

Consolidated Financial Statements

Coastal Contacts Inc.

October 31, 2005 and 2004

Coastal Contacts Inc.

CONSOLIDATED BALANCE SHEETS

As at October 31

	2005	2004
	\$	\$
ASSETS [note 8]		
Current		
Cash	2,985,600	843,681
Short-term investments [note 2]	10,624,139	776,675
Accounts receivable [note 3]	4,809,216	3,043,140
Income taxes receivable	3,598	3,598
Inventory	7,020,637	3,997,434
Prepaid expenses	949,662	234,963
Due from related parties [note 13]	322,250	194,856
	26,715,102	9,094,347
Long-term receivable	—	13,713
Property, equipment and leasehold improvements [note 6]	1,446,029	841,506
Intangible assets [note 7]	5,466,712	5,041,909
Goodwill [notes 4 and 5]	5,479,147	6,137,943
	39,106,990	21,129,418
LIABILITIES AND SHAREHOLDER'S EQUITY		
Current		
Bank indebtedness	328,157	683,863
Accounts payable and accrued liabilities [note 3]	10,259,818	5,215,624
Income taxes payable	308,447	99,552
Deferred revenue	77,502	307,067
Due to related parties [note 13]	—	38,733
Current portion of lease inducement	24,337	24,337
Current portion of long-term debt [note 8]	379,257	610,408
	11,377,518	6,979,584
Long-term lease inducement	114,177	133,853
Long-term debt [note 8]	—	409,242
Future income tax liability [note 12]	1,646,676	1,415,911
	13,138,371	8,938,590
Commitments [note 15]		
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:		
51,632,951 common shares [2004 - 33,874,860]	26,263,656	11,569,500
Shares to be issued [note 9]	—	1,762,560
Contributed surplus [note 10]	593,083	105,898
Cumulative foreign currency translation adjustment	(1,808,808)	(71,745)
Retained earnings (deficit)	920,688	(1,175,385)
	25,968,619	12,190,828
	39,106,990	21,129,418

See accompanying notes

On behalf of the Board:

Director

Director

Coastal Contacts Inc.**CONSOLIDATED STATEMENTS OF INCOME (LOSS)
AND RETAINED EARNINGS (DEFICIT)**

Years ended October 31

	2005	2004
	\$	\$
Sales	67,527,885	31,246,283
Cost of sales	49,663,779	25,536,880
Gross profit	17,864,106	5,709,403
Selling, general and administration expenses	14,486,606	5,934,077
Stock-based compensation	175,632	105,898
Amortization	832,831	195,323
Interest on long-term debt	99,001	87,673
Interest income	(206,930)	(14,626)
Income (loss) before income taxes	2,476,966	(598,942)
Income tax expense (recovery) - current <i>[note 12]</i>	474,596	(21,347)
Income tax recovery - future <i>[note 12]</i>	(93,703)	(38,045)
Net income (loss)	2,096,073	(539,550)
Deficit, beginning of year	(1,175,385)	(635,835)
Retained earnings (deficit), end of year	920,688	(1,175,385)
Basic earnings (loss) per share	0.05	(.03)
Diluted earnings (loss) per share	0.04	(.03)
Weighted average number of commons shares outstanding - basic	44,887,816	21,218,334
Weighted average number of common shares outstanding - diluted	54,665,591	21,218,334

See accompanying notes

Coastal Contacts Inc.

