

Management's Discussion and Analysis of Financial Condition and Results of Operations September 6, 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 July 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 "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 of the Company dated January 26, 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. By leveraging the internet, global purchasing and our logistics expertise to sell directly to the consumer, we continue to strengthen our worldwide Lensway, Coastal Contacts, Clearly Contacts, Mylenses and Asian brands.

Our annual 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 \$75.5 million to date in 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.

Results of Operations – three and nine months ended July 31, 2007 compared to the three and nine months ended July 31, 2006

(\$000's)	For the three months ended July 31,		For the nine months ended July 31,	
	2007	2006	2007	2006
Sales	27,310	21,657	75,517	57,670
Gross profit	7,538	4,630	20,463	13,537
Income (loss) before taxes	594	(1,865)	2,077	(1,081)
Net income (loss)	374	(2,143)	1,368	(1,806)
EBITDA ¹	1,087	(1,793)	3,264	(755)

Revenues increased 26% in the third quarter of 2007 to \$27.3 million from \$21.7 million in the same quarter of 2006. Revenues for the quarter grew \$0.1 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, \$1.2 million as a result of an increase in organic sales and \$0.6 million increase in bulk sales. Revenues increased 31% in the nine months ended July 31, 2007 to \$75.5 million from \$57.7 million in the nine months ended July 31, 2006. Revenues for the period grew \$2.3 million as a result of favorable foreign exchange rates, \$11.7 million as a result of the inclusion of revenue from the Mylenses and Asianzakka businesses that we acquired in the fourth quarter of 2006 and \$4.4 million as a result of an increase in organic sales, partially offset by a \$0.6 million decrease in bulk sales in 2007.

We shipped 278,272 orders for the third fiscal quarter of 2007, an increase of 43,595 orders or 19% over the third quarter of fiscal 2006. The third quarter orders include 40,383 orders related to businesses acquired in the fourth quarter of 2006. Reorders represented 60% to 65% of the orders in the third quarter of 2007.

Gross margin increased to 27.6% in the quarter ended July 31, 2007 from 21.4% in the third quarter of fiscal 2006. Gross margin increased to 27.1% in the nine months ended July 31, 2007 from 23.5% in 2006. Improved pricing and product costs across Europe and North America offset the effects of the increase of lower-margin Asian sales as a proportion of total sales, and greater shipping costs resulting from increased shipments to countries with higher postage rates.

¹ EBITDA, reorders and orders shipped are non-GAAP measures that do not have standardized meanings prescribed by Canadian GAAP and are therefore unlikely to be comparable to similar measures presented by other companies. Refer to *Supplemental Non-GAAP Measures*.

Selling, general and administrative expenses ("SG&A") decreased to \$6.3 million in the third fiscal quarter of 2007, as compared with \$6.5 million in last year's third quarter. Overall SG&A spending declined despite increases to support growing operations and sales, as we did not repeat the radio advertising campaigns undertaken in the third quarter of 2006 and we did not incur comparative legal and accounting costs related to uncompleted acquisitions in the third quarter of 2007. SG&A expenses increased to \$17.9 million in the nine months ended July 31, 2007, from \$15.1 million in 2006. Higher employee, marketing and professional costs to support our increase in business and expansion of our global operations exceeded the savings gained by the elimination of radio advertising and legal and accounting costs related to uncompleted acquisitions that had occurred in the third quarter of 2006.

In the quarter ended July 31, 2007 we recognized foreign currency exchange losses on the translation of our monetary assets of \$0.2 million, respectively, compared to gains of \$0.1 million in the same periods of the previous year. In the nine months ended July 31, 2007 we recognized foreign currency exchange gains on the translation of our monetary assets of \$0.7 million, compared to gains of \$0.8 million in the previous year. We operate globally and our financial results are therefore impacted by fluctuations in foreign exchange rates, particularly those with respect to the Swedish Krona, the Japanese Yen, the Euro and the US dollar. A significant portion of our foreign exchange gains and losses are related to the translation of intercompany loans denominated in currencies other than the functional currency. Other sources of foreign exchange gains and losses include cash and working capital. 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 July 31, 2007 increased by \$0.2 million from the same quarter of the previous year to \$0.5 million. Amortization increased to \$1.5 million in the nine months ended July 31, 2007 from \$0.9 million in 2006. The increases are due to expenditures on leasehold improvements, software development costs and intangible assets related to acquisitions made in the prior year.

Net interest income decreased from \$0.3 million in the quarter ended July 31, 2006 to \$0.2 million in the quarter ended July 31, 2007 due to lower average cash and short-term investment balances in the respective quarters. Net interest income remained constant at \$0.6 million in the nine months ended July 31, 2007 and 2006.

Our tax expense, as a percentage of taxable income in the countries in which we generate taxable income, remained constant in the third quarter and the first nine months of 2007 compared to the same periods 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. 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, 2007 we had cash and cash equivalents of \$19.5 million and \$3.9 million in short-term investments, totaling \$23.4 million, as compared to cash and cash equivalents of \$24.3 million and no short-term investments at October 31, 2006.

Cash inflows from operations during the third fiscal quarter of 2007 was \$3.9 million, \$1.4 million of which was from net income excluding non-cash items, and \$2.5 million of which was from reductions in total working capital. This compares to cash outflows from operations of \$1.7 million in the same period last year, of which \$1.8 million was from net income excluding non-cash items, offset by cash inflows of \$0.1 million from working capital. The decrease in our non-cash working capital is primarily due to lower inventory levels and higher accounts payable and accrued liabilities, offset by an increase in accounts receivables resulting from the increase in sales during the period.

Cash inflow from operations for the first nine months of 2007 was \$3.7 million, \$2.6 million of which was from net income excluding non-cash items, and \$1.1 million of which was from reductions in working capital. For the same period in 2006, we had cash outflows from operations of \$5.2 million, of which \$1.4 million was from net income excluding non-cash items and working capital increases resulted in cash outflows of \$3.8 million. The decrease in our non-cash working capital is primarily due to lower inventory levels, offset by a decrease in accounts payable and accrued liabilities. Cash flow from changes in non-cash working capital can fluctuate from quarter to quarter in the ordinary course of business with the timing of receipts and payments from customers and suppliers.

Cash used in investing activities was \$0.5 million for the third quarter and \$5.5 million for the first nine months of 2007, of which \$3.9 million relates to the purchase of short-term investments during the second quarter. 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 July 31, 2007 was \$1.4 million, of which \$0.3 million was incurred in the quarter. Cash provided by investing activities was \$8.3 million for the third quarter of fiscal 2006, of which \$9.1 million relates to the sale of short-term investments. Cash used in investing activities was \$11.4 million in the first nine months of 2006, of which \$9.0 million relates to the purchase and sale of short-term investments.

Cash of \$0.5 million was used in financing activities in the third quarter of the 2007 fiscal year compared to cash of \$1.1 million provided by financing activities in the quarter ended July 31, 2006. For the nine months ended July 31, 2007, cash of \$2.6 million was used in financing activities, compared to \$23.9 million of cash provided in the same period of 2006.

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. Effective, October 18, 2006, we began buying back our common shares. Any shares we acquired were and any shares we will acquire will be purchased at the market price for the common shares at the time of acquisition and cancelled after purchase. The NCIB will terminate on the earlier of the date we determine or October 17, 2007. As at July 31, 2007, 2,625,400 shares were repurchased, for cash of \$2.6 million, of which 2,202,200 shares have been cancelled during the nine months ended July 31, 2007 and 423,200 shares were cancelled in August, 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 through fiscal 2008.

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 consolidated financial statements in accordance with Canadian 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 \$15.6 million and \$15.5 million at July 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 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 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 July 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 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 September 6, 2007, we had 72,056,312 common shares and 2,367,172 options outstanding. Of these securities, 2,037,450 common shares are subject to voluntary pooling agreements and 1,307,602 options have not yet vested as of September 6, 2007.

Quarterly Financial Information

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

Quarter ended	July 31, 2007	Apr. 30, 2007	Jan. 31, 2007	Oct. 31, 2006	July 31, 2006	Apr. 30, 2006	Jan. 31, 2006	Oct. 31, 2005
Sales	27,310	24,602	23,605	23,344	21,657	17,603	18,410	20,819
Net Income (loss)	374	313	681	469	(2,143)	100	237	217
Weighted Average # of shares - Basic	72,454	72,974	74,339	71,250	69,705	63,682	58,035	50,573
Weighted Average # of shares - Diluted	73,031	73,457	74,869	73,882	69,705	65,204	60,265	60,983
Basic Earnings (Loss) per share	0.01	0.00	0.01	0.01	(0.03)	0.00	0.00	0.00
Diluted Earnings (Loss) per share	0.01	0.00	0.01	0.01	(0.03)	0.00	0.00	0.00

Related Party Balances

The following amounts were due from related parties:

	July 31, 2007 \$000's	October 31, 2006 \$000's
Promissory notes receivable	342	376
Advances to officers	286	234
	628	610

The amounts due from related parties on July 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. These notes and advances are payable on demand and bear interest at 5% per annum.

We did not issue any loans to officers and employees in the first nine months of 2007. Promissory notes of \$0.1 million were issued in the third quarter of 2006. During the first nine months of 2007 we received \$0.06 million in payments towards the promissory notes receivable.

Contractual Obligations

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

	\$000's
2007	328
2008	1,041
2009	980
2010	546
Thereafter	166
	<hr/> 3,061 <hr/>

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 January 31, 2008 and July 31, 2008, respectively 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 July 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.

Subsequent event

On September 6, 2007, the Company received a petition filed by the College of Opticians of British Columbia (the "Opticians") in the Supreme Court of British Columbia. The Opticians seek an order to restrict Coastal Contacts from selling contact lenses to members of the public in British Columbia. Management of the Company believes the petition is without merit, and intends to vigorously defend against these actions.

Management Assessment of Internal Controls

During the most recent interim quarter ending July 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.

Supplemental Non-GAAP Measures

The Company reports its results in accordance with Canadian GAAP; however, the Company presents EBITDA and the number of orders shipped in its filings because it believes its investors use these figures to make investment decisions about the Company.

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. 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.

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

The following table shows a reconciliation of net income to EBITDA:

(\$000's)	For the three months ended July 31,		For the nine months ended July 31,	
	2007	2006	2007	2006
Net income (loss)	374	(2,143)	1,368	(1,806)
Amortization	537	332	1,498	882
Interest income, net	(176)	(300)	(626)	(642)
Income tax expense - current	268	195	813	438
Income tax expense (recovery) - future	(48)	83	(104)	287
Share-based compensation	132	40	315	86
EBITDA	1,087	(1,793)	3,264	(755)

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.