

EMERGING VISION INC  
Form 10-K  
April 02, 2007  
**United States**

**Securities and Exchange Commission**

**Washington, DC 20549**

**FORM 10-K**

**Annual Report**

**Pursuant to Section 13 or 15 (d)**

**of the Securities and Exchange Act of 1934**

**For the fiscal year ended December 31, 2006**

Commission File Number 1-14128

**EMERGING VISION, INC.**

(Exact name of Registrant as specified in its Charter)

**NEW YORK**

(State or other jurisdiction of incorporation or organization)

**11-3096941**

(I.R.S. Employer Identification No.)

**100 Quentin Roosevelt Boulevard**

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**Garden City, NY 11530**

(Address and Zip Code of Principal Executive Offices)

**Telephone Number: (516) 390-2100**

(Registrant's telephone number, including area code)

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Securities registered pursuant to Section 12(b) of the Act: **None**

Securities registered pursuant to Section 12(g) of the Act: **Common Stock, par value \$0.01 per share**

Indicate by check mark if the Registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act:

Yes \_\_\_\_\_ No

Indicate by check mark if the Registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act:

Yes \_\_\_\_\_ No

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 \_\_\_

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**Part I**

**Item 1. Business**

*GENERAL*

Emerging Vision, Inc. (the Registrant and, together with its subsidiaries, hereinafter the Company or Emerging ) operates one of the largest chains of retail optical stores and one of the largest franchise optical chains in the United States, based upon management's beliefs, domestic sales and the number of locations of Company-owned and franchised stores (collectively referred to hereinafter as Sterling Stores ). Additionally, Emerging operates one of the leading optical purchasing groups in the United States (hereinafter referred to as COM ), based upon management's beliefs, domestic sales and the number of Member locations (collectively referred to hereinafter as COM Members). The Registrant was incorporated under the laws of the State of New York in January 1992 and, in July 1992, purchased substantially all of the assets of Sterling Optical Corp., a New York corporation, then a debtor-in-possession under Chapter 11 of the U.S. Bankruptcy Code.

*STORE OPERATIONS*

The Company and its franchisees operate retail optical stores under the trade names Sterling Optical, Site For Sore Eyes, Duling Optical and Singer Specs, although most stores (other than the Company's Site for Sore Eyes stores located in Northern California) operate under the name Sterling Optical. The Company also operates VisionCare of California, Inc. ( VCC ), a specialized health care maintenance organization licensed by the State of California, Department of Managed Health Care, which employs licensed optometrists who render services in offices located immediately adjacent to, or within, most Sterling Stores located in California.

Most Sterling Stores offer eye care products and services such as prescription and non-prescription eyeglasses, eyeglass frames, ophthalmic lenses, contact lenses, sunglasses and a broad range of ancillary items. To the extent permitted by individual state regulations, an optometrist is employed by, or affiliated with, most Sterling Stores to provide professional eye examinations to the public. The Company fills prescriptions from these employed or affiliated optometrists, as well as from unaffiliated optometrists and ophthalmologists. Most Sterling Stores have an inventory of ophthalmic and contact lenses, as well as on-site lab equipment for cutting and edging ophthalmic lenses to fit into eyeglass frames, which, in many cases, allows Sterling Stores to offer same-day service.

Occasionally, the Company sells the assets of certain of its Company-owned stores to qualified franchisees and, in certain instances, realizes a profit on the conveyance of the assets of such stores. Through these sales, along with the opening of new stores by qualified franchisees, the Company seeks to create a stream of royalty payments based upon a percentage of the gross revenues of the franchised locations, and grow both the Sterling Optical and Site For Sore Eyes brand names. The Company currently derives its revenues from the sale of eye care products and services at Company-owned stores, membership fees paid to VCC, ongoing royalty fees based upon a percentage of the gross revenues of its franchised stores, and product pricing extended to COM members associated with the sale of vendor's eye care products to such COM members.

As of December 31, 2006, there were 154 Sterling Stores in operation, consisting of 10 Company-owned stores and 144 franchised stores. Sterling Stores are located in 14 states, the District of Columbia, Canada and the U.S. Virgin Islands.

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The following chart sets forth the breakdown of Sterling Stores in operation as of December 31, 2006 and 2005:

	<b>December 31,</b>	
<b>I. <u>COMPANY-OWNED STORES:</u></b>	<b><u>2006*</u></b>	<b><u>2005</u></b>
Company-owned stores	10	10
Company-owned stores managed by franchisees	-	2
Total	10	12

(\* Existing store locations: New York (8), Pennsylvania (1) and Virginia (1).

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	<b>December 31,</b>	
<b>II. <u>FRANCHISED STORES:</u></b>	<b><u>2006*</u></b>	<b><u>2005</u></b>
	144	147

(\* Existing store locations: California (40), Delaware (5), Florida (1), Illinois (1), Maryland (14), Massachusetts (1), Nevada (1), New Jersey (7), New York (37), North Dakota (3), Ontario, Canada (2), Pennsylvania (11), South Dakota (1), Virginia (7), Washington D.C. (2), West Virginia (1), Wisconsin (8) and the U.S. Virgin Islands (2)

Sterling Stores generally range in size from approximately 1,000 square feet to 2,000 square feet, are similar in appearance and are operated under certain uniform standards and operating procedures. Many Sterling Stores are located in enclosed regional shopping malls and smaller strip centers, with a limited number of Sterling Stores being housed in freestanding buildings with adjacent parking facilities. Sterling Stores are generally clustered within geographic market areas to maximize the benefit of advertising strategies and minimize the cost of supervising operations.

In response to the eyewear market becoming increasingly fashion-oriented during the past decade, most Sterling Stores carry a large selection of ophthalmic eyeglass frames. The Company frequently test-markets various brands of sunglasses, ophthalmic lenses, contact lenses and designer frames. Small quantities of these items are usually purchased for selected stores that test customer response and interest. If a product test is successful, the Company attempts to negotiate a system-wide preferred vendor discount for the product in an effort to maximize system-wide sales and profits.

### *FRANCHISE SYSTEM*

An integral part of the Company's franchise system includes providing a high level of marketing, training and administrative support to its franchisees. The Company provides grand opening assistance for each new franchised location by consulting with its franchisees with respect to

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store design, fixture and equipment requirements and sources, inventory selection and sources, and marketing and promotional programs, as well as assistance in obtaining managed care contracts. Specifically, the Company's grand opening assistance helps to establish business plans and budgets, provides preliminary store design and plan approval prior to construction of a franchised store, and provides training, an operations manual and a comprehensive business review to aid the franchisee in attempting to maximize its sales and profitability. Further, on an ongoing basis, the Company provides training through regional and national seminars, offers assistance in marketing and advertising programs and promotions, offers online communication, franchisee group discussion as well as updated training modules and product information through its interactive Franchisee Intranet, and consults with its franchisees as to their management and operational strategies and business plans.

*Preferred Vendor Network.* With the collective buying power of Company-owned and franchised Sterling Stores, the Company has established a network of preferred vendors (the Preferred Vendors ) whose products may be purchased directly by franchisees at group discount prices, thereby providing such franchisees with the opportunity for higher gross margins. Additionally, the Company negotiates and executes cooperative advertising programs with its Preferred Vendors for the benefit of all Company-owned and franchised stores.

*Franchise Agreements.* Each franchisee enters into a franchise agreement (the Franchise Agreement ) with the Company, the material terms of which are as follows:

- a. *Term.* Generally, the term of each Franchise Agreement is ten years and, subject to certain conditions, is renewable at the option of the franchisee.
- b. *Initial Fees.* Generally, franchisees (except for any franchisees converting their existing retail optical store to a Sterling Store (a Converted Store ), and those entering into agreements for more than one location) must pay the Company a non-recurring, initial franchise fee of \$20,000. For each franchisee entering into agreements for more than one location, the Company charges a non-recurring, initial franchise fee of \$15,000 for the second location, and \$10,000 for each location in excess of two. The Company charges each franchisee of a Converted Store a non-recurring, initial franchise fee of \$10,000 per location.

- c. *Ongoing Royalties.* Franchisees are obligated to pay the Company ongoing royalties in an amount equal to a percentage (generally 8%) of the gross revenues generated by their Sterling Store. Franchisees of Converted Stores, however, pay ongoing royalties, on their store's historical average base sales, at reduced rates increasing (in most cases) from 2% to 6% for the first three years of the term of the Franchise Agreement. In addition, most of the Franchise Agreements acquired by the Company from Singer Specs, Inc. (the Singer Franchise Agreements ) provide for ongoing royalties calculated at 7% of gross revenues. Franchise Agreements entered into prior to January 1994 provide for the payment of ongoing royalties on a monthly basis, while those entered into after January 1994 provide for their payment on a weekly basis, in each case, based upon the gross revenues for the preceding period. Gross revenues generally include all revenues generated from the operation of the Sterling Store in question, excluding refunds to customers, sales taxes, a limited amount of bad debts and, to the extent required by state law, fees charged by independent optometrists.
- d. *Advertising Fund Contributions.* Most franchisees must make ongoing contributions to an advertising fund (the Advertising Fund ) equal to a percentage of their store's gross revenues. Except for the Singer Franchise Agreements, which generally provide for contributions equal to 7% of gross revenues, for Franchise Agreements entered into prior to August 1993, the rate of contribution is generally 4% of the store's gross revenues, while Franchise Agreements entered into after August 1993 generally provide for contributions equal to 6% of the store's gross revenues. Generally, 50% of these funds are expended at the direction of each individual franchisee (for the particular Sterling Store in question), with the balance being expended on joint advertising campaigns for all franchisees located within specific geographic areas.
- e. *Termination.* Franchise Agreements may be terminated if a franchisee has defaulted on its payment of monies due to the Company, or in its performance of the other terms and conditions of the Franchise Agreement. During 2006, the assets of (as well as possession of) three franchised stores were reacquired by the Company. Substantially all of the assets located in such stores were voluntarily surrendered and transferred back to the Company in connection with the termination of the related Franchise Agreements. In certain instances, the Company will re-convey the assets of such a store to a new franchisee, requiring the new franchisee to enter into the Company's then current form of Franchise Agreement. However, the Company reviews each store's historical performance to consider if the Company will continue to operate such store (as a Company-owned location) without re-conveying the assets of such store to a new franchisee.