CONSOLIDATED STATEMENTS OF CASH FLOWS

Years ended October 31

	2005 \$	2004 \$
OPERATING ACTIVITIES		
Net income (loss)	2,096,073	(539,550)
Non-cash items:		
Amortization	832,831	195,323
Amortization of deferred lease inducement	(19,676)	—
Accrued interest	(189,333)	(7,446)
Stock-based compensation	175,632	105,898
Shares issued for goods and services	—	350,000
Loss on disposal of short-term investment	—	67,844
Future income taxes	(222,679)	(38,045)
Changes in non-cash working capital:		
Accounts receivable	(2,056,153)	(1,016,847)
Inventory	(3,285,210)	(1,309,389)
Prepaid expenses	(775,936)	(6,775)
Accounts payable and accrued liabilities	5,466,888	2,422,234
Income taxes payable	566,208	(15,620)
Deferred revenue	(259,837)	307,067
Due from related parties	(45,729)	30,169
Lease inducements	—	158,190
Cash provided by operating activities	2,283,079	703,053
INVESTING ACTIVITIES		
Purchase of short-term investments	(10,168,251)	(4,909,519)
Sale of short-term investments	448,664	4,332,157
Business acquisition, net of cash acquired	(955,369)	(5,878,869)
Acquisition of property, equipment and leasehold improvements	(773,569)	(478,956)
Advances to related parties	(168,970)	(156,912)
Acquisition of intangible assets	(573,672)	(111,910)
Cash used in investing activities	(12,191,167)	(7,204,009)
FINANCING ACTIVITIES		
Issuance of share capital	14,138,984	6,515,107
Proceeds received for shares to be issued	—	2,000,000
Bank indebtedness	(355,706)	146,354
Loan payments	(606,662)	(300,302)
Share issue costs	(931,903)	(1,110,045)
Cash provided by financing activities	12,244,713	7,251,114
Effect of exchange rate changes on cash	(194,706)	(7,891)
Increase in cash	2,141,919	742,267
Cash, beginning of year	843,681	101,414
Cash, end of year	2,985,600	843,681
Income taxes paid (recovered) in cash	11,315	(15,943)
Interest paid in cash	99,001	87,216

See accompanying notes

Coastal Contacts Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

October 31, 2005 and 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 subsidiaries. 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, 2005 and 2004

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

Translation of accounts of foreign subsidiaries

Foreign subsidiaries are classified as a self-sustaining foreign operations 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. The Company has a restriction of \$187,000 (1,265,000 Swedish Krona) against its short term investments. This restriction is required by the Norwegian government as security against Value added tax payments.

Inventory

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

Coastal Contacts Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

October 31, 2005 and 2004

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

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

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
Customer lists	5 years straight-line basis

The Company intends to keep the Lensway and Yourlenses names and brands intact. All future sales and marketing efforts in Europe will be conducted using these names. As a result, trade names are considered to have an indefinite life and will not be amortized. Their values will be reviewed for possible impairments annually or more frequently if events or changes in circumstances indicate possible impairment, based on the profitability and cash flows of Lensway and Yourlenses. Based on this testing the Company has determined that no impairment charge is required as at October 31, 2005.

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 the Swedish reporting unit. Based on this testing, the Company has determined that no goodwill impairment charge is required as at October 31, 2005.

Coastal Contacts Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

October 31, 2005 and 2004

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

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.

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 consolidated 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.

Coastal Contacts Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

October 31, 2005 and 2004

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

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.

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.

3. ACCOUNTS RECEIVABLE, ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

Accounts receivable

	2005	2004
	\$	\$
Accounts receivable	4,104,580	2,469,536
Allowance for doubtful accounts	(259,980)	(598,161)
Value added tax receivable	964,616	1,171,765
	<u>4,809,216</u>	<u>3,043,140</u>

Coastal Contacts Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

October 31, 2005 and 2004

3. ACCOUNTS RECEIVABLE, ACCOUNTS PAYABLE AND ACCRUED LIABILITIES (cont'd.)

Accounts payable and accrued liabilities

	2005 \$	2004 \$
Accounts payable - trade	8,902,550	3,948,782
Accrued liabilities	1,095,294	1,019,471
Value added tax payable	261,974	247,371
	10,259,818	5,215,624

4. ACQUISITION OF LENSWAY

On July 26, 2004, the Company completed the acquisition of all of the shares of Lensway AB, ("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.

Coastal Contacts Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

October 31, 2005 and 2004

4. ACQUISITION OF LENSWAY (cont'd.)

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

Goodwill is not deductible for income tax purposes.

The results of operations of Lensway have been included in the accompanying consolidated 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.

