

**MANAGEMENT'S DISCUSSION AND ANALYSIS
OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

The following management's discussion and analysis should be read in conjunction with the company's audited financial statements for the year ended October 31, 2003 and its Prospectus dated March 18, 2004. Coastal Contacts Inc. (the "Company") prepares its financial statements in accordance with Canadian GAAP. This discussion of our business may include forward looking statements about our future operations, financial results and objectives. These statements are necessarily based on estimates and assumptions that are subject to risks and uncertainties. Our actual results could differ materially from those expressed or implied by such forward looking information due to a variety of factors including, but not limited to, our ability to implement our business strategies, competition, general economic conditions, currency fluctuations, and other risks detailed in our filings with the Canadian securities regulatory authorities.

Overview

The Company is a direct marketer of replacement contact lenses. The Company was incorporated pursuant to the provisions of the *Canada Business Corporations Act* on December 14, 2000. Since its formation, the Company has experienced significant growth. Coastal Contacts' revenue has grown from \$2.5 million in 2001 to \$8.9 million in 2002, an increase of 256%, and to \$20.2 million in 2003, an increase of 127%.

On July 26, 2004, the Company acquired 100% of the issued and outstanding shares of Lensway AB. Lensway is leading European direct marketer of replacement contact lenses. Lensway has demonstrated consistent growth since its inception in 2000 and provides the Company with access to the European contact lens market. Europe currently accounts for 27% of the world's \$5 billion market for contact lenses.

Results of Operations

Quarter Ended July 31, 2004

Net sales for the third quarter ended July 31, 2004 were \$6,992,208, an increase of \$1,149,732 or 19.68% over the previous quarter. Total order volume shipped for the third quarter 2004 was 67,787 orders, an increase of 12,408 or 22.41% over the previous quarter. The number of orders shipped to new customers during the third quarter ended July 31, 2004 was 46,997, an increase of 6,997 orders or 16.48% over the previous quarter. Repeat orders from existing customers were 20,790, an increase of 5,759, or approximately 38.31% over the preceding quarter. Orders shipped to returning customers year to date to July 31, 2004 are 53,126, an increase of 25,423 or 91.76% over the same period ending July 31, 2003.

Gross profit for the third quarter ended July 31, 2004 was \$1,323,173, an increase of \$642,467 or 94.3% over the previous quarter, net of reclassification. The company calculates gross profit by including the cost of purchases, freight, credit card charges, non management labor and bags and packaging as its cost of goods.

Selling, General and Administrative expenses for the quarter ended July 31, 2004 were \$1,469,254. Selling, general and administrative expenses remained consistent at 21% of net sales for the quarter ended July 31, 2004 compared to the preceding quarter.

Net loss for the second quarter of 2004 was \$176,540 or .01 per share. This compares to a loss of \$590,722 in the preceding quarter. The company continued to incur a slight loss for the reasons outlined below.

The Company had reached a definitive agreement to purchase an on-line retailer in Europe prior to the end of the second quarter. The third quarter saw increased expenditures relating to this purchase, with the acquisition being completed on July 26, 2004.

In February, 2004, the Fairness to Contact Lens Consumer Act was implemented in the United States. Since the law went into effect, the company has had to cancel a significant number of orders in accordance with the passive verification requirement laid out in the legislation. While the cancellation rate has decreased in the quarter ended July 31, 2004 versus the preceding quarter, the company continues to work to find means within the Act to reduce this cancellation rate. The Company believes that the Fairness to Contact Lens Consumer Act will have the designed affect of increasing customers' choice in the market. The law requires that all eye care practioners provide their customers with a copy of their prescription after a contact lens fitting. With this information, the customer is in a more informed position and can include other value propositions such as price and convenience in their purchase decision. The on-line retailer segment of the market offers consumers an attractive alternative through significantly reduced pricing, much greater stock selection, and home delivery.

Liquidity and Capital Resources

The Company has historically funded its growth through a combination of funds generated from operations and borrowings. Working capital requirements generally precede the realization of sales on a monthly basis. The Company uses funds generated from operations and borrowings to increase inventory levels in anticipation of future sales realization. The Company's supply arrangements have historically required the Company to pay cash upon delivery of inventory. As a result, the Company is generally unable to rely on standard trade credit arrangements in purchasing its inventory, which would ordinarily permit the net amount due to be paid within 30 days of shipment of ordered merchandise. In addition, in order to help ensure sufficient supply, the Company generally carried a higher level of inventory than if it were able to purchase directly from contact lens manufacturers. On May 2, 2004, the Company signed an agreement with Johnson and Johnson Eye care division, allowing the company to obtain credit terms and operate its inventory in a more efficient manner. Since signing the agreement, the Company will be able to reduce its inventory levels of Johnson and Johnson product.