#### MARKETING AND ADVERTISING

The Company's marketing strategy emphasizes professional eye examinations, competitive pricing (primarily through product promotions), convenient locations, excellent customer service, customer-oriented store design and product displays, knowledgeable sales associates, and a broad range of quality products, including privately-labeled contact lenses presently being offered by the Company and certain of its franchisees. Examinations by licensed optometrists are generally available on the premises of, or directly adjacent to, substantially all Sterling Stores.

The Company continually prepares and revises its in-store, point-of-purchase displays, which provide various promotional messages to customers. Both Company-owned and franchised Sterling Stores participate in advertising and in-store promotions, which include visual merchandising techniques to draw attention to the products displayed in the Sterling Store in question. The Company is also continually refining its interactive web sites, which further markets the Sterling Optical and Site for Sore Eyes brands in an effort to increase traffic to its stores and, in many instances, also uses direct mail advertising as well as opt-in email advertising to reach prospective, as well as existing, consumers.

The Company annually budgets approximately 4% to 6% of system-wide sales for advertising and promotional expenditures. Generally, franchisees are obligated to contribute a percentage of their Sterling Store's gross revenues to the Company's segregated advertising fund accounts, which the Company maintains for advertising, promotional and public relations programs. In most cases, the Company permits each franchisee to direct the expenditure of approximately 50% of such contributions, with the balance being expended to advertise and promote all Sterling Stores located within the geographic area of the Sterling Store in question, and/or on national promotions and campaigns.





*INSIGHT MANAGED VISION CARE*

Managed care is a substantial and growing segment of the retail optical business. The Company, under the trade name Insight Managed Vision Care, contracts with payors (i.e. health maintenance organizations, preferred provider organizations, insurance companies, Taft-Hartley unions, and mid-sized to large companies) that offer eye care benefits to their covered participants. When Sterling Stores provide services or products to a covered participant, it is generally at a discount from the everyday advertised retail price. Typically, participants will be eligible for greater eye care benefits at Sterling Stores than those offered at eye care providers that are not participating in a managed care program. The Company believes that the additional customer traffic generated by covered participants, along with purchases by covered participants above and beyond their eye care benefits, more than offsets the reduced gross margins being realized on these sales. The Company believes that convenience of store locations and hours of operation are key factors in attracting managed care business. As the Company increases its presence within markets it has already entered, as well as expands into new markets, it believes it will be more attractive to managed care payors due to the additional Sterling Stores being operated by the Company and its franchisees.

*OPTICAL PURCHASING GROUP BUSINESS*

COM, which is based in the state of Florida, is one of the leading optical purchasing groups in the United States. COM operates an optical purchasing group business, which provides COM Members with vendor discounts on optical products for resale. COM Member are typically independent optical retailers. COM is in the process of integrating an internet-based purchasing website to allow current COM Members and potential new members to purchase eye care products via the internet. COM is also in the developmental stages of a nutraceutical business that is focused on the development and distribution of nutritional supplements targeted to consumers with pre-dispositions to certain eye diseases and conditions. As of December 31, 2006, COM had 909 active members in its optical purchasing group.

*COMPETITION*

The optical business is highly competitive and includes chains of retail optical stores, superstores, individual retail outlets, the operators of web sites and a large number of independent opticians, optometrists and ophthalmologists who provide professional services and may, in connection therewith, dispense prescription eyewear. As retailers of prescription eyewear generally service local markets, competition varies substantially from one location or geographic area to another. Since 1994, certain major competitors of the Company have been offering promotional incentives to their customers and, in response thereto, the Company generally offers the same or similar incentives to its customers.

The Company believes that the principal competitive factors in the retail optical business are convenience of location, on-site availability of professional eye examinations, rapid service, quality and consistency of product and service, price, product warranties, a broad selection of merchandise, the participation in third-party managed care provider programs and the general consumer acceptance of refractive laser surgery. The Company believes that it competes favorably in each of these areas, except in regards to laser surgery as the Company discontinued operations of its laser vision correction centers.

*GOVERNMENT REGULATION*

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The Company and its operations are subject to extensive federal, state and local laws, rules and regulations affecting the health care industry and the delivery of health care, including laws and regulations prohibiting the practice of medicine and optometry by persons not licensed to practice medicine or optometry, prohibiting the unlawful rebate or unlawful division of fees, and limiting the manner in which prospective patients may be solicited. The regulatory requirements that the Company must satisfy to conduct its business vary from state to state. In particular, some states have enacted laws governing the ability of ophthalmologists and optometrists to enter into contracts to provide professional services with business corporations or lay persons, and some states prohibit the Company from computing its continuing royalty fees based upon a percentage of the gross revenues of the fees collected by affiliated optometrists. Various federal and state regulations limit the financial and non-financial terms of agreements with these health care providers; and the revenues potentially generated by the Company differ among its various health care provider affiliations.

The Company is also subject to certain regulations adopted under the Federal Occupational Safety and Health Act with respect to its in-store laboratory operations. The Company believes that it is in material compliance with all such applicable laws and regulations.

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As a franchisor, the Company is subject to various registration and disclosure requirements imposed by the Federal Trade Commission and by many states in which the Company conducts franchising operations. The Company believes that it is in material compliance with all such applicable laws and regulations.

The Company must comply with the Health Insurance Portability and Accountability Act of 1996 ( HIPAA ), which governs our participation in managed care programs. We also must comply with the privacy regulations under HIPAA, which went into effect in April 2003. In addition, all states have passed laws that govern or affect our arrangements with the optometrists who practice in our vision centers. Some states, such as California, have particularly extensive and burdensome requirements that affect the way we do business. In California, optometrists who practice adjacent to our retail locations are providers to, and subtenants of, a subsidiary, which is licensed as a single-service HMO.

### *ENVIRONMENTAL REGULATION*

The Company's business activities are not significantly affected by environmental regulations, and no material expenditures are anticipated in order for the Company to comply with any such environmental regulations. However, the Company is subject to certain regulations promulgated under the Federal Environmental Protection Act with respect to the grinding, tinting, edging and disposal of ophthalmic lenses and solutions, with which the Company believes it is in material compliance.

### *EMPLOYEES*

As of March 4, 2007, the Company employed approximately 146 individuals, of which approximately 69% were employed on a full-time basis. No employees are covered by any collective bargaining agreement. At franchised store locations, employees are hired and governed by the franchisee, not the Company. The Company considers its labor relations with its associates to be in good standing and has not experienced any interruption of its operations due to disagreements.

*Item 1A. Risk Factors*

An investment in the Company's common stock involves a number of very significant risks. Because of these risks, only persons able to bear the risk and withstand the loss of their entire investment should invest in the Company's common stock. Prospective investors should consider the following risk factors before making an investment decision.

The Company's common stock was delisted from The Nasdaq National Market (NASDAQ), which makes it more difficult for shareholders to sell shares of the Company's common stock. On August 24, 2001, the Nasdaq Stock Market terminated the listing of the Company's common stock on NASDAQ as a result of the Company's failure to maintain a \$1.00 per share minimum bid price for the Company's common stock. As a result, the Company's common stock began trading on the OTC Bulletin Board on August 24, 2001. The OTC is generally considered a less efficient market than NASDAQ. Shareholders are likely to find it more difficult to trade the Company's common stock on the OTC than on NASDAQ. In order for the Company's common stock to resume trading on NASDAQ, it must satisfy all of NASDAQ's requirements for initial listing on NASDAQ, apply for listing and be accepted for listing. The Company does not currently satisfy NASDAQ's initial listing requirements for either NASDAQ or The Nasdaq SmallCap Market, and the Company is unable to determine whether it will ever be able to satisfy either of those initial listing requirements.

The application of the "penny stock rules" could reduce the liquidity and, therefore, the market price of the Company's common stock. On March 30, 2007, the last reported sales price of the Company's common stock was \$0.17. Because the trading price of the Company's common stock is less than \$5.00 per share and no longer trades on either NASDAQ or The Nasdaq SmallCap Market, the Company's common stock comes within the definition of a "penny stock." The penny stock rules impose additional sales practice requirements on broker-dealers who sell the Company's securities to persons other than established customers and accredited investors, generally those with assets in excess of \$1,000,000 or annual income exceeding \$200,000, or \$300,000 together with their spouse. Before a broker-dealer can sell a penny stock, SEC rules require the firm to first approve the customer for the transaction in question and receive from the customer a written agreement to such transaction. The firm must furnish the customer a document describing the risks of investing in penny stocks. The broker-dealer must also advise the customer of the current market quotation, if any, for the penny stock and the compensation the firm and its broker will receive for the trade. Finally, the firm must send monthly account statements showing the market value of each penny stock held in the customer's account. These additional burdens imposed on broker-dealers may restrict the ability of broker-dealers to sell the Company's securities and may affect your ability to resell the Company's common stock.

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Certain of the Company's directors are involved with other companies in the retail optical industry, which are in competition with the Company's Sterling Stores and/or COM Members, and may result in potential conflicts. Dr. Robert Cohen and Dr. Alan Cohen, two of the Company's directors, are also the principal shareholders and executive officers and directors of Cohen Fashion Optical, Inc. and its affiliate, Real Optical, LLC. Drs. Alan and Robert Cohen are brothers. Cohen Fashion Optical and Real Optical operate and franchise retail optical stores similar to Sterling Stores and COM Members in the States of Connecticut, Florida, New Hampshire, Massachusetts, New Jersey and New York and may, in the future, operate in other states as well. As of the date hereof, many Cohen Fashion Optical stores were located in the same shopping center or mall as, or in close proximity to, certain Sterling Stores and COM Member locations; and, in the future, Cohen Fashion Optical and/or Real Optical may open or franchise additional stores that are located in the same areas as Sterling Stores and/or COM Member locations. These competing businesses could reduce the revenues generated at the Company's competing Sterling Stores and/or from COM Members.