Coastal Contacts Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

October 31, 2005 and 2004

5. ACQUISITION OF YOURLENSES

On May 4, 2005 through the Company's wholly owned subsidiary, Lensway, the Company completed the acquisition of all of the shares of Yourlenses Scandinavia AB, ("Yourlenses"), a European retailer of contact lenses. The consideration paid consisted of cash of \$949,032 (5,380,000 Swedish Krona) and the assumption of debt in the amount of \$156,167, with fifty percent of the cash paid upon signing on May 4, 2005 and the remaining fifty percent held in escrow, payable eighteen months from such 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

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

	\$
Cash	949,032
Direct acquisition costs	111,193
Total consideration	1,060,225
Cash	33,988
Other current assets	240,942
Property and equipment	5,865
Yourlenses customer list	735,000
Yourlenses trade name	514,500
Website development	134,750
Current liabilities	(313,440)
Long-term debt	(85,361)
Future income tax liability	(387,590)
Net assets acquired	878,654
Goodwill	181,571

Goodwill has been allocated to the Swedish reporting unit and is not deductible for income tax purposes.

The results of operations have been included in the accompanying consolidated financial statements since May 4, 2005.

Coastal Contacts Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

October 31, 2005 and 2004

6. PROPERTY, EQUIPMENT AND LEASEHOLD IMPROVEMENTS

	Cost	Accumulated	Net Book
	\$	Amortization	Value
		\$	\$
2005			
Leasehold improvements	465,094	70,667	394,427
Computer hardware	500,506	120,134	380,372
Computer software	564,037	113,161	450,876
Furniture and fixtures	292,488	72,134	220,354
	1,822,125	376,096	1,446,029
2004			
Leasehold improvements	355,314	—	355,314
Computer hardware	196,466	38,526	157,940
Computer software	234,933	70,104	164,829
Furniture and fixtures	199,404	35,981	163,423
	986,117	144,611	841,506

Coastal Contacts Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

October 31, 2005 and 2004

7. INTANGIBLE ASSETS

	Cost	Accumulated	Net Book
	\$	Amortization	Value
		\$	\$
2005			
Website creation	800,167	119,954	680,213
Lensway name	2,439,537	—	2,439,537
Yourlenses name	432,833	—	432,833
Lensway customer list	1,785,027	501,557	1,283,470
Yourlenses customer list	618,333	63,812	554,521
Pharmalens agreements	76,138	—	76,138
	6,152,035	685,323	5,466,712
2004			
Website creation	303,050	59,021	244,029
Lensway name	2,830,783	—	2,830,783
Yourlenses name	—	—	—
Lensway customer list	2,071,306	104,209	1,967,097
Yourlenses customer list	—	—	—
Pharmalens agreements	—	—	—
	5,205,139	163,230	5,041,909

Coastal Contacts Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

October 31, 2005 and 2004

8. LONG-TERM DEBT

	2005	2004
	\$	\$
Vancity Capital		
Loan #1: Repayable in monthly instalments of \$7,381, blended principal and interest at prime (4.25%) plus 10.5%. The loan matured on March 15, 2005.	—	35,776
Loan #2: Repayable in monthly instalments of \$8,378, blended principal and interest at 13%. The loan matures on March 15, 2006.	170,690	232,759
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.	68,412	127,560
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.	140,155	623,555
	379,257	1,019,650
Less current portion	379,257	610,408
	—	409,242

All of the Vancity Capital loans are collateralized by a general security agreement over all the assets of the Company and certain personal guarantees by shareholders. These Vancity Capital 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.

Coastal Contacts Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

October 31, 2005 and 2004

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

Anticipated requirements to meet long term debt principal repayments over the next year from November 1, 2005 are as follows:

	\$
<hr/>	
2005	379,257
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Under terms of the banks loan facilities with Vancity 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, 2005, the Company had exceeded the covenant restricting annual capital expenditures to less than \$100,000 per annum. While the Company has obtained waivers from the lender in regards the above covenant restrictions for the first three quarters of the fiscal year, as at October 31, 2005, the Company has not obtained a waiver from the lender for the fourth quarter as all of the Company's loans are due and payable in the upcoming fiscal year and are already classified as current liabilities.

Coastal Contacts Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

October 31, 2005 and 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.

	2005		2004	
	Number of Common Shares #	\$	Number of Common Shares #	\$
Balance - beginning of period	33,874,860	11,569,500	12,280,000	77,000
Issued in private placement	2,500,000	1,762,560	—	—
Issued in private placement	11,200,000	10,901,871	620,000	310,000
Issued on exercise of warrants	1,646,775	1,903,516	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	2,371,166	86,059	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
Issued to Marlin Financial Group Inc.	40,150	40,150	—	—
Balance - end of period	51,632,951	26,263,656	33,874,860	11,569,500

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, 2005 and 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 costs 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 4].

On February 22, 2005, the Company, through its newly incorporated subsidiary Coastal Pharma Lens Inc. entered into a purchase and sale agreement with Marlin Financial Group Inc. The Company acquired the Pharma Lens trademark application, the Distributorship Pilot Agreement between Ahold USA Inc. and Marlin Financial Group Inc. and the supply contract between Ralphs Grocery Company and Marlin Financial Group Inc. for 40,150 shares valued at \$1.00 per share and cash of \$14,850. The shares are subject to a voluntary pooling agreement of three years with tranches released at six month intervals.

On March 1, 2005, 198,840 options were issued to employees of Lensway AB at \$1.00. These options vest evenly over three years, beginning on March 31, 2005.

On March 1, 2005, 54,000 options were issued to directors of the Company. These options are exercisable at \$1.00 per share. 30,000 of these options vest on February 18, 2005 while the remaining options vest on February 18, 2006.

On March 10, 2005, the Company undertook a private placement issuing 11,200,000 shares at \$1.10 per share. The underwriters received a commission of 6.5% of gross proceeds and "Compensation Warrants" of 9.5% of the total number of shares sold. These warrants are exercisable at \$1.10 per warrant and are exercisable for up to 18 months after closing. Net proceeds were \$11,380,671 after underwriters commission and other share issue costs. In addition, the "Compensation Warrants" have been valued at \$478,800 and offset against the proceeds with a corresponding increase in contributed surplus.

Coastal Contacts Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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9. SHARE CAPITAL (cont'd.)

Between February 4 and April 26, 2005, 11,500 and 304,147 agents warrants were exercised at \$0.80 and \$1.00 respectively for proceeds of \$311,796.

Between February 16 and April 26, 2005, 18,750 agents warrants and 1,900,000 options were exercised for proceeds of \$48,574.

Between May 1 and July 31, 2005, 91,629 agents warrants and 167,444 options were exercised for proceeds of \$89,680 and \$7,015 respectively.

Between August 1 and October 31, 2005, 1,239,499 agents warrants and 284,972 options were exercised for proceeds of \$1,502,040 and \$30,470 respectively.

[b] Stock options

The shareholders of the Corporation have adopted a stock option plan (the "Option Plan") for its directors, officers and employees. The Option Plan provides that options to purchase common shares may be granted to eligible persons on terms determined within the limitations set out in the Option Plan. The maximum number of common shares to be reserved for issuance anytime under the Option Plan and any other employee incentive plan is 10% of the issued and outstanding common shares. The exercise price for an option granted under the Option Plan may not be less than that permitted by applicable regulatory authorities. Options granted may be subject to vesting requirements. Non-assignable options will be granted for a period which may not exceed five years from the date of the grant and will expire within 90 days upon the participant ceasing to be a director or an employee of the Company. The Option Plan is administered by the Company's Compensation and Corporate Governance Committee. The Option Plan is subject to the rules and policies of the TSX Venture Exchange.

The following table contains information with respect to stock options:

	#	\$
Options outstanding, October 31, 2003	11,134,700	.005 - .275
Granted	432,501	.005 - 1.00
Exercised	(264,960)	.005 - .125
Options outstanding, October 31, 2004	11,302,241	.005 - 1.00
Granted	252,840	1.00
Exercised	(2,371,166)	.005 - 1.00
Options outstanding, October 31, 2005	9,183,915	.005 - 1.00

Coastal Contacts Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

October 31, 2005 and 2004

9. SHARE CAPITAL (cont'd.)

The following table summarizes information about share options outstanding as at October 31, 2005:

Options Outstanding			Options Exercisable	
Shares #	Weighted Average Contractual Life	Exercise Price \$	Shares #	Exercise Price \$
7,237,500	4.08	.005	7,237,500	.005
1,125,240	3.60	.125	1,125,240	.125
295,500	2.62	.175	295,500	.175
66,000	2.25	.275	66,000	.275
459,675	4.93	1.00	146,781	1.00
9,183,915	3.50	0.08	8,871,021	0.04

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 \$1.00 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 \$53,142 has been recognized as expense in the year ended October 31, 2005, with \$12,733 to be recognized in 2006 and \$3,875 in 2007.

On March 1, 2005, 198,840 options were issued to employees of Lensway. These options are exercisable at \$1.00 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 \$143,165. Compensation of \$90,990 has been recognized as expense in the year ended October 31, 2005, with \$23,644 to be recognized in 2006, \$23,861 in 2007 and \$5,302 in 2008.

On March 1, 2005, 54,000 options were issued to directors of the Company. These options are exercisable at \$1.00 per share. 30,000 of these options vested on February 18, 2005 while the remaining options vest on February 18, 2006. Using the Black-Scholes option-pricing model, the Company estimates the fair value of this option grant to be \$38,880. Compensation of \$31,500 has been recognized as expense in the year ended October 31, 2005 with \$7,380 to be recognized in 2006.

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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:

	2005	2004
Dividend yield	0%	0%
Expected volatility	70%	70%
Risk free interest rate	3.10%	3.24%
Expected lives	3 years	3 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)	0.05
Warrants outstanding, October 31, 2004	3,871,490	0.80 - 1.50
Granted	1,064,000	1.10
Exercised	(1,646,775)	0.80 - 1.50
Warrants outstanding, October 31, 2005	3,288,715	0.80 - 1.50

The following table summarizes information about warrants outstanding as at October 31, 2005:

Warrants Outstanding			Warrants Exercisable	
Shares #	Average Life	Weighted Average Price \$	Shares #	Weighted Average Price \$
203,747	2.0	0.80	203,747	0.80
2,174,677	2.0	1.00	2,174,677	1.00
720,805	1.5	1.10	720,805	1.10
189,486	2.0	1.50	189,486	1.50
3,288,715	1.875	1.04	3,288,715	1.04

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10. CONTRIBUTED SURPLUS

	2005	2004
	\$	\$
Balance - beginning of period	105,898	—
Stock-based compensation	175,632	105,898
Compensation warrants	478,800	—
Reclassification to share capital on exercise of warrants	(167,247)	—
Balance - end of period	593,083	105,898

11. EARNINGS PER SHARE

	2005	2004
	\$	\$
Weighted average number of common shares outstanding - basic	44,887,816	21,218,334
Stock options	8,720,949	—
Warrants	1,056,827	—
Weighted average number of common shares outstanding - diluted	54,665,592	21,218,334

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12. 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:

	2005	2004
	\$	\$
Future tax assets		
Non-capital loss carryforwards	194,376	402,416
Net book value of capital assets in excess of tax value	(139,617)	(37,700)
Deferred income recognized for tax purposes	47,260	56,347
Share issue costs	708,430	451,675
Other	(1,000)	630
Total future tax assets	809,449	873,368
Valuation allowance	(809,449)	(873,368)
Total future tax assets	—	—
Future tax liabilities		
Foreign income tax reserves	260,680	39,266
Carrying value of intangible assets in excess of tax basis	1,385,996	1,376,645
	1,646,676	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, 2005 and 2004.

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

	2005	2004
	\$	\$
Current income tax expense (recovery)	474,596	(21,347)
Future income tax recovery relating to the utilization of Previously unrecognized losses	(168,941)	—
Future income tax recovery relating to reversal of taxable temporary differences	(140,977)	(30,929)
Future income tax recovery relating to foreign tax reserves	216,215	(7,116)
	<u>380,893</u>	<u>(59,392)</u>

The reconciliation of income taxes attributable to continuing operations computed at the statutory income tax rates to income tax expense, at the statutory tax rate of 35.12% [2004 - 35.95%] is as follows:

	2005	2004
	\$	\$
Income tax expense (recovery) at statutory tax rates	869,910	(215,319)
Expenses not deductible for income tax purposes	60,736	47,862
Financing costs deductible for income tax purposes	(210,421)	(113,965)
Non-capital losses generated	—	186,061
Non-capital losses utilized	(179,187)	—
Recognition of deferred income for accounting purposes	(6,910)	—
Amortization in excess of capital cost allowance for tax	(39,721)	19,722
Foreign tax rate differential	(113,514)	16,247
	<u>380,893</u>	<u>(59,392)</u>

As at October 31, 2005, the Company has non-capital loss carryforwards of \$570,000 for Canadian income tax purposes that expire as follows:

	\$
2010	134,000
2011	436,000
	<u>570,000</u>

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13. RELATED PARTY TRANSACTIONS

Due from related parties

	2005	2004
	\$	\$
Promissory notes receivable	115,000	115,000
Advances to officers	167,559	40,165
CMP Medical Inc.	39,691	39,691
	322,250	194,856

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 \$167,559. 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

	2005	2004
	\$	\$
Advances from officers	—	38,733

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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14. 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 \$	Sweden \$	Norway \$	Other \$	Intercompany Eliminations \$	Total \$
2005						
Sales	29,411,272	19,198,996	9,108,434	11,425,166	(1,615,983)	67,527,885
Property, equipment and leasehold improvements	742,251	703,778	—	—	—	1,466,029
Goodwill	—	5,479,147	—	—	—	5,479,147
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

15. COMMITMENTS

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

	\$
2006	239,511
2007	433,810
2008	589,439
2009	679,499
2010	245,585
2011 and thereafter	52,000
	<u>2,239,844</u>

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16. SUBSEQUENT EVENTS

Option exercises

On November 21, 2005 and on January 1, 2006, officers, directors and certain other parties whose securities are subject to escrow under terms of the Company's initial public offering, exercised 8,173,740 options for proceeds of \$117,868. Of the options converted into shares 4,558,115 are still subject to escrow and are releasable in equal amounts semiannually on March 31 and September 30 until March 31, 2007.

Private placement

On January 18, 2006, the Company reached an agreement to sell, on a bought deal underwritten basis, 8,000,000 special warrants by way of private placement, at a price of \$2.50 per special warrant, for gross proceeds of \$20.0 million. On January 19, 2006, the underwriters for the bought deal financing exercised their option to acquire the additional 1.0 million special warrants for additional gross proceeds of \$2.5 million. The Company has agreed to pay to the underwriters a commission equal to 6% of the gross proceeds from the sale of the special warrants. The Company has also agreed to pay up to \$30,000 for expenses and fees related to the offering.

Closing of the offering is anticipated to occur on or about January 31, 2006 and is subject to receipt of applicable regulatory approval including approval of the TSX Venture Exchange. The special warrants and common shares issuable upon exercise of the special warrants are subject to resale restrictions for a period of four months from the closing date.

Each special warrant is exercisable to acquire one common share of the Company for no additional consideration. The special warrants shall be exercisable by the holders thereof at any time and will be automatically exercised on the earlier of the following dates: (i) the fifth business day after a receipt is issued by the last of the securities regulatory authorities in each of the jurisdictions in Canada in which purchasers of the special warrants are resident for a final prospectus qualifying the common shares to be issued upon the exercise of the special warrants; and (ii) the date which is four months and one day after the closing date.

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17. COMPARATIVE FIGURES

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