006	Apr. 31, 2006	Jan. 31, 2006	Oct. 31, 2005	July 31, 2005	Apr. 31, 2005
Net Income (loss)	681	469	(2,143)	100	237	217	1,200	436
Weighted Average # of shares - Basic	74,339	71,250	69,705	63,682	58,035	50,573	50,044	43,123
Weighted Average # of shares - Diluted	74,869	73,882	69,705	65,204	60,265	60,983	60,252	52,959
Basic Earnings (Loss) per share	0.01	0.01	(0.03)	0.00	0.00	0.00	0.02	0.01
Diluted Earnings (Loss) per share	0.01	0.01	(0.03)	0.00	0.00	0.00	0.02	0.01

Related Party Balances

The following amounts were due from related parties:

	Q1 2007 \$000's	Q4 2006 \$000's
Promissory notes receivable	358	376
Advances to officers	248	234
	606	610

The amounts due from related parties on January 31, 2007 include nine promissory notes from employees and officers ranging in value from \$0.01 million to \$0.1 million and advances to officers. The notes and advances are payable on demand. All amounts due from related parties on January 31, 2007 bear interest at 5% per annum.

We did not issue loans to officers and employees in the first quarter of 2007 or the first quarter of 2006. During the first quarter of 2007, we received \$0.02 million in payments on the loans.

During 2006, CMP Medical Inc, a company controlled by an officer of the Company, ceased to operate and as a consequence the loan advanced in 2002 was written off and included in selling, general and administrative expenses.

Contractual Obligations

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

	\$000's
2007	681
2008	859
2009	786
2010	377
Thereafter	105
	2,808

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

Pursuant to the terms of the agreement to acquire the shares of Asianzakka Pte. Ltd., the Company would be required to make contingent payments of \$0.5 million (\$0.8 million Singapore Dollars) and \$0.3 million (\$0.4 million Singapore Dollars) on October 11, 2008 and April 11, 2009 provided that Asianzakka meets specified revenue and net income margin targets in 2007 and 2008. The liability has not been accrued in the financial statements as the amount of the liability cannot be determined at this time.

In the ordinary course of the Company's business, inquiries are made periodically by regulatory authorities and assertions are made. These matters are reviewed by the Company and the Company responds 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

The Company does not have any off balance sheet arrangements as defined by applicable securities regulations in Canada at January 31, 2007 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.

Management assessment of Internal Controls

During the most recent interim quarter ending January 31, 2007, there have not been changes in the design of the Company's internal controls over financial reporting that has materially affected, or is reasonably likely to materially affect, the Company's internal controls over financial reporting.

Additional Information

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