Drs. Robert and Alan Cohen are also the principal members and executive officers of General Vision Services, LLC, or GVS, which operates retail optical stores located in the New York metropolitan area. GVS stores are similar to, and compete with, the Sterling Stores and/or COM Members being operated in the same areas. Furthermore, GVS solicits and administers third party benefit programs, similar to those being administered by the Company, through GVS's network of company-owned and independent retail optical stores. It is possible that additional GVS stores, or other retail optical stores, which provide services under third party benefit plans administered by GVS, may, in the future, be located near one or more of the Company's Sterling Stores and/or COM Member locations, and may compete directly with such locations.

Additionally, the Company, Cohen Fashion Optical and/or GVS jointly participate in certain third party benefit plans and certain Sterling Stores, Cohen Fashion Optical stores and GVS stores participate as providers under third party benefit plans obtained by the Company, Cohen Fashion Optical or GVS and, in all likelihood, will continue to do so in the future.

A possible consequence of Drs. Robert and Alan Cohen's interests in Cohen Fashion Optical, Real Optical, GVS and their respective affiliates is that conflicts of interest may arise when business opportunities, in the Company's line of business, are presented to them, whether in their capacity as members of the Company's Board or as shareholders, officers and directors in these other entities. While there can be no assurance as to the manner in which corporate opportunities presented to Drs. Robert and Alan Cohen will be allocated, by them, among the various competing business entities in which they are involved, as a supplement to the common law fiduciary duties to which all directors owe the Company and its shareholders, the Company has adopted a Corporate Code of Ethics (which can be accessed on the Company's website [www.emergingvision.com](http://www.emergingvision.com)) to which Drs. Robert and Alan Cohen must adhere, which, in part, establishes guidelines as to how potential conflicts of interest are to be handled.

The Company significantly depends on the ability and experience of certain members of its management, and their departure may prevent or delay the successful execution of the Company's business plan. The Company relies on the skills of certain members of its senior management team to guide its operations including, but not limited to, Mr. Christopher G. Payan, the Company's Chief Executive Officer, the loss of whom could have an adverse effect on the Company's operations. The Company currently has an employment agreement with Mr. Payan through November 2009, however, only one other member of senior management has an employment agreement. Accordingly, certain of the Company's key executives may not continue to work for the Company, which could prevent or delay the successful execution of its business plan and attainment of profitability.

The Company does not control the management of all of the Sterling Stores that operate under its name, nor does it control any of the COM Members, and these stores may be managed by unsuccessful franchisees and COM Members, which would reduce the Company's revenues from these stores. The Company relies, in substantial part, on franchisees and COM Members for revenues. Since the Company does not control the management of these locations, it is possible that a franchisee/owner may not have the business acumen or financial resources to successfully operate his or her franchised Sterling Store or COM Member location. The Company, together with a substantial number of franchisees, has recently experienced an increase in the sales generated from the operation of Sterling Stores, however it can not guarantee continued increases in the future. If a substantial number of franchisees and/or COM Members experience a future decline in their sales and/or are ultimately not successful, revenues from franchisees and/or COM Members would decrease. Some of the factors that could lead to future decline in sales, include, among others: decreased spending by consumers, due to a weaker economy; increased competition by large discount eyewear chains, which increases the need for franchisees and COM Members to provide more aggressive promotional sales, thus decreasing their profit margins; and the limitations of vision care benefits available under medical and third party benefit plans.



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Better financed competitors that provide greater levels of advertising obtain favorable discounts from suppliers and offer customers aggressive discount pricing. The Company competes with many types of eyewear providers, which may prevent it from increasing or maintaining market share. The retail optical business is highly competitive and includes chains of retail optical stores, superstores, individual retail outlets and a large number of individual opticians, optometrists and ophthalmologists that provide professional services and dispense prescription eyewear. These competitors may take advantage of prompt payment discount plans, aggressive discounting and price-cutting for customers, and increased advertising. As retailers of prescription eyewear, the Company and its franchisees generally service local markets and, therefore, competition varies substantially from one location or geographic area to another. If the Company is not successful in dealing with competition, the Company will not be able to increase or maintain its customer base or market share.

The Company often offers incentives to its customers, which lower profit margins. At times when major competitors offer significantly lower prices for their products, the Company is required to do the same. Certain of major competitors offer promotional incentives to their customers including free eye exams, "50% Off" on designer frames and "Buy One, Get One Free" eyecare promotions. In response to these promotions, the Company has offered the same or similar incentives to its customers. This practice has resulted in lower profit margins and these competitive promotional incentives may further reduce revenues, gross margins and cash flows. Although the Company believes that Sterling Stores provide quality service and products at competitive prices, several of the large retail optical chains have greater financial resources. Therefore, the Company may not be able to continue to deliver cost efficient products in the event of aggressive pricing by competitors, which would reduce the Company's profit margins, net income and cash flow.

Laser surgery could eliminate the need for certain eyeglasses and contact lenses. As refractive laser surgery gains market acceptance, the Company may lose revenue from traditional eyewear customers. As traditional eyewear users undergo laser vision correction procedures or other vision correction techniques, the demand for certain contact lenses and eyeglasses will decrease. Due to the fact that the marketing and sale of eyeglasses and contact lenses is a significant part of the Company's business, a decrease in customer demand for these products could have a material adverse effect on sales of prescription eyewear, as well as those of the Company's franchisees.

The Company is subject to a variety of state, local and federal regulations that affect the health care industry, which may affect its ability to generate revenues or subject the Company to additional expenses. The regulatory requirements that the Company and its franchisees must satisfy to conduct its businesses, varies from state to state. For example, some states have enacted laws governing the ability of ophthalmologists and optometrists to enter into contracts with business corporations or lay persons, and some states prohibit companies from computing their royalty fees based upon a percentage of the gross revenues generated by optometrists from exam fees. Various federal and state regulations also limit the financial and non-financial terms of agreements with health care providers and, therefore, potential revenues may differ depending upon the nature of the Company's various health care provider affiliations.

The Company and its franchisees are also subject to the requirements of the Health Insurance Portability and Accountability Act of 1996 (HIPAA), which governs participation in managed care programs. The Company also must comply with the privacy regulations under HIPAA. In addition, all states have passed laws that govern or affect arrangements with the optometrists who practice in vision centers. Additionally, the Company and its franchisees are also subject to regulations regarding franchise business and in-store laboratory operations, as well as the operation, in California, of VCC, which is regulated by the State of California Department of Managed Health Care. As a franchisor, the Company is subject to various registrations and disclosure requirements imposed by the Federal Trade Commission and by many of the states in which the Company conducts franchising operations. The Federal Occupational Safety and Health Act regulates the Company's in-store laboratory operations. Although the Company believes that it is in material compliance with all applicable laws and/or regulations, the Company may not be able to sustain compliance if these laws and/or regulations change in the future and, in that event, the Company may have to incur significant expenses to maintain compliance.

If the Company's subsidiary, VCC, is no longer permitted to employ optometrists, then the revenue generated from its California Sterling Stores would, in all likelihood, decrease materially, thereby decreasing net income and cash flow.

A class action was commenced against the Company and VCC alleging that the operation of VCC, which employs licensed optometrists, violates certain provisions of the California Business and Professions Code. Although the Company and VCC prevailed in this case, in such event that VCC would lose its right to employ licensed optometrists in the future, then sales, net income and cash flow would, in all likelihood, decrease.



The Company may be exposed to significant risk from liability claims if it is unable to obtain insurance, at acceptable costs, to protect the Company against potential liability claims. The provision of professional eyecare services entails an inherent risk of professional malpractice and other similar claims. The Company does not influence or control the practice of optometry by the optometrists that it employs or affiliates with, nor does it have responsibility for their compliance with certain regulatory and other requirements directly applicable to these individual professionals. As a result of the relationship between the Company and its employed or affiliated optometrists, the Company may become subject to professional malpractice actions or claims under various theories relating to the professional services provided by these individuals. The Company may not be able to continue to obtain adequate liability insurance at reasonable rates, in which event, its insurance may not be adequate to cover claims asserted against the Company, thus, potentially decreasing the Company's future cash position and potentially jeopardizing the Company's ability to continue operations.

The Company's operations and success are highly dependent upon health care providers, and the Company may be unable to enter into favorable arrangements with these providers. Certain states prohibit the Company from employing optometrists to render professional services. Accordingly, the success of the Company's operations as full-service eye care providers depends upon its ability to enter into agreements with these health care providers to render professional services at Sterling Stores and COM Member locations. Due to the increased competition, among large discounters of retail eyewear, to enter into agreements with health care providers and the finite number of available health care providers, the costs of compensating these health care providers has increased materially. The Company, its franchisees and COM Members may not be able to enter into agreements with these health care providers on satisfactory terms, or these agreements may not be profitable, which would reduce the revenues the Company, its franchisees and COM Members could generate from their operations.

Certain events could result in a dilution of your ownership of the Company's common stock. As of December 31, 2006, the Company had 80,921,672 shares that were reserved for issuance under outstanding warrants, options and senior convertible preferred stock. The exercise and conversion prices, as the case may be, of common stock equivalents range from \$0.04 to \$8.25 per share. If converted or exercised, these securities will result in a dilution of your percentage ownership of the Company's common stock. In addition, if the Company acquires new companies through the issuance of common or preferred stock, your percentage of ownership will be further diluted.

The Company's potential limitation on the use of its net operating loss carry-forwards in accordance with Section 382 of the Internal Revenue Code of 1986, as amended, due to certain changes in ownership that have occurred or could occur in the future. Furthermore, in order to limit the potential that future transactions could have a similar effect on the Company's tax attributes, the Company amended its by-laws to provide the Board of Directors with the ability to void certain transactions in Company securities that may impair or limit the future utilization of its tax attributes, including its net operating loss carry-forwards. However, there can be no assurance that the Company has been, or will in the future be, successful in preventing an event which could materially impair or limit the Company's utilization of its net operating loss carry-forwards and other tax attributes.

The acquisition of Combine, which conducts business with approximately 900 retail optical stores (COM Members), could create an appearance of conflict amongst the COM Members. COM Members operate retail optical stores similar to Sterling Stores in the states of California, Delaware, Florida, Illinois, Maryland, Massachusetts, Nevada, New Jersey, New York, North Dakota, Pennsylvania, South Dakota, Virginia, West Virginia, Wisconsin, and in the District of Columbia and the Virgin Islands, and may, in the future, operate in other states as well. As of the date hereof, many COM Member locations are in the same shopping center or mall as, or in close proximity to, certain Sterling Stores; and in the future, the Company may open Sterling Stores that are located in the same areas as COM Members. These competing businesses could reduce the revenues generated at, both, the Company's Sterling Stores and COM Member locations, or could cause COM Members to leave COM because they view COM as the competition.

COM's operations and success are highly dependent upon the purchases of eye care products by independent optical retailers (COM Members). If COM Members decide to purchase their eye care products through a competing optical purchasing group business or purchase direct from a vendor, then revenues generated from COM would decrease. A decrease in the number of COM members could reduce COM's profit margins, net income and cash flow.

COM utilizes certain key vendors to provide its members with a broad spectrum of product purchasing options. If one of these key vendors ceases to do business with COM, or ceases to exist, COM could see a decrease in the amount of product purchased by its members, thus decreasing its revenues and net income.



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Section 404 of the Sarbanes-Oxley Act ( SOX ) requires the Company to perform an evaluation of its internal controls over financial reporting. The Company s compliance with SOX will first be included with the filing of the Company s annual report on Form 10-K for the fiscal year ended December 31, 2007. The rules governing the standards that must be met for

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management to assess the Company's internal controls over financial reporting are complex and require significant documentation, testing and possible remediation to meet the detailed standards under the rule. The costs associated with such tasks could be significant. Additionally, management may identify material weaknesses or significant control deficiencies which may not be remedied in time to meet the deadline imposed by SEC rules on SOX. If management cannot favorably assess the effectiveness of the Company's internal controls over financial reporting or the Company's auditors identify material weaknesses, investor confidence may weaken, and the share price of the Company's stock may suffer.

The Company relies heavily on computer systems in managing financial results. The Company is subject to damage and interruption from power outages, computer and telecommunications failures, computer viruses, security breaches, catastrophic events and usage by employees. This includes any damage to the systems that allow for electronic payments from the Company's franchisees and credit card payments from its Sterling Store customers. Any repairs necessary to replace and/or fix these systems could result in a significant expense to the Company. Additionally, certain of the Company's financial reporting processes are not part of an integrated financial reporting system, which requires additional hours and administrative costs to operate, manage and control these systems. The Company is working to transition most of the processes to an integrated financial reporting system. The conversion of these systems and processes to become SOX compliant could result in a significant expense to the Company and may pose greater risks associated with maintaining internal controls as the systems are integrated.

The Company's leasing space for a majority of its Sterling Stores could expose it to possible liabilities and losses. The Company's leases are generally for 10 years. Many of the leases provide for annual increases over the term of the lease in addition to the costs associated with insurance, taxes, repairs, maintenance and utilities. If an existing Sterling Store becomes non-profitable and the Company decides to close the location, the Company may still be required to pay the base rent, taxes and other rental charges for the balance of the lease.

The Company may be unable to service its debt obligations. In connection with the purchase of COM, along with other debt obligations, the Company has approximately \$2,367,000 of outstanding debt as of December 31, 2006. If the Company is unable to generate sufficient cash flows from operations in the future, it may be unable to make principal or interest payments on such borrowings when they become due and may need to refinance all or a portion of the existing debt, or obtain additional financing. The Company cannot guarantee that such refinancing or financing would be available on favorable terms, or at all.

***Item 1B. Unresolved Staff Comments***

Not Applicable

***Item 2. Properties***

The Company's headquarters, consisting of approximately 7,000 square feet, are located in an office building situated at 100 Quentin Roosevelt Boulevard, Garden City, New York 11530. The Company renewed its sublease, for such location, in December 2006, which sublease expires in November 2010. This facility houses the Company's principal executive and administrative offices.

VCC's headquarters, consisting of approximately 1,050 square feet, are located in an office building situated at 9625 Black Mountain Road, Suite 311, San Diego, California 92126, under a lease that expires in March 2010.

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COM's headquarters, consisting of approximately 1900 square feet, are located in an office building situated at 6001 Broken Sound Parkway, Suite 508, Boca Raton, Florida 33487, under a lease that expires in June 2009.

The Company leases the space occupied by all of its Company-owned Sterling Stores and certain of its franchised Sterling Stores. The remaining leases for its franchised Sterling Stores are held in the names of the respective franchisees, of which the Company holds a collateral assignment on certain of those leases. The Company does not hold any of the leases, nor does it hold any collateral assignments, on COM Member locations.

Sterling Stores are generally located in commercial areas, including major shopping malls, strip centers, freestanding buildings and other areas conducive to retail trade. Generally, Sterling Stores range in size from 1,000 to 2,000 square feet.

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### ***Item 3. Legal Proceedings***

Information with respect to the Company's legal proceedings required by Item 103 of Regulation S-K is set forth in the Notes to the Consolidated Financial Statements included in Item 8 of this Report, and is incorporated by reference herein.

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

There were no matters submitted to a vote by the Company's shareholders during the fourth quarter ended December 31, 2006.

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**PART II**

**Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities**

The Registrant's Common Stock is traded in the over-the-counter market and quoted on the OTC Bulletin Board under the trading symbol ISEE . Over-the-counter market quotations reflect inter-dealer prices, without retail mark-up, mark-down or commission and may not necessarily represent actual transactions. The range of the high and low closing bid prices for the Registrant's Common Stock for each quarterly period of the last two years is as follows:

<b>Quarter Ended:</b>	<b>2006</b>		<b>2005</b>	
	<b>High</b>	<b>Low</b>	<b>High</b>	<b>Low</b>
March 31	\$0.16	\$0.10	\$0.20	\$0.13
June 30	\$0.16	\$0.12	\$0.20	\$0.09
September 30	\$0.21	\$0.13	\$0.18	\$0.12
December 31	\$0.21	\$0.15	\$0.18	\$0.09

The approximate number of shareholders of record of the Company's Common Stock as of March 15, 2007 was 280.

There was one shareholder of record of the Company's Senior Convertible Preferred Stock as of April 2, 2007.

Historically, the Company has not paid dividends on its Common Stock, and has no intention to pay dividends on its Common Stock in the foreseeable future. It is the present policy of the Registrant's Board of Directors to retain earnings, if any, to finance the Company's future operations and growth.

Although the Company has not paid dividends, if the Company does in the future, those dividend payments could affect the Company's financial covenants related to their credit facility. Such credit facility is described in Item 7 of this Report.

**Item 6. Selected Financial Data**

*USE OF NON-GAAP FINANCIAL MEASURE*

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In this document, at times we refer to EBITDA. EBITDA is calculated as net earnings before interest, taxes, depreciation and amortization. We refer to EBITDA because it is a widely accepted financial indicator of a company's ability to service or incur indebtedness.

EBITDA does not represent cash flow from operations as defined by generally accepted accounting principles, is not necessarily indicative of cash available to fund all cash flow needs, should not be considered an alternative to net income or to cash flow from operations (as determined in accordance with GAAP) and should not be considered an indication of our operating performance or as a measure of liquidity. EBITDA is not necessarily comparable to similarly titled measures for other companies.

### *SELECTED CONSOLIDATED FINANCIAL AND OPERATING DATA*

The following Selected Financial Data has been derived from the audited consolidated financial statements of the Company and should be read in conjunction with those statements, which are included in this Report. The consolidated financial statements for each of the five years ended December 31, 2006 were audited by Miller Ellin & Company LLP, independent public accountants.

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(In thousands, except for per share data)

Year Ended December 31,

Statement of Operations Data:	2006	2005	2004	2003	2002
Total revenues	\$ 21,712	\$ 13,757	\$ 14,314	\$ 14,038	\$ 18,000
Income (loss) from continuing operations	\$ 2,019	\$ 571	\$ 884	\$ (2,967)	\$ (4,721)
(Loss) income from discontinued operations	\$ (159)	\$ (305)	\$ -	\$ -	\$ 74
Net income (loss)	\$ 1,860	\$ 266	\$ 884	\$ (2,967)	\$ (4,647)
<u>Per Share Information - Basic</u>					
Income (loss) from continuing operations	\$ 0.03	\$ 0.01	\$ 0.01	\$ (0.05)	\$ (0.17)
(Loss) income from discontinued operations	\$ (0.00)	\$ (0.01)	\$ -	\$ -	\$ 0.01
Net income (loss) per share	\$ 0.03	\$ 0.00	\$ 0.01	\$ (0.05)	\$ (0.16)
<u>Per Share Information - Diluted</u>					
Income (loss) from continuing operations	\$ 0.02	\$ 0.01	\$ 0.01	\$ (0.05)	\$ (0.17)
(Loss) income from discontinued operations	\$ (0.00)	\$ (0.01)	\$ -	\$ -	\$ 0.01
Net income (loss) per share	\$ 0.02	\$ 0.00	\$ 0.01	\$ (0.05)	\$ (0.16)

Weighted-average common shares outstanding:

Basic	70,324	70,324	69,475	56,507	28,641
Diluted	111,556	112,422	113,696	56,507	28,641

**Balance Sheet Data:**

Working capital deficit	\$ (673)	\$ (207)	\$ (603)	\$ (1,590)	\$ (4,632)
Total assets	12,597	6,190	5,989	6,639	6,650
Total debt	2,367	619	658	931	1,494

**Other Data:**

EBITDA (1)	\$ 914	\$ 607	\$ 1,200	\$ (2,435)	\$ (3,879)
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**Quarterly Data:**

	<b>First Quarter</b>		<b>Second Quarter</b>		<b>Third Quarter</b>		<b>Fourth Quarter</b>	
	<b>2006</b>	<b>2005</b>	<b>2006</b>	<b>2005</b>	<b>2006</b>	<b>2005</b>	<b>2006</b>	<b>2005</b>
Net revenues	\$ 3,736	\$ 3,740	\$ 3,475	\$ 3,455	\$ 6,464	\$ 3,325	\$ 8,037	\$ 3,237
Net income (loss)	\$ 1,964	\$ 447	\$ (375)	\$ 200	\$ 111	\$ (50)	\$ 160	\$ (331)
EBITDA (1)	\$ 761	\$ 529	\$ (159)	\$ 269	\$ 241	\$ 26	\$ 71	\$ (217)
<b>Earnings Per Share:</b>								
Basic	\$ 0.03	\$ 0.01	\$ (0.00)	\$ 0.00	\$ 0.00	\$ (0.00)	\$ (0.00)	\$ (0.00)
Diluted	\$ 0.02	\$ 0.00	\$ (0.00)	\$ 0.00	\$ 0.00	\$ (0.00)	\$ (0.00)	\$ (0.00)

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**Sterling Store Data:****(In thousands, except for number of stores)****Year Ended December 31,**

	<b>2006</b>	<b>2005</b>	<b>2004</b>	<b>2003</b>	<b>2002</b>
Company-owned stores bought, opened or reacquired	5	4	2	3	4
Company-owned stores sold or closed	(5)	(3)	(2)	(9)	(14)
Company-owned stores at end of period	10	10	9	9	15
Company-owned stores being managed by Franchisees at end of period	-	2	2	5	8
Franchised stores at end of period	144	147	154	158	159
Average sales per store (2):					
Company-owned stores	\$ 489	\$ 421	\$ 467	\$ 408	\$ 394
Franchised stores	\$ 577	\$ 545	\$ 545	\$ 545	\$ 591
Average franchise royalties per franchised store (2)					
	\$ 48	\$ 43	\$ 42	\$ 40	\$ 47

(1) EBITDA (which is a **Non-GAAP Financial Measure**) is calculated as net earnings before interest, taxes, depreciation and amortization. The following is a reconciliation of net income to EBITDA (amounts in thousands) for the five years ended December 31, 2006:

	<b>2006</b>	<b>2005</b>	<b>2004</b>	<b>2003</b>	<b>2002</b>
Net income (loss)	\$ 1,860	\$ 266	\$ 884	\$ (2,967)	\$ (4,647)
Add back:					
Interest expense	48	43	59	197	211
Taxes	(1,321)	43	30	57	69
Depreciation and amortization	327	255	227	278	488
EBITDA	\$ 914	\$ 607	\$ 1,200	\$ (2,435)	\$ (3,879)

The Company also incurred other non-cash charges that effected earnings including compensation expenses for the grants of stock options and warrants of \$534,000, \$176,000, \$148,000 and \$4,739,000 for the years ended December 31, 2006, 2005, 2004 and 2003, respectively. There were no such charges during the year ended December 31, 2002.



- (2) Average sales per store and average franchise royalties per franchised store are computed based upon the weighted-average number of Company-owned and franchised stores in operation, respectively, for each of the specified periods. For periods of less than a year, the averages have been annualized.

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***Item 7. Management's Discussion and Analysis of Financial Condition and 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, there can be no assurance, may, could, would, might, intends 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 view of the Company at the date they are made with respect to future events, are not guarantees of future performance and are subject to various risks and uncertainties as identified in Item 1A. Risk Factors. 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 with the forward-looking statements referred to above. The Company does not intend to update these forward-looking statements for new information, or otherwise, for the occurrence of future events.

***COMPARISON OF OPERATING RESULTS FOR THE YEARS ENDED DECEMBER 31, 2006 AND 2005***

Total revenues for the Company increased approximately \$7,955,000, or 57.8%, to \$21,712,000 for the year ended December 31, 2006, as compared to \$13,757,000 for the year ended December 31, 2005. This increase was mainly a result of the acquisition, on September 29, 2006, having an effective date of August 1, 2006, of substantially all of the assets of Combine Optical Management Corporation (Combine) through the Company's wholly-owned subsidiary, COM Acquisition, Inc. (COM). During the five months ended December 31, 2006, COM generated net revenues of approximately \$7,186,000.

Total costs, and selling, general and administrative expenses for the Company increased approximately \$8,013,000, or 60.2%, to \$21,325,000 for the year ended December 31, 2006, as compared to \$13,312,000 for the year ended December 31, 2005. This increase was mainly a result of the acquisition of substantially all of the assets of Combine. During the five months ended December 31, 2006, COM incurred total costs, and selling, general, and administrative expenses of approximately \$7,085,000.

**Retail Optical Store Segment**

Net sales for Company-owned stores increased approximately \$217,000, or 3.1%, to \$7,287,000 for the year ended December 31, 2006, as compared to \$7,070,000 for the year ended December 31, 2005. This increase was mainly attributable to the Company putting more focus on the Company-owned stores during 2006. During 2006, the Company began modifying the product mix in such stores and started promoting a new advertising campaign around the new product mix. As of December 31, 2006, there were 10 Company-owned stores, as compared to 10 Company-owned stores as of December 31, 2005. On a same store basis (for stores that operated as a Company-owned store during the entirety of both of the years ended December 31, 2006 and 2005), comparative net sales increased approximately \$300,000, or 10.6%, to \$3,138,000 for

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the year ended December 31, 2006, as compared to \$2,838,000 for the year ended December 31, 2005. Management believes that these increases will continue during 2007 as the Company continues its focus on improving store operations through training, the implementation of a new point-of-sale system and, where necessary, the addition of key personnel in certain areas relating to store operations.

Revenues generated by the Company's wholly-owned subsidiary, VisionCare of California, Inc. ( VCC ), a specialized health care maintenance organization licensed by the State of California Department of Managed Health Care, decreased approximately \$16,000, or 0.5%, to \$3,382,000 for the year ended December 31, 2006, as compared to \$3,398,000 for the year ended December 31, 2005. This decrease was primarily due to a decrease in membership fees generated by VCC during 2006.

Franchise royalties increased approximately \$478,000, or 7.3%, to \$7,042,000 for the year ended December 31, 2006, as compared to \$6,564,000 for the comparable period in 2005. Management believes this increase was a result of increased levels of field support to franchisees, the success of the Company's audits of franchised locations, which generated additional royalties, and an increase in franchise sales for the stores that were in operation during both of the comparable periods, offset by a lower average number of stores in operation during the same comparable periods. As of December 31, 2006, there were 144 franchised stores, as compared to 147 stores in operation as of December 31, 2005.

Other franchise related fees (which includes initial franchise fees, renewal fees and fees related to the transfer of store ownership from one franchisee to another) increased approximately \$74,000, or 60.2%, to \$197,000 for the year ended December 31, 2006, as compared to \$123,000 for the year ended December 31, 2005. This increase was primarily attributable to the Company recognizing franchise fees on 7 new franchise agreements, 3 franchise agreement renewals, and

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4 franchise agreement transfers during the year ended December 31, 2006, as compared to 4 new franchise agreements, 4 franchise agreement renewals, and 3 franchise agreement transfers during the year ended December 31, 2005. During the 2nd quarter of 2005, the Company increased the cost to renew or enter into a new franchise agreement from \$10,000 to \$20,000. In the future, other franchise related fees are likely to fluctuate depending on the timing of franchise agreement expirations, new store openings and franchise store transfers.

Including revenues solely generated by the Company-owned stores, the Company's gross profit margin increased by 1.1%, to 73.0%, for the year ended December 31, 2006, as compared to 71.9% for the year ended December 31, 2005. 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, amongst other things.

Selling, general and administrative expenses increased approximately \$861,000, or 6.9%, to \$13,269,000 for the year ended December 31, 2006, as compared to \$12,408,000 for the year ended December 31, 2005. This increase was partially a result of increases to compensation expense of \$362,000 incurred due to the vesting of certain stock options and warrants in April 2006, advertising expense of \$388,000 due to the promotion of a new marketing campaign around the new product mix in our Company-owned stores, and payroll and related expenses of \$249,000 due, in part, to the additions of certain key employees hired to enhance Company store operations and expand the franchise chain for the year ended December 31, 2006. Additionally, during the 3rd quarter of 2006, the Company incurred a \$60,000 expense related to a settlement with a former employee of VCC, and during the 4th quarter of 2006, the Company incurred expenses of \$101,000 related to the Company's annual franchise convention. These expenses were offset, in part, by a decrease in professional fees of \$49,000, as the Company incurred legal fees related to proactive litigation to enforce franchise agreement during the 3rd quarter of 2005, and bad debt expense of \$322,000.

Gain on sale of company-owned stores to franchisees related to the sale of an existing Company-owned store in upstate New York for a purchase price of \$225,000, which included the net fixed assets of such store (such assets having a net book value of \$7,000), and to the sale of an existing Company-owned store in southern California for a purchase price of \$200,000 allocated as follows: \$100,000 in the form of a promissory note to be recognized when the cash is received under the terms of the note; \$50,000 to gain on the sale of company-owned stores to franchisees; and \$50,000 to franchise fee income, advertising fund contribution and rent security).

### **Optical Purchasing Group Business Segment**

On September 29, 2006, having an effective date of August 1, 2006, the Company, through its wholly-owned subsidiary COM Acquisition, Inc. ( COM ), acquired substantially all of the assets of Combine Optical Management Corporation ( Combine ) for a purchase price of approximately \$2,473,000 and 3,515,625 options to purchase shares of the Company's common stock. COM activity for the five months ended December 31, 2006 has been included in the Company's results of operations as of and for the five months ended December 31, 2006.

Net revenues for COM were \$7,186,000 for the five months ended December 31, 2006, which represented 33.1% of the total revenue of the Company.

Costs of sales for COM were \$6,742,000 for the five months ended December 31, 2006, which represented 87.1% of the total costs of sales of the Company.

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Selling, general and administrative expenses for COM were \$343,000 for the five months ended December 31, 2006, which represented 2.5% of the total selling, general and administrative expenses of the Company. These expenses included payroll and related benefits of \$116,000, depreciation and amortization of \$63,000, and bank and credit card fees of \$38,000.

There are no comparatives provided for COM as the acquisition of Combine was consummated during the 3rd quarter of 2006.

### *COMPARISON OF OPERATING RESULTS FOR THE YEARS ENDED DECEMBER 31, 2005 AND 2004*

#### **Retail Optical Store Segment**

Net sales for Company-owned stores decreased approximately \$157,000, or 4.1%, to \$3,664,000 for the year ended December 31, 2005, as compared to \$3,821,000 for the year ended December 31, 2004. On a same store basis (for stores that operated as a Company-owned store during the entirety of both of the years ended December 31, 2005 and 2004),

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comparative net sales decreased approximately \$171,000, or 5.0%, to \$3,266,000 for the year ended December 31, 2005, as compared to \$3,437,000 for the year ended December 31, 2004. Management believes that this decrease was a direct result of generally weak sales levels experienced in the upstate New York market, combined with the effects of employee turnover in certain of the stores.

Revenues generated by VCC decreased approximately \$298,000, or 8.1%, to \$3,398,000 for the year ended December 31, 2005, as compared to \$3,696,000 for the comparable period in 2004. This decrease was primarily due to a decrease in membership fees generated by VCC during 2005.

Franchise royalties decreased approximately \$24,000, or 0.4%, to \$6,564,000 for the year ended December 31, 2005, as compared to \$6,588,000 for the year ended December 31, 2004. Management believes the decrease was due to a lower average number of stores in operation during the same comparable periods, offset by a slight increase in franchise sales for the stores that were open during both of the comparable periods. As of December 31, 2005, there were 147 franchised stores, as compared to 154 stores in operation as of December 31, 2004.

Other franchise related fees (which includes initial franchise fees, renewal fees and fees related to the transfer of store ownership from one franchisee to another) decreased approximately \$78,000, or 38.8%, to \$123,000 for the year ended December 31, 2005, as compared to \$201,000 for the year ended December 31, 2004. This decrease was primarily attributable to the Company recognizing franchise fees on 4 franchise agreement renewals, 5 new franchise agreements and 3 franchise agreement transfers in 2005, as compared to 5 franchise agreement renewals, 5 new franchise agreements and 8 franchise agreement transfers in 2004. In the future, other franchise related fees are likely to fluctuate depending on the timing of franchise agreement expirations, new store openings and franchise store transfers.

Including revenues solely generated by the Company-owned stores, the Company's gross profit margin increased by 0.8%, to 71.9% for the year ended December 31, 2005, as compared to 71.1% for the year ended December 31, 2004. 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, among other things.

Selling, general and administrative expenses increased approximately \$413,000, or 3.4%, to \$12,409,000 for the year ended December 31, 2005, as compared to \$11,996,000 for the year ended December 31, 2004. The increase was partially a result of increases in facility charges of \$320,000 and other overhead charges of \$86,000. The increase in selling, general and administrative expenses was also attributable to an increase in professional fees of \$207,000 relating to proactive litigation to enforce franchise agreements and an increase in bad debt expense of \$148,000 related, in part, to certain franchisee bankruptcies and franchise store closures. These increases were offset, in part, by a decrease in certain travel and other related expenses of \$234,000.

### *LIQUIDITY AND CAPITAL RESOURCES*

As of December 31, 2006, the Company had negative working capital of \$673,000 and cash on hand of \$1,289,000. During 2006, cash flows provided by its operating activities were \$1,301,000. This was principally due to earnings before taxes, depreciation and amortization from continuing operations of \$1,051,000 in addition to equity compensation charges of \$534,000, as well as the gain on the sale of two of the Company-owned stores totaling \$268,000. The Company believes it will continue to improve its operating cash flows through franchisee audits, through its current and future acquisitions, and through new marketing strategies and increased gross margins, among other things, for its Company-owned stores.

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For the year ended December 31, 2006, cash flows used in investing activities were \$704,000, primarily due to the acquisition of substantially all of the assets of Combine that included cash paid at closing totaling \$700,000, certain capital expenditures (which included the Company's new accounting system, as well as the remodeling of two of the Company-owned stores) made by the Company during 2006, and the issuance of new franchise notes, offset by proceeds received on the sale of two of the Company-owned stores and proceeds received on certain franchise notes.

For the year ended December 31, 2006, cash flows used in financing activities were \$85,000 due to the repayment of the Company's related party borrowings and loans.

### *CREDIT FACILITY*

On August 19, 2005, the Company entered into a Credit Agreement (the "Credit Agreement") with Manufacturers and Traders Trust Corporation ("M&T"), establishing a revolving credit facility (the "Credit Facility"), for aggregate borrowings of up to \$2,000,000, which may be used for general working capital needs and certain permitted acquisitions. The initial term

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of the Credit Facility expires in August 2007, but the term may be renewed in accordance with the terms of the Credit Agreement. Borrowing are payable in August 2007 with interest accruing at the variable rate of LIBOR plus 2.75% per annum in accordance with the terms of a Grid Note. The Credit Facility includes various financial covenants including minimum net worth, maximum funded debt and debt service ratio requirements. As of December 31, 2006, the Company had no outstanding borrowings under the Credit Facility and was in compliance with all of the financial covenants.

### *CONTRACTUAL OBLIGATIONS*

Payments due under contractual obligations as of December 31, 2006 were as follows (in thousands):

	<b>Within 1 year</b>	<b>1-3 years</b>	<b>After 3 years</b>	<b>Total</b>
Long-term debt and related party borrowings (a) (b)	\$ 1,174	\$ 1,193	\$ -	\$ 2,367
Interest on long-term debt and related party borrowings (a)	125	-	-	125
Employment Agreement (c)	268	805	157	1,230
Operating Leases	4,427	5,500	5,796	15,723
	<b>\$ 5,994</b>	<b>\$ 7,498</b>	<b>\$ 5,953</b>	<b>\$ 19,445</b>

- a) Effective April 14, 2003, in connection with certain Rescission Transactions consummated by the Company on December 31, 2003, the Company signed numerous promissory notes with certain of its shareholders, two of whom are also directors of the Company. The notes, which aggregate \$520,000, bear interest at a rate of 6% per annum, and all sums (principal and interest) under the notes are due and payable in April 2007. Information with respect to the Company's contractual obligations is set forth in the Notes to the Consolidated Financial Statements included in Item 8 of this Report.
- b) In connection with the acquisition of substantially all of the assets of Combine, the Company entered into two promissory notes with Combine. The first note provides for four annual installments commencing October 1, 2007, totaling \$1,273,000 (without interest). The second note provides for sixty monthly installments commencing October 1, 2006, totaling \$500,000 at 7% interest per annum.
- c) The Company has an employment agreement with one of its key executives that provides for an annual salary of \$210,000 with certain other benefits.

### *OFF-BALANCE SHEET ARRANGEMENTS*

An off-balance sheet arrangement is any contractual arrangement involving an unconsolidated entity under which a company has (a) made guarantees, (b) a retained or a contingent interest in transferred assets, (c) any obligation under certain derivative instruments or (d) any obligation under a material variable interest in an unconsolidated entity that provides financing, liquidity, market risk, or credit risk support to the company, or engages in leasing, hedging, or research and development services within the company.

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The Company does not have any off-balance sheet financing or unconsolidated variable interest entities, with the exception of certain guarantees on leases. We refer the reader to the Notes to the Consolidated Financial Statements included in Item 8 of this Report for information regarding the Company's lease guarantees.

### *MANAGEMENT'S DISCUSSION OF CRITICAL ACCOUNTING POLICIES AND ESTIMATES*

High-quality financial statements require rigorous application of high-quality accounting policies. Management believes that its policies related to revenue recognition, legal contingencies and allowances on franchise, notes and other receivables are critical to an understanding of the Company's consolidated financial statements because their application places the most significant demands on management's judgment, with financial reporting results relying on estimation about the effect of matters that are inherently uncertain.

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Management's estimate of the allowances on receivables is based on historical sales, historical loss levels, and an analysis of the collectibility of individual accounts. To the extent that actual bad debts differed from management's estimates by 10 percent, consolidated net income would be an estimated \$22,000 higher/lower, based upon 2006 results, depending upon whether the actual write-offs are greater or less than estimated.

Management's estimate of the valuation allowance on deferred tax assets is based on whether it is more likely than not that the Company's net operating loss carry-forwards will be utilized. Factors that could impact estimated utilization of the Company's net operating loss carry-forwards are the success of its stores and franchisees, the Company's operating efficiencies and the effects of Section 382 of the Internal Revenue Code of 1986, as amended, based on certain changes in ownership that have occurred, or could occur in the future. To the extent that management lowered its valuation allowance on deferred tax assets by 10 percent, consolidated net income would be an estimated \$1,600,000 higher, based on 2006 results.

The Company recognizes revenues in accordance with SEC Staff Accounting Bulletin (SAB) No. 104, Revenue Recognition. Accordingly, revenues are recorded when persuasive evidence of an arrangement exists, delivery has occurred or services have been rendered, the Company's price to the buyer is fixed or determinable, and collectibility is reasonably assured. To the extent that collectibility of royalties and/or interest on franchise notes is not reasonably assured, the Company recognizes such revenues when the cash is received. To the extent that revenues that were recognized on a cash basis were recognized on an accrual basis, consolidated net income would be an estimated \$125,000 higher, based upon 2006 results.

#### *RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS*

In February 2006, the Financial Accounting Standards Board (FASB) Statement of Financial Accounting Standards (SFAS) No. 155, *Accounting for Certain Hybrid Financial Instruments*—An amendment to SFAS No. 133 and SFAS 140 (SFAS 155). SFAS 155 simplifies the accounting for certain hybrid financial instruments containing embedded derivatives. SFAS 155 allows fair value measurement for any hybrid financial instrument that contains an embedded derivative that otherwise would require bifurcation under SFAS 133. In addition, it amends SFAS 140 to eliminate the prohibition on a qualifying special-purpose entity from holding a derivative financial instrument that pertains to beneficial interest other than another derivative financial instrument. The new standard is effective to new or modified financial instruments in fiscal years beginning after September 15, 2006. The implementation of SFAS 155 is not expected to have material impact on the Company's consolidated financial statements.

In March 2006, the FASB issued SFAS No. 156, *Accounting for Servicing of Financial Assets—An Amendment of SFAS No. 140* (SFAS 156). This statement amends FASB Statement No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*, with respect to the accounting for separately recognized servicing assets and servicing liabilities. This standard clarifies when servicing rights should be separately accounted for, requires companies to account for separately recognized servicing rights initially at fair value, and gives companies the option of subsequently accounting for those servicing rights at either fair value or under the amortization method. SFAS 156 is effective for fiscal years beginning after September 15, 2006. The implementation of SFAS 156 is not expected to have a material impact on the Company's consolidated financial statements.

In July 2006, the FASB issued Interpretation (FIN) No. 48 *Accounting for Uncertainty in Income Taxes—An Interpretation of SFAS No. 109*. FIN 48 prescribes a recognition threshold and measurement attribute for how a company should recognize, measure, present, and disclose in its financial statements uncertain tax positions that the company has taken or expects to take on a tax return. FIN 48 will require that the financial statements reflect expected future tax consequences of such positions presuming the taxing authorities' full knowledge of the position and all relevant facts, but without considering time values. FIN 48 is effective for annual periods beginning after December 15, 2006. The implementation of FIN 48 is not expected to have a material impact on the Company's consolidated financial statements.



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In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements*. SFAS No. 157 defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. The new FASB rule does not supersede all applications of fair value in other pronouncements, but creates a fair value hierarchy and prioritizes the inputs to valuation techniques for use in most pronouncements. It requires companies to assess the significance of an input to the fair value measurement in its entirety. SFAS 157 also requires companies to disclose information to enable users of financial statements to assess the inputs used to develop the fair value measurements. SFAS 157 is effective for fiscal periods beginning after November 15, 2007. The Company is currently evaluating the impact on its consolidated financial statements.

In September 2006, the FASB issued SFAS No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans - An amendment of SFAS No. 87, 88, 106, and 132(R)*. SFAS No. 158 enhances disclosure regarding the funded status of an employer's defined benefit postretirement plan by requiring companies to include the funding status in comprehensive income and recognize transactions and events that affect the funded status in the financial statements in the year in which they occur at a measurement date of the employer's fiscal year-end. SFAS 158 is not expected to apply to the Company.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities - Including an amendment of SFAS No. 115*. SFAS No. 159 amends SFAS No. 115, *Accounting for Certain Investment in Debt and Equity Securities*, with respect to accounting for a transfer to the trading category for all entities with available-for-sale and trading securities electing the fair value option. This standard allows companies to elect fair value accounting for many financial instruments and other items that currently are not required to be accounted as such, allows different applications for electing the option for a single item or groups of items, and requires disclosures to facilitate comparisons of similar assets and liabilities that are accounted for differently in relation to the fair value option. SFAS 159 is effective for fiscal years beginning after November 15, 2007. The implementation of SFAS 159 is not expected to have a material impact on the Company's consolidated financial statements.

*Item 7A. 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 believes that the level of risk related to its cash equivalents is not material to the Company's financial condition or results of operations.

The Company is exposed to interest rate risk under its Credit Facility with M&T Bank. Any increase in the LIBOR rate would lead to higher interest expense, if the Company borrows against the Credit Facility. The Company has not borrowed from the inception of the Credit Facility on August 19, 2005.

*Item 8. Financial Statements and Supplementary Data*

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Information required by schedules called for under Regulation S-X is either not applicable or is included in the consolidated financial statements or notes thereto.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Shareholders of Emerging Vision, Inc. and Subsidiaries:

We have audited the accompanying consolidated balance sheets of Emerging Vision, Inc. (a New York corporation) and subsidiaries (the Company ) as of December 31, 2006 and 2005, and the related consolidated statements of income, shareholders' equity (deficit) and cash flows for each of the three years ended December 31, 2006. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Emerging Vision, Inc. and subsidiaries as of December 31, 2006 and 2005, and the results of their operations and their cash flows for each of the three years ended December 31, 2006 in conformity with accounting principles generally accepted in the United States.

/S/ MILLER, ELLIN & COMPANY LLP

New York, New York

March 22, 2006,



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

<u>ASSETS</u>	<b>December 31,</b>	
	<b>2006</b>	<b>2005</b>
Current assets:		
Cash and cash equivalents	\$ 1,289	\$ 816
Franchise receivables, net of allowance of \$110 and \$195, respectively	1,620	1,836
Optical purchasing group receivables, net of allowance of \$40	1,914	-
Other receivables, net of allowance of \$2 and \$2, respectively	312	210
Current portion of franchise notes receivable, net of allowance of \$44 and \$150, respectively	79	158
Inventories, net	431	345
Prepaid expenses and other current assets	648	395
Net assets of discontinued operations	-	162
Deferred tax asset, current portion	600	-
Total current assets	6,893	3,922
Property and equipment, net	923	610
Franchise notes receivable, net of allowance of \$5 and \$41, respectively	214	129
Deferred tax asset, net of current portion	800	-
Goodwill	2,745	1,266
Intangible assets, net	808	20
Other assets	214	243
Total assets	\$ 12,597	\$ 6,190
 <u>LIABILITIES AND SHAREHOLDERS' EQUITY</u>		
Current liabilities:		
Accounts payable and accrued liabilities	\$ 4,595	\$ 4,049
Optical purchasing group payables	1,760	-
Accrual for store closings	37	37
Short-term debt	991	-
Related party obligations, current portion	183	43
Total current liabilities	7,566	4,129
Long-term debt	1,185	385
Related party obligations, net of current portion	8	191
Franchise deposits and other liabilities	487	667
Contingencies		
Shareholders' equity:		
Preferred stock, \$0.01 par value per share; 5,000,000 shares authorized: Senior Convertible Preferred Stock, \$100,000 liquidation preference per share; 0.74 shares issued and outstanding	74	74
Common stock, \$0.01 par value per share; 150,000,000 shares authorized; 70,506,035 share issued and 70,323,698 shares outstanding	705	705
Treasury stock, at cost, 182,337 shares	(204)	(204)



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Additional paid-in capital	127,062	126,389
Accumulated deficit	(124,286)	(126,146)
Total shareholders' equity	3,351	818
Total liabilities and shareholders' equity	\$ 12,597	\$ 6,190

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

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## EMERGING VISION, INC. AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF INCOME

(In Thousands, Except Per Share Data)

	For the Year Ended December 31,		
	2006	2005	2004
<b>Revenues:</b>			
Net sales	\$ 7,287	\$ 7,070	\$ 7,525
Optical purchasing group sales	7,186	-	-
Franchise royalties	7,042	6,564	6,588
Other franchise related fees	197	123	201
<b>Total revenue</b>	<b>21,712</b>	<b>13,757</b>	<b>14,314</b>
<b>Costs and expenses:</b>			
Cost of sales	7,712	903	964
Selling, general and administrative expenses	13,613	12,409	11,996
<b>Total costs and expenses</b>	<b>21,325</b>	<b>13,312</b>	<b>12,960</b>
<b>Operating income</b>	<b>387</b>	<b>445</b>	<b>1,354</b>
<b>Other income (expense):</b>			
Interest on franchise notes receivable	45	61	88
Gain on sale of company-owned stores to franchisees	268	-	-
Other income	118	108	82
Costs for proxy contest and related litigation	-	-	(581)
Interest expense	(48)	(43)	(59)
<b>Total other income (expense)</b>	<b>383</b>	<b>126</b>	<b>(470)</b>
<b>Income from continuing operations before income tax benefit</b>	<b>770</b>	<b>571</b>	<b>884</b>
<b>Income tax benefit</b>	<b>1,249</b>	<b>-</b>	<b>-</b>
<b>Income from continuing operations</b>	<b>2,019</b>	<b>571</b>	<b>884</b>
<b>(Loss) from discontinued operations</b>	<b>(264)</b>	<b>(305)</b>	<b>-</b>
<b>Income tax benefit</b>	<b>105</b>	<b>-</b>	<b>-</b>
<b>(Loss) from discontinued operations</b>	<b>(159)</b>	<b>(305)</b>	<b>-</b>
<b>Net income</b>	<b>\$ 1,860</b>	<b>\$ 266</b>	<b>\$ 884</b>
<b>Net income per share basic</b>			
Income from continuing operations	\$ 0.03	\$ 0.00	\$ 0.01
(Loss) from discontinued operations	(0.00)	(0.00)	-
Net income	\$ 0.03	\$ 0.00	\$ 0.01
<b>Net income per share diluted</b>			
Income from continuing operations	\$ 0.02	\$ 0.00	\$ 0.01
(Loss) from discontinued operations	(0.00)	(0.00)	-
Net income	\$ 0.02	\$ 0.00	\$ 0.01
<b>Weighted-average number of common shares outstanding</b>			
Basic	70,324	70,324	69,475
Diluted	111,556	112,422	113,696

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

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## EMERGING VISION, INC. AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF SHAREHOLDERS EQUITY (DEFICIT)

FOR THE YEARS ENDED DECEMBER 31, 2006, 2005 AND 2004

(In Thousands, Except Share Data)

	Senior Convertible		Common Stock		Treasury Stock, at cost		Additional	Accumulated	Total
	Preferred Stock						Paid-In	Deficit	Shareholders
	Shares	Amount	Shares	Amount	Shares	Amount	Capital		Equity (Deficit)
<b>Balance December 31, 2003</b>	1	\$ 74	67,682,087	\$ 677	182,337	\$ (204)	\$ 125,987	\$ (127,296)	\$ (762)
Exercise of stock options and warrants	-	-	2,823,948	28	-	-	78	-	106
Issuance of warrants for services rendered in connection with Proxy Contest	-	-	-	-	-	-	5	-	5
Issuance of stock options and warrants	-	-	-	-	-	-	143	-	143
Net income	-	-	-	-	-	-	-	884	884
<b>Balance December 31, 2004</b>	1	\$ 74	70,506,035	\$ 705	182,337	\$ (204)	\$ 126,213	\$ (126,412)	\$ 376
Issuance of stock options and warrants	-	-	-	-	-	-	176	-	176
Net income	-	-	-	-	-	-	-	266	266
<b>Balance December 31, 2005</b>	1	\$ 74	70,506,035	\$ 705	182,337	\$ (204)	\$ 126,389	\$ (126,146)	\$ 818
Issuance of stock options and warrants	-	-	-	-	-	-	534	-	534
Issuance of stock options in connection with the acquisition of substantially all of the assets of Combine	-	-	-	-	-	-	139	-	139
Net income	-	-	-	-	-	-	-	1,860	1,860
<b>Balance December 31, 2006</b>	1	\$ 74	70,506,035	\$ 705	182,337	\$ (204)	\$ 127,062	\$ (124,286)	\$ 3,351

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

## EMERGING VISION, INC. AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF CASH FLOWS

(Dollars in Thousands)

	For the Year Ended December 31,		
	2006	2005	2004
<b>Cash flows from operating activities:</b>			
Income from continuing operations	\$ 2,019	\$ 571	\$ 884
Adjustments to reconcile income from continuing operations to net cash provided by (used in) operating activities:			
Depreciation and amortization	327	230	227
Provision for doubtful accounts	220	501	353
Deferred tax assets	(1,295)	-	-
Non-cash compensation charges related to options and warrants	534	176	148
Gain on the sale of Company-owned stores to franchisees	(268)	-	-
Changes in operating assets and liabilities:			
Franchise and other receivables	(151)	(616)	(128)
Optical purchasing group receivables	(518)	-	-
Inventories	54	50	(4)
Prepaid expenses and other current assets	(253)	57	(63)
Intangible and other assets	(148)	(54)	28
Accounts payable and accrued liabilities	592	(159)	(1,254)
Optical purchasing group payables	414	-	-
Payables associated with proxy contest and related litigation	(46)	(46)	92
Franchise deposits and other liabilities	(180)	8	(278)
Accrual for store closings	-	(5)	(102)
Net cash provided by (used in) operating activities	1,301	713	(97)
<b>Cash flows from investing activities:</b>			
Franchise notes receivable issued	(143)	(150)	(377)
Proceeds from franchise and other notes receivable	277	231	344
Proceeds from the sale of Company-owned stores to franchisees	250	-	-
Purchases of property and equipment	(388)	(418)	(233)
Acquisition of Combine	(700)	-	-
Net cash used in investing activities	(704)	(337)	(266)
<b>Cash flows from financing activities:</b>			
Proceeds from the issuance of common stock upon			
the exercise of stock options and warrants	-	-	106
Payments on borrowings	(85)	(39)	(246)
Net cash used in financing activities	(85)	(39)	(140)
<b>Net cash provided by (used in) continuing operations</b>	<b>512</b>	<b>337</b>	<b>(503)</b>
<b>Net cash used in discontinued operations</b>	<b>(39)</b>	<b>(401)</b>	<b>-</b>
<b>Net increase (decrease) in cash and cash equivalents</b>	<b>473</b>	<b>(64)</b>	<b>(503)</b>
<b>Cash and cash equivalents beginning of year</b>	<b>816</b>	<b>880</b>	<b>1,383</b>
<b>Cash and cash equivalents end of year</b>	<b>\$ 1,289</b>	<b>\$ 816</b>	<b>\$ 880</b>
<b>Supplemental disclosures of cash flow information:</b>			
Cash paid during the year for:			
Interest	\$ 8	\$ 12	\$ 25
Taxes	\$ 34	\$ 43	\$ 93

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Non-cash investing and financing activities:

Accounts receivable, property and equipment, intangible assets and goodwill acquired in connection with the purchase of Combine Optical Management Corporation	\$ 1,773	\$ -	\$ -
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The accompanying notes are an integral part of these consolidated statements.

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**EMERGING VISION, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**NOTE 1 ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES:**

**Business**

Emerging Vision, Inc. (the Registrant and, together with its subsidiaries, hereinafter the Company or Emerging ) operates one of the largest chains of retail optical stores and one of the largest franchise optical chains in the United States, based upon management's beliefs, domestic sales and the number of locations of Company-owned and franchised stores (collectively referred to hereinafter as Sterling Stores ). Additionally, Emerging operates one of the leading optical purchasing groups in the United States (hereinafter referred to as COM ), based upon management's beliefs, domestic sales and the number of Member locations (collectively referred to hereinafter as COM Members). The Registrant was incorporated under the laws of the State of New York in January 1992 and, in July 1992, purchased substantially all of the assets of Sterling Optical Corp., a New York corporation then a debtor-in-possession under Chapter 11 of the U.S. Bankruptcy Code.

As of December 31, 2006, there were 154 Sterling Stores in operation, consisting of 10 Company-owned stores and 144 franchised stores, and 909 active members of COM.

**Basis of Presentation**

The Consolidated Financial Statements reflect the operations of the COM and the Company's retail optical store operations as continuing operations. The results of the retail operations and cash flows conducted in the state of Arizona are reflected as discontinued operations in accordance with the provisions of Financial Accounting Standards Board ( FASB ) Statement of Financial Accounting Standards ( SFAS ) No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets. As a result, the Company determined that substantially all of the net assets of the Company-owned stores located in Arizona as of December 31, 2005 were impaired. During the years ended December 31, 2006 and 2005, the Company incurred losses, net of taxes, related to the discontinued operations of approximately \$159,000 and \$305,000, respectively. As of December 31, 2005, there was approximately \$162,000 of assets associated with the Company's discontinued operations included as part of net assets of discontinued operations on the accompanying Consolidated Balance Sheets. There were no such assets as of December 31, 2006.

**Principles of Consolidation**

The Consolidated Financial Statements include the accounts of Emerging Vision, Inc. and its operating subsidiaries, all of which are wholly-owned. All intercompany balances and transactions have been eliminated in consolidation.

**Use of Estimates**

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amount of assets and liabilities and the disclosure of contingent assets and liabilities as of the dates of such financial statements, and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from those estimates. Significant estimates made by management include, but are not limited to, allowances on franchise, notes and other receivables, and costs of current and potential litigation.

**Cash and Cash Equivalents**

Cash represents cash on hand at Company-owned stores and cash on deposit with financial institutions. All highly liquid investments with an original maturity (from date of purchase) of three months or less are considered to be cash equivalents. The Company's cash equivalents are invested in various investment-grade money market accounts.

**Fair Value of Financial Instruments**

In determining the fair value of its financial instruments, the Company uses a variety of methods and assumptions that are based on market conditions and risks existing as of each balance sheet date. For the majority of financial instruments, including receivables, long-term debt, and stock options and warrants, standard market conventions and techniques, such as discounted cash flow analysis, option pricing models, replacement cost and termination cost, are used to determine fair value. All methods of assessing fair value result in a general approximation of value, and such value may never actually be realized.



**Inventories, net**

Inventories, net, are stated at the lower of cost or market, using the first-in, first-out (FIFO) method, and consist primarily of contact lenses, ophthalmic lenses, eyeglass frames and sunglasses.

**Property and Equipment, net**

Property and equipment, net, are recorded at cost, less accumulated depreciation and amortization. Depreciation is recorded on a straight-line basis over the estimated useful lives of the respective classes of assets. All depreciation and amortization costs are reflected in selling, general and administrative expenses in the accompanying Consolidated Statements of Income.

**Software**

Certain software development costs have been capitalized in accordance with the provisions of Statement of Position 98-1, Accounting for the Costs of Computer Software Developed or Obtained for Internal Use. Such costs include charges for consulting services and costs for personnel associated with programming, coding and testing such software. Amortization of capitalized software costs begins when the software is placed into service, is recorded on a straight-line basis over the estimated useful life and is reflected in selling, general and administrative expenses in the accompanying Consolidated Statements of Income.

**Goodwill and Intangible Assets, net**

In 2001, the FASB issued SFAS No. 142, Goodwill and Other Intangible Assets. This Statement provides that goodwill and intangible assets with indefinite lives should no longer be amortized, but should be reviewed, at least annually, for impairment. Intangible assets with definite useful lives are amortized over their respective estimated useful lives to their estimated residual value. In accordance with the adoption of SFAS No. 142, management performed a review of its existing goodwill and determined that it is not impaired as of December 31, 2006. All other intangible assets are being amortized over their useful lives.

**Impairment of Long-Lived Assets**

The Company follows the provisions of SFAS No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets. This Statement requires that long-lived assets and certain identifiable intangibles be reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of the assets may not be recoverable, but amends the prior accounting and reporting standards for segments of a business to be disposed of. The Company periodically evaluates its long-lived assets (on a store-by-store basis) based on, among other factors, the estimated, undiscounted future cash flows expected to be generated from such assets in order to determine if an impairment exists. For the years ended December 31, 2006, 2005 and 2004, the Company did not record any impairment charges for stores it will continue to operate, and

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wrote off \$0, \$40,000 and \$0, respectively, of long-lived assets related to stores that management has made the decision not to continue to operate. All of the aforementioned amounts are reflected in loss from discontinued operations in the accompanying Consolidated Statements of Income for the years ended December 31, 2006, 2005 and 2004, respectively, and a new basis, if any, for the impaired assets was established.

### **Revenue Recognition**

The Company recognizes revenues in accordance with SEC Staff Accounting Bulletin ( SAB ) No. 104, Revenue Recognition. