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EMERGING VISION INC
Form 10-Q
May 15, 2002

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark one)

Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the quarterly period ended March 31, 2002

OR

Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the transition period from _____ to _____

Commission file number: 1-14128

EMERGING VISION, INC.
(Exact name of Registrant as specified in its Charter)

New York

(State of Incorporation)

11-3096941

(IRS Employer Identification No.)

100 Quentin Roosevelt Boulevard
Garden City, NY 11530

(Address of Principal Executive Offices, including Zip Code)

(516) 390-2100
(Registrant's Telephone Number, Including Area Code)

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes No

APPLICABLE ONLY TO CORPORATE ISSUERS:

There were 29,004,972 shares outstanding of the Registrant's Common Stock, par value \$0.01 per share, as of May 13, 2002.

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Item 1. Financial Statements

EMERGING VISION, INC. AND SUBSIDIARIES CONSOLIDATED BALANCE SHEETS (In Thousands, Except Share Data)

ASSETS

Current assets:

Cash and cash equivalents
Franchise receivables, net of allowance of \$2,110 and \$3,095,
respectively
Other receivables, net of allowance of \$133 and \$171, respectively
Current portion of franchise notes receivable
Inventories, net
Prepaid expenses and other current assets

Total current assets

Property and equipment, net
Franchise notes and other receivables, net of allowance of \$3,326 and \$3,326,
respectively
Intangible assets, net
Other assets

Total assets

LIABILITIES AND SHAREHOLDERS' EQUITY

Current liabilities:

Current portion of long-term debt
Accounts payable and accrued liabilities
Accrual for store closings (Note 5)
Related party borrowings
Net liabilities of discontinued operations

Total current liabilities

Long-term debt, net (Note 9)

Related party borrowings

Franchise deposits and other liabilities

Contingencies (Note 6)

Shareholders' equity

Preferred stock, \$0.01 par value per share; authorized 5,000,000 shares:
Senior Convertible Preferred Stock, \$100,000 liquidation preference
per share;
3 shares issued and outstanding

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Common stock, \$0.01 par value per share; authorized 50,000,000 shares;
 issued 27,187,309; and 27,004,972 shares outstanding
 Treasury stock, at cost, 182,337 shares
 Additional paid-in capital
 Accumulated deficit

Total shareholders' equity

Total liabilities and shareholders' equity

The accompanying notes are an integral part of these consolidated balance sheets.

EMERGING VISION, INC. AND SUBSIDIARIES
 CONSOLIDATED STATEMENTS OF OPERATIONS (UNAUDITED)
 (In Thousands, Except Per Share Data)

	For th
	----- 20 -----
Revenues:	
Net sales	\$ 2
Franchise royalties	1
Net gains and fees from the conveyance of Company-store assets to franchisees	
Interest on franchise notes	
Other income	
Total revenues	----- 4 -----
Costs and expenses:	
Cost of sales	
Selling, general and administrative expenses	4
Loss from franchised stores operated under management agreements	
Non-cash charges for issuance of warrants and induced conversion of warrants	
Interest expense	
Total costs and expenses	----- 5 -----
Loss from continuing operations before provision for income taxes	
Provision for income taxes	
Loss from continuing operations	----- -----
Discontinued operations (Note 3):	
Income from discontinued operations	

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Net income (loss)	\$

=====	
Per share information - basic and diluted (Note 4):	
Loss from continuing operations	\$ (
Income from discontinued operations)

Net income (loss)	\$ (

=====	
Weighted-average number of common shares outstanding - basic and diluted	26

=====	

The accompanying notes are an integral part of these consolidated statements.

EMERGING VISION, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(In Thousands)

	For t

	20

Cash flows from operating activities:	
Net loss from continuing operations	\$
Adjustments to reconcile net loss from continuing operations to net cash (used in) provided by operating activities:	
Depreciation and amortization	
Provision for doubtful accounts	
Non-cash charges related to options and warrants	
Charges related to long-lived assets	
Changes in operating assets and liabilities:	
Franchise and other receivables	
Inventories	
Prepaid expenses and other current assets	
Other assets	
Accounts payable and accrued liabilities	
Franchise deposits and other liabilities	
Accrual for store closings	
Net cash (used in) provided by operating activities	-----

Cash flows from investing activities:	
Franchise notes receivable issued	
Proceeds from franchise and other notes receivable	
Purchases of property and equipment	

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Net cash provided by investing activities	-----

Cash flows from financing activities:	
Proceeds from borrowings	1
Payments on borrowings	
Acquisition of treasury shares	

Net cash provided by (used in) financing activities	-----
Net cash (used in) provided by continuing operations	-----
Net cash used in discontinued operations	-----
Net decrease in cash and cash equivalents	
Cash and cash equivalents - beginning of period	1

Cash and cash equivalents - end of period	\$ =====
Supplemental disclosures of cash flow information: Cash paid during the period for:	
Interest	\$ =====
Taxes	\$ =====
Non-cash investing and financing activities:	
Net assets of franchise stores reacquired through exchange of receivables	\$

The accompanying notes are an integral part of these consolidated statements.

EMERGING VISION, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF SHAREHOLDERS' EQUITY (UNAUDITED)
FOR THE THREE MONTHS ENDED MARCH 31, 2002
(In Thousands, Except Share Data)

	Senior Convertible Preferred Stock Shares	Amount	Common Stock Shares	Amount	Treasury Stock, at cost Shares	Amount	Add Pa Ca
	-----	-----	-----	-----	-----	-----	-----
BALANCE - DECEMBER 31, 2001	3	\$ 287	27,187,309	\$ 272	182,337	\$(204)	\$1

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Issuance of warrants in connection with financing arrangements (Note 9)	-	-	-	-	-	-	-
Net loss	-	-	-	-	-	-	-
BALANCE - MARCH 31, 2002	3	\$ 287	27,187,309	\$ 272	182,337	\$(204)	\$1

The accompanying notes are an integral part of this consolidated statement.

EMERGING VISION, INC. AND SUBSIDIARIES
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
 (UNAUDITED)

NOTE 1 - BASIS OF PRESENTATION:

The accompanying Consolidated Financial Statements of Emerging Vision, Inc. and subsidiaries (collectively, the "Company") have been prepared in accordance with accounting principles generally accepted for interim financial statement presentation and in accordance with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted for complete financial statement presentation. In the opinion of management, all adjustments for a fair statement of the results of operations and financial position for the interim periods presented have been included. All such adjustments are of a normal recurring nature. This financial information should be read in conjunction with the Consolidated Financial Statements and Notes thereto included in the Company's Annual Report on Form 10-K, as amended, for the year-ended December 31, 2001. There have been no changes in significant accounting policies since December 31, 2001.

NOTE 2 - MANAGEMENT'S LIQUIDITY PLANS

As of March 31, 2002, the Company had negative working capital of \$1,535,000 (an improvement from \$1,758,000 as of December 31, 2001), and cash on hand of \$808,000. During the three months ended March 31, 2002, the Company used approximately \$792,000 of cash in its operating activities. This usage was in line with management's plans and was mainly a result of \$206,000 of costs related to the Company's store closure plan (Note 5), \$516,000 related to the Company's settlement of certain accounts payable and accrued liabilities that existed as of December 31, 2001, and \$108,000 related to the prepayment of certain other business expenses, offset in part by a \$304,000 decrease in franchise and other receivables. Management anticipates that it will continue to incur significant costs in order to continue to close certain of its non-profitable Company-owned stores in its effort to eliminate future cash flow losses currently generated by such stores.

The Company plans to continue to attempt to improve its cash flows during

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2002 by improving store profitability through increased monitoring of store-by-store operations, closing non-profitable Company-owned stores, implementing reductions of administrative overhead expenses, where necessary and feasible, actively supporting development programs for franchisees, and seeking additional financing, if necessary and available. Management believes that with its plans to attempt to improve cash flows as discussed above, its existing cash, the collection of outstanding receivables, and the availability under its existing credit facility (Note 9), there will be sufficient liquidity available to the Company to continue in operation until at least the end of the second quarter of 2003. However, there can be no assurance that the Company will be able to achieve the aforementioned plans, or that additional financing will be available.

NOTE 3 - Discontinued Operations:

On March 28, 2001, the Board of Directors decided that the Company should focus its efforts and resources on growing its retail optical business and, as a result, approved a plan to discontinue all other operations then being conducted by the Company. In connection with this decision, during 2001, the Company completed its plan of disposal of substantially all of the net assets of Insight Laser Centers, Inc. ("Insight Laser") - which operated three laser vision correction centers in the New York metropolitan area, Insight Laser Centers N.Y.I, Inc. (the "Ambulatory Center") - the owner of the assets of an ambulatory surgery center located in Garden City, New York, and its Internet Division - which was to provide a web-based portal being designed to take advantage of business-to-business opportunities in the optical industry. As a result, the remaining results of operations and cash flows of these divisions have been reflected as discontinued operations in the accompanying Consolidated Financial Statements.