Net cash provided by operating activities was \$ 481,431 in Quarter 3 of 2004.

Net cash used in investing activities, principally related to the acquisition of Lensway was \$ 1,420,697 in Quarter 3 of 2004.

Net cash provided by financing activities for Quarter 3 of 2004 was \$ 1,478,939.

Between November 1, 2003 and December 15, 2003 the Company issued 710,000 common shares to non-related parties of the Company. 360,000 of the shares were issued for cash of \$315,000. The remaining 350,000 shares were issued in exchange for accounts payable. On December 23, 2003, the Company underwent a share subdivision issuing two new commons shares for every one issued and outstanding common share.

On March 29, 2004, the company undertook and Initial Public Offering (IPO), issuing 6,000,000 common shares for proceeds of \$6,000,000. There were a further 375,000 units consisting of shares and warrants issued to the underwriter as part of the underwriting fees. Share issue costs related to this financing amounted to \$872,605, which has been netted against the proceeds.

On April 7, 2004, certain insiders of the Company exercised options for 164,000 shares, for proceeds of \$820.

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 \$47,820 respectively.

On July 22, 2004, the Company undertook a Private Placement issuing 2,500,000 units for proceeds of \$2,000,000. Each unit is comprised of one common share and 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, with each unit comprising one common share and one purchase warrant, issued to the underwriter as part of the underwriting fees. 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 Options exercisable at \$0.80 for a period of 2 years. Issue costs of \$337,442 have been netted against the proceeds.

The Company believes that its available cash after this Offering, together with cash flow from operations, will be sufficient to support current operations and future growth at least through fiscal 2005. The Company may be required to seek additional sources of funds for accelerated growth or continued growth after that point, 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.

Contractual Obligations	Total	Less than 1 year	1 – 3 years	4 to 5 years
Long Term Debt	\$1,215,899	\$651,799	\$564,100	\$0

Accounting Policies

Stock Based Compensation:

Effective November 1, 2003, the Company adopted the recommendations of the Canadian Institute of Chartered Accountants ("CICA") Handbook Section 3870, Stock Based Compensation and other Stock Based which require prospective application to all stock options granted on or after the date of adoption. Under this standard, fair value accounting is required for all stock options granted. Previously, stock options were not recognized in the financial statements.

Earnings per Share

Effective November 1, 2003, the Company 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 net 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 net 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 are dilutive when the company has income from continuing operations and the average market price of the common shares during the period exceed the exercise price of the options.

Lensway Acquisition

On July 26, 2004, the Company completed the acquisition of all of the shares of Lensway AB (Lensway). The consideration paid included \$5,655,000 in cash and 13,195,000 restricted 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 until 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 stock 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 definitive agreement to acquire Lensway (June 24, 2004). This average price was then reduced by a 36% 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. The overall purchase price allocation set out below is preliminary and will be finalized in the fourth quarter of 2004. The final allocations may differ materially from the preliminary allocations presented below.

Cash	\$5,655,000
Restricted shares	\$6,531,525
Direct acquisition costs	\$797,840
Total consideration	\$12,984,365
Cash	\$471,435
Other current assets	\$3,096,225
Property and equipment	\$367,133
Intangible assets	\$2,431,450
Current liabilities	(\$1,118,016)
Long-term debt	(\$769,999)
Future income taxes	(\$718,000)
Net assets acquired	\$3,760,228
Goodwill	\$9,224,137

Goodwill represents the shares and cash paid to Lensway (purchase price) less the net assets of Lensway and the value attributed to the Lensway name and Lensway customer list. The goodwill resulting from the purchase of Lensway has an indefinite life and will not be amortized. Goodwill will be reviewed for possible impairment at least annually or more frequently upon the occurrence of an event or when circumstances indicate.

The unaudited pro forma information below sets forth summary results of operations as if the acquisitions of Lensway (acquired July 26, 2004) 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 9 months ended July 31, 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.

	Nine Months Ended July 31, 2004	Year Ended Oct. 31, 2003
	\$	\$
Net sales	28,907,927	27,517,335
Net loss	(298,341)	(562,778)
Basic and diluted (loss) earnings per share	(.01)	(0.03)
Basic and diluted weighted average number of common shares outstanding	21,235,996	21,235,996