As of March 31, 2002 and December 31, 2001, respectively, net liabilities of \$218,000 and \$235,000 related to these discontinued operations were segregated on the accompanying Consolidated Balance Sheets. In addition, as of March 31, 2002 and December 31, 2001, approximately \$58,000 and \$141,000, respectively, was accrued as part of accounts payable and accrued liabilities on the accompanying Consolidated Balance Sheets, representing the remaining estimated costs associated with the Company's original plan of disposal.

NOTE 4 - PER SHARE INFORMATION:

In accordance with Statement of Financial Accounting Standards ("SFAS") No. 128, "Earnings Per Share", basic net income (loss) per common share ("Basic EPS") is computed by dividing net income (loss) by the weighted-average number of common shares outstanding. Diluted net income (loss) per common share ("Diluted EPS") is computed by dividing the net income (loss) by the weighted-average number of common shares and dilutive common share equivalents and convertible securities then outstanding. SFAS No. 128 requires the presentation of both Basic EPS and Diluted EPS on the face of the Company's Consolidated Statements of Operations. Common stock equivalents were excluded from the computation for all periods presented, as their impact would be anti-dilutive.

The following table sets forth the computation of basic and diluted per share information:

For th

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Numerator:

Loss from continuing operations	\$ (53
Income from discontinued operations	
Net (loss) income	\$ (53

Denominator:

Denominator for basic and diluted per share information - weighted average shares outstanding	26,40
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Basic and Diluted Per Share Information:

Loss from continuing operations	\$ (0.0
Income from discontinued operations	0.0
Net (loss) income	\$ (0.0

NOTE 5 - PROVISION FOR STORE CLOSINGS:

The Company follows the provisions of Emerging Issues Task Force Issue 94-3 "Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity," and in accordance therewith, provides for losses it anticipates incurring with respect to those Company-owned stores that it has identified for future closure, at the time that management makes a formal commitment to any such plan of closure. The provision is recorded at the time the determination is made to close a particular store and is based on the expected net proceeds, if any, to be generated from the disposition of the store's assets, as compared to the carrying value (after consideration of impairment, if any) of such store's assets and the estimated costs (including lease termination costs and other expenses) that are anticipated to be incurred in the closing of the store in question. As of December 31, 2001, the Company had accrued for 11 store closings totaling approximately \$964,000 (comprised of \$766,000 in lease termination costs and \$198,000 for other associated expenses). During the three months ended March 31, 2002, the Company successfully closed 2 of such stores and, as of March 31, 2002, \$758,000 remains accrued as accrual for store closings on the accompanying Consolidated Balance Sheet. Additionally, in April 2002, the Company closed 4 more of such non-profitable Company-owned store locations. The Company anticipates completing its closure plan by the end of 2002.

NOTE 6 - Contingencies:

In 1999, the Company commenced an action in the Supreme Court of the State of New York against Dr. Larry Joel and Apryl Robinson for amounts claimed due by the Company on a series of five separate Negotiable Promissory Notes (the "Notes"). The Notes were issued by corporations owned by the defendants in connection with their purchase of the assets of, and a Sterling Optical Center Franchise for, an aggregate of four of the Company's retail optical stores and an optical laboratory. The repayment of each of the Notes was personally guaranteed by each of the defendants. In response, the defendants asserted counterclaims in excess of \$13,000,000 based upon the Company's alleged failure

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to comply with the terms of an oral, month-to-month consulting agreement between Dr. Joel and the Company, as well as to purchase the assets of various companies owned by Dr. Joel, including Duling Optical and D & K Optical - notwithstanding the fact that the parties failed to agree upon the terms of any such purchase, the parties failed to enter into any written agreement memorializing such a transaction, and the Company subsequently purchased such assets from Norwest Bank (which held a first lien on substantially all of the assets as collateral for various loans made to each of the entities, all of which were then in default) in a private foreclosure sale. In March 2001, the Appellate Division granted the Company's Motion for Summary Judgment on the issue of the defendants' liability, as guarantors of each of such Notes; and, in August 2001, the Court granted the Company's claim for damages in the approximate amount of \$800,000, which the Company is seeking to enforce. In November 2001, the defendants each filed for protection under the U.S. Bankruptcy Code and, in February 2002, received a discharge in such proceedings, which the Company is presently attempting to overturn. In addition, in March 2001, the Company filed an additional Motion for Summary Judgment seeking dismissal of all of the defendants' counterclaims; and the defendant, Dr. Joel, thereafter filed a cross-motion seeking a determination that the Company breached the aforementioned oral, month-to-month consulting agreement and that he is, accordingly, entitled to damages of approximately \$13,000,000, each of which motions were decided entirely in favor of the Company. Subsequently, on July 2, 2001, the defendants, without counsel, filed an appeal of this decision by the Court, which appeal has not yet been decided. Furthermore, in 1999, Apryl Robinson commenced an action in Kentucky against Larry Joel and the Company seeking an unspecified amount of damages, and alleging a myriad of claims, including fraud and misrepresentation. The Company is defending such action and intends to file a motion to dismiss the same based on the decisions in the New York action.

In February 2000, Essilor Laboratories of America, L.P. commenced an action against the Company in the District Court of Dallas County, Texas seeking damages of approximately \$250,000, representing the alleged unpaid cost of certain ophthalmic lenses previously purchased by the Company. In April 2002, the Company settled this action for approximately \$50,000.

In April 2000, the Company commenced an action in the Supreme Court of the State of New Jersey against Preit-Rubin, Inc. and Cumberland Mall Associates, the landlord of the former Sterling Optical Store located in Cumberland Mall, Vineland, New Jersey, seeking damages of approximately \$200,000 as a result of the defendants alleged wrongful eviction of the Company from this location. In response thereto, the defendants asserted counterclaims of approximately \$300,000 for lost rent and legal fees based upon the Company's alleged breach of the lease pursuant to which it occupied such Store.

In January 2001, the Company commenced an action against Binns Optical, Inc. ("BOI"), Michael Binns and Mary Ann Binns (collectively, the "Guarantors") in the United States District Court for the Eastern District of Missouri, seeking to prohibit the defendants from operating the Sterling Optical store located in Ballwin, Missouri, under any name other than Sterling Optical, as well as to require the defendants to return to the Company all patient records, customer lists, furniture, fixtures and equipment removed by the defendants from the six Sterling Optical stores previously franchised to, and ultimately abandoned by, BOI. In February 2001, the defendants entered into a Stipulation agreeing to the entry of a preliminary injunction whereby the defendants agreed to substantially all of the relief requested by the Company; and in March 2001, the defendants filed a counterclaim against the Company seeking damages in the amount of \$3,000,000, plus punitive damages, as a result of the Company's alleged fraud in the inducement, negligent misrepresentation, breach of fiduciary duty and claims stated in the alternative for breach of contract and breach of oral agreement. The Company denied the defendants' counterclaims and filed a motion to dismiss all such counterclaims, as well as a claim for its

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legal fees and costs associated with the action. On March 29, 2002, this motion was decided by the Court in favor of the Company and, in connection therewith, the Company was awarded legal fees and costs in the approximate amount of \$40,000. In a related matter, in February 2001, the Company commenced a separate action against the Guarantors in the New York State Supreme Court by filing a Motion for Summary Judgment in Lieu of Complaint, seeking damages (under the Guarantors' payment guarantee in favor of the Company) as a result of the failure of BOI to comply with its obligations under a series of eight Negotiable Promissory Notes made by BOI in its favor; and in April 2001 and July 2001, the Court granted the Company's motion and awarded the Company judgments for damages, in the aggregate approximate amount of \$1,500,000, which the Company is seeking to enforce in the State of Missouri, where the Guarantors both reside.

In February 2001, five of the Company's Site for Sore Eyes franchisees (owning an aggregate of seven franchised Site for Sore Eyes stores) commenced an action in the United States District Court for the Northern District of California seeking \$35,000,000 of damages as a result of the Company's alleged breach of the respective Franchise Agreements whereby each franchisee/plaintiff operates its Site for Sore Eyes Optical store(s), fraud and violations of California law, as well as a declaratory judgment that each of the Franchise Agreements had been modified to afford each plaintiff certain rights which are in addition to those set forth in the applicable Franchise Agreements. On April 1, 2002, the parties entered into a Settlement Agreement, whereby the plaintiffs dismissed the action, with prejudice, in exchange for the Company agreeing to certain amendments to the Franchise Agreement pertaining to each of the aforementioned seven Site for Sore Eyes Optical Centers, and the Company and Site-Ncal Area Rep, LLC, a California limited liability company owned by the plaintiffs ("NCAL"), entering into an Area Representation Agreement whereby NCAL is authorized to solicit individuals that are interested in acquiring a franchise for one or more new Site for Sore Eyes retail optical stores to be opened in the San Francisco Bay area of California. Additionally, NCAL agreed to provide certain services to each such new franchisee, all in consideration for the Company's payment, to NCAL, of a portion of the initial franchise fees and continuing royalty fees to become payable to the Company under each new Franchise Agreement, as well as the Company's reimbursement of the estimated administrative costs and expenses to be incurred by NCAL in connection therewith.

In July 2001, the Company commenced an Arbitration Proceeding in the Ontario Superior Court of Justice, against Eye-Site, Inc. and Eye Site (Ontario), Ltd., as the makers of two promissory notes (in the aggregate original principal amount of \$600,000) made by one or more of the makers in favor of the Company, as well as against Mohammed Ali, as the guarantor of the obligations of each maker under each note. The notes were issued by the makers in connection with their acquisition of a Master Franchise Agreement for the Province of Ontario, Canada, as well as their purchase of the assets of, and a Sterling Optical Center Franchise for, four of the Company's retail optical stores then located in Ontario, Canada. In response, the defendants counterclaimed for damages, in the amount of \$1,500,000, based upon, among other items, alleged misrepresentations made by representatives of the Company in connection with these transactions. The Company believes that it has a meritorious defense to each counterclaim. As of the date hereof, these proceedings were in the discovery stage.

In February 2002, Kaye Scholer, LLP, the law firm previously retained by the Company as its outside counsel, commenced an action in the New York State Supreme Court seeking unpaid legal fees in the amount of \$122,500. As of the date hereof, the Company has answered the Complaint in such action. The Company believes that it has a meritorious defense to such claim.

In addition to the foregoing, the Company is a defendant in certain lawsuits alleging various claims incurred in the ordinary course of business,

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certain of which claims are covered by various insurance policies, subject to certain deductible amounts and maximum policy limits. In the opinion of management, the resolution of these claims should not have a material adverse effect, individually or in the aggregate, upon the Company's business or financial condition. Other than as set forth above, management believes that there are no other legal proceedings pending or threatened to which the Company is, or may be, a party, or to which any of its properties are or may be subject, which, in the opinion of management, will have a material adverse effect on the Company.

NOTE 7 - RELATED PARTY TRANSACTIONS:

On December 3, 2001 and December 20, 2001, respectively, the Company's Board of Directors authorized the Company to borrow \$150,000 and \$300,000 from Horizon Investors Corp. ("Horizon"), a New York corporation principally owned by a director and principal shareholder of the Company. The loan was payable on demand, together with interest calculated at the prime rate plus 1%. The Company repaid these loans (which aggregated \$450,000 as of December 31, 2001), in full, on January 23, 2002 (Note 9).

On December 6, 2001, the Company's Board of Directors authorized the Company to borrow \$300,000 from Broadway Partners LLC, a partnership owned by certain of the children of certain of the Company's principal shareholders and directors. The loan was payable on demand, together with interest calculated at the prime rate plus 1%. The Company repaid this loan (\$300,000 as of December 31, 2001), in full, on January 23, 2002 (Note 9).

Until January 10, 2002, the Company subleased, from a limited liability company owned by certain of the Company's principal shareholders and directors, and shared with Cohen Fashion Optical, Inc. ("CFO"), a retail optical chain owned by certain of the principal shareholders and directors of the Company, and other tenants, an office building located in East Meadow, New York. Occupancy costs were appropriately allocated based upon the applicable square footage leased by the respective tenants of the building. For the year ended December 31, 2001, the Company paid approximately \$440,000 for rent and related charges for these offices. On January 10, 2002, the Company relocated to an office building located in Garden City, New York, and entered into a sublease with CFO for one of the two floors then being subleased to CFO. The Company estimates that its new annual rent will be approximately \$163,000. Occupancy costs are being allocated between the Company and CFO based upon the respective square footages being occupied. Management believes that such sublease is at fair market value.

In April 2002, the Company sold to General Vision Services LLC, a retail optical chain owned by certain of the principal shareholders and directors of the Company, and members of their respective immediate families, for the sum of \$55,000, substantially all of the assets of one of its stores located in New York City, together with all of the capital stock of its wholly-owned subsidiary, Sterling Vision of 125th Street, Inc., which is the tenant under the Master Lease for such store.

In the ordinary course of business, largely due to the fact that the entities occupy office space in the same building, and in an effort to obtain savings with respect to certain administrative costs, the Company and CFO will, at times, share in the costs of minor expenses. Management believes that these expenses have been appropriately accounted for herein.

In the opinion of management, all of the above transactions were conducted at "arms-length."

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NOTE 8 - SHAREHOLDERS' EQUITY:

Issuance of Warrants in Connection with Financing Arrangements

On January 23, 2002, in connection with obtaining its financing arrangements (Note 9), the Company granted Horizon an aggregate of 2,500,000 warrants (1,750,000 of which were immediately exercisable, with the balance vesting in quarterly increments of 250,000, beginning April 22, 2002, so long as any amounts remain unpaid under the secured term note and/or credit facility). Each warrant has a five-year term and provides for an exercise price of \$0.01 per share. The fair value of the warrants issued (valued using the Black-Scholes model) was approximately \$234,000. On May 5, 2002, Horizon exercised 2,000,000 of such warrants.

NOTE 9 - FINANCING ARRANGEMENTS

On January 23, 2002, the Company secured two separate financing arrangements as follows:

Secured Term Note. The Company entered into a secured term note for \$1,000,000 with an independent financial institution. This note is repayable in 24 equal monthly installments of \$41,666, and bears interest as defined (4.95% at the inception of the note, and subsequently amended on April 1, 2002 to 3.95%). The note is fully collateralized/guaranteed by a \$1,000,000 certificate of deposit posted by Horizon, a related party (Note 7), at the same financial institution.

Credit Facility. The Company entered into an agreement with Horizon to borrow up to a maximum of \$1,000,000. This credit facility bears interest at the prime rate plus 1% (5.5% as of the date of the loan agreement), provided for an initial advance of \$300,000, requires minimum incremental advances of \$150,000, matures on January 22, 2004, requires ratable monthly principal and interest payments of each borrowing, amortizable through the maturity date of the facility, is fully collateralized by the Company's qualifying franchise notes (as referenced by a pledge agreement), and requires the payment of a facility fee of 2% per annum, payable monthly, on the unused portion of the credit facility. As of the date hereof, \$700,000 remained available to the Company under the credit facility.

Simultaneous with obtaining the above financing, the Company repaid its outstanding related party borrowings totaling \$750,000, plus interest (Note 7). In consideration for providing access to the credit facility and guaranteeing the term note, the Company granted Horizon an aggregate of 2,500,000 warrants, the fair value of which was \$234,000 (Note 8). The net proceeds received were allocated based on the relative fair values of the debt and the warrants. Accordingly, \$810,000 was allocated to the debt, and \$190,000 was allocated to the warrants as a discount to the debt to be amortized as interest expense over the term of the note (2 years). For the three months ended March 31, 2002, approximately \$18,000 of such discount was amortized and recognized as interest expense in the accompanying Consolidated Statement of Operations.

Item 2. Management's Discussion and Analysis of Financial Condition and

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Results of Operations

This Report contains certain forward-looking statements and information relating to the Company that is based on the beliefs of the Company's management, as well as assumptions made by, and information currently available to, the Company's management. When used in this Report, the words "anticipate", "believe", "estimate", "expect", and similar expressions, as they relate to the Company or the Company's management, are intended to identify forward-looking statements. Such statements reflect the current view of the Company with respect to future events, are not guarantees of future performance and are subject to certain risks and uncertainties. These risks and uncertainties may include: product demand and market acceptance risks; the effect of economic conditions; the impact of competitive products, services and pricing; product development, commercialization and technological difficulties; and the outcome of current and future litigation. Should one or more of these risks or uncertainties materialize, or should underlying assumptions prove incorrect, actual results may vary materially from those described herein as anticipated, believed, estimated, or expected. The Company does not intend to update these forward-looking statements.

Results of Operations

For the Three Months Ended March 31, 2002 compared to March 31, 2001

Net sales for Company-owned stores, including revenues generated by the Company's wholly owned subsidiary, VisionCare of California ("VCC"), a specialized health care maintenance organization licensed by the State of California Department of Managed Health Care, increased by approximately \$150,000, or 5.3%, to \$2,990,000 for the three months ended March 31, 2002, as compared to \$2,840,000 for the comparable period in 2001. While there was a lower average number of Company-owned stores in operation during the three months ended March 31, 2002, as compared to the same period in 2001, as described below, the non-comparative stores in operation during the three months ended March 31, 2002, outperformed the non-comparative stores in operation during the comparable period in 2001. As of March 31, 2002, there were 199 Sterling Stores in operation, consisting of 33 Company-owned stores (including 8 Company-owned stores being managed by franchisees) and 166 franchised stores, as compared to 223 Sterling Stores in operation for the comparable period in 2001, consisting of 39 Company-owned stores (including 12 Company-owned stores being managed by franchisees) and 184 franchised stores (including 3 stores being managed by the Company on behalf of franchisees). On a same store basis (for stores that operated as a Company-owned store during both of the three month periods ended March 31, 2002 and 2001), comparative net sales decreased by \$203,000, or 10.6%, to \$1,714,000 for the three months ended March 31, 2002, as compared to \$1,917,000 for the comparable period in 2001. Management believes that this decline was a direct result of a general downturn in the economy that carried from the end of 2001 into the beginning of 2002.

Franchise royalties decreased by \$535,000, or 24.0%, to \$1,697,000 for the three months ended March 31, 2002, as compared to \$2,232,000 for the comparable period in 2001. This decrease was as a result of a lower average number of franchised stores in operation during the three month period ended March 31, 2002, as compared to 2001, as described above.

For the three months ended March 31, 2002, there were no net gains and fees from the conveyance of Company-owned store assets to franchisees (including initial franchise fees). For the comparable period in 2001, the Company recognized \$88,000 of such gains and fees. This decrease was due to the fact that the Company did not convey to franchisees (and thus did not realize a gain on) any assets of Company-owned stores during the three months ended March 31,

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2002.

Interest on franchise notes receivable decreased by \$214,000, or 71.6%, to \$85,000 for the three months ended March 31, 2002, as compared to \$299,000 for the comparable period in 2001. This decrease was due to several franchise notes maturing, a decrease in the principal balance of several franchisees notes and fewer notes being generated during the three months ended March 31, 2002, as compared to the comparable period in 2001.

Other income increased to \$30,000 for the three months ended March 31, 2002, as compared to \$5,000 for the comparable period in 2001, primarily due to an increase in franchise fee income (related to renewals and/or transfers) of \$20,000 during the three months ended March 31, 2002.

The Company's gross profit margin decreased by 6.5% to 74.0% for the three months ended March 31, 2002, as compared to 80.5% for the comparable period in 2001. In an effort to remain competitive with other retail optical chains in the industry during the economic downturn, the Company reduced the selling prices on many of its products by a substantial amount, thus causing profit margins to decrease. Further, in the first quarter of 2001, the Company obtained better discounts from certain of its vendors than in the comparable period in 2002. In the future, the Company's gross profit margin may fluctuate depending upon the extent and timing of changes in the product mix in Company-owned stores, competitive pricing, and promotional incentives

Selling, general and administrative expenses remained relatively constant during the three-month periods ended March 31, 2002 and 2001. Management anticipates that it will reduce its selling, general and administrative expenses during 2002 through closure of its non-profitable Company-owned stores, implementing reductions of administrative overhead expenses where necessary and feasible, and closer monitoring of store-by-store and corporate operations.

There were no non-cash charges for issuance of warrants and induced conversion of warrants for the three months ended March 31, 2002. However, the Company has certain outstanding contingent warrants that become exercisable upon the achievement, by the Company, of certain predetermined EBITDA targets. Due to these contingencies, the future valuation of the contingent warrants, if and when they become exercisable, will result in charges to the Company's results of operations in future periods. The significance of these charges, if any, will be dependent upon the fair market value of the Company's common stock at the time that the respective EBITDA targets are achieved.

Loss from the operation of franchised stores managed by the Company was \$113,000 for the three months ended March 31, 2001. There was no such loss for the three months ended March 31, 2002, as there are no longer any franchised stores being managed by the Company on behalf of franchisees.

Interest expense increased \$18,000, to \$39,000 for the three months ended March 31, 2002 as compared to \$21,000 for the comparable period in 2001. This increase was primarily due to the amortization of the discount associated with the related party debt financing obtained in January 2002 (Note 9).

Liquidity and Capital Resources

For the three months ended March 31, 2002, the Company used approximately \$792,000 of cash in its operating activities. This usage was in line with management's plans and was mainly a result of \$206,000 of costs related to the Company's store closure plan (Note 5), \$516,000 related to the Company's settlement of certain accounts payable and accrued liabilities that existed as of December 31, 2001, and \$108,000 related to the prepayment of certain other business expenses, offset in part by a \$304,000 decrease in franchise and other

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receivables.

For the three months ended March 31, 2002, cash flows provided by investing activities were \$190,000, as compared to \$266,000 for the comparable period in 2001. This decrease was principally due to a decrease of approximately \$361,000, to \$231,000, in proceeds from franchise and other notes receivables, and a decrease of approximately \$291,000 in notes issued by franchisees.

For the three months ended March 31, 2002, cash flows provided by financing activities were \$457,000, principally due to the \$1,300,000 of financing the Company received in January 2002 (Note 9), offset principally by the repayment of \$750,000 of related party borrowings.

As of March 31, 2002, the Company had negative working capital of \$1,535,000 (an improvement from \$1,758,000 as of December 31, 2001), and cash on hand of \$808,000.

On January 23, 2002, the Company secured two separate financing arrangements, as follows:

Secured Term Note. The Company entered into a secured term note for \$1,000,000 with an independent financial institution. This note is repayable in 24 equal monthly installments of \$41,666, and bears interest as defined (4.95% at the inception of the note, and subsequently amended on April 1, 2002 to 3.95%). The note is fully collateralized/guaranteed by a \$1,000,000 certificate of deposit posted by Horizon, a related party, at the same financial institution.

Credit Facility. The Company entered into an agreement with Horizon to borrow up to a maximum of \$1,000,000. This credit facility bears interest at the prime rate plus 1% (5.5% as of the date of the loan agreement), provided for an initial advance of \$300,000, requires minimum incremental advances of \$150,000, matures on January 22, 2004, requires ratable monthly principal and interest payments of each borrowing, amortizable through the maturity date of the facility, is fully collateralized by the Company's qualifying franchise notes (as referenced by a pledge agreement), and requires the payment of a facility fee of 2% per annum, payable monthly, on the unused portion of the credit facility.

Simultaneous with obtaining the above financing, the Company repaid outstanding related party borrowings due to Horizon and Broadway totaling \$750,000, plus interest. In consideration for providing access to the credit facility and guaranteeing the term note, the Company granted Horizon an aggregate of 2,500,000 warrants (1,750,000 of which were immediately exercisable, with the balance vesting in quarterly increments of 250,000, beginning April 22, 2002, so long as any amounts remain unpaid under the secured term note and/or credit facility). Each warrant has a five-year term and provides for an exercise price of \$0.01. As of the date hereof, remaining availability under the credit facility was approximately \$700,000.

The Company plans to continue to attempt to improve its cash flows during 2002 by improving store profitability through increased monitoring of store-by-store operations, closing non-profitable Company-owned stores, implementing reductions of administrative overhead expenses, where necessary and feasible, actively supporting development programs for franchisees, and by seeking additional financing, if necessary and available. Management believes that with its plans to attempt to improve cash flows as discussed above, its existing cash, the collection of outstanding receivables, and the availability

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under its existing credit facility (Note 9), there will be sufficient liquidity available to the Company to continue in operation until at least the end of the second quarter of 2003. However, there can be no assurance that the Company will be able to achieve the aforementioned plans, or that additional financing will be available.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

The Company presently has outstanding certain equity instruments with beneficial conversion terms. Accordingly, the Company, in the future, could incur non-cash charges to equity (as a result of the exercise of such beneficial conversion terms), which would have a negative impact on future per share calculations.

The Company is exposed to market risks from potential changes in interest rates as they relate to the Company's investments in highly liquid marketable securities and borrowings under its credit facility. The Company believes that the amount of risk as it relates to its investments and any such borrowings is not material to the Company's financial condition or results of operations. The Company does not expect to use interest rate swaps or other instruments to hedge its borrowings under its credit facility.

PART II - OTHER INFORMATION

Item 1. Legal Proceedings

In April 2000, the Company commenced an action in the Supreme Court of the State of New Jersey against Preit-Rubin, Inc. and Cumberland Mall Associates, the landlord of the former Sterling Optical Store located in Cumberland Mall, Vineland, New Jersey, seeking damages of approximately \$200,000 as a result of the defendants alleged wrongful eviction of the Company from this location. In response thereto, the defendants asserted counterclaims of approximately \$300,000 for lost rent and legal fees based upon the Company's alleged breach of the lease pursuant to which it occupied such Store.

In February 2002, Kaye Scholer, LLP, the law firm previously retained by the Company as its outside counsel, commenced an action in the New York State Supreme Court seeking unpaid legal fees in the amount of \$122,500. As of the date hereof, the Company has answered the Complaint in such action. The Company believes that it has a meritorious defense to such claim.

Item 2. Changes in Securities and Use of Proceeds.

On January 23, 2002, the Company issued warrants to Horizon to purchase an aggregate of 2,500,000 shares of its Common Stock at an exercise price of \$0.01 per share, in consideration for providing the Company access to a \$1,000,000 credit facility and for guaranteeing a \$1,000,000 term note made by the Company in favor of an independent financial institution. The issuance of these securities was exempt from registration requirements pursuant to an exemption under Section 4(2) of the Securities Act of 1933, as amended.

Item 3. Defaults Upon Senior Securities.

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Not applicable.

Item 4. Submission of Matters to a Vote of Security Holders.

Not applicable.

Item 5. Other Information.

Not applicable.

Item 6. Exhibits and Reports on Form 8-K.

A. Exhibits

Not applicable.

B. Reports on Form 8-K

On February 4, 2002, the Company filed a Report on Form 8-K regarding its loan from North Fork Bank, and its credit facility from Horizon Investors Corp.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, as amended, the Registrant has duly caused this Report to be signed on its behalf by the undersigned hereunto duly authorized.

EMERGING VISION, INC.
(Registrant)

BY: /s/ Robert S. Hillman

Robert S. Hillman
President and Chief Executive Officer
(Principal Executive Officer)

BY: /s/ Christopher G. Payan

Christopher G. Payan
Senior Vice President and
Chief Financial Officer
(Principal Financial and Accounting Officer)

Dated: May 15, 2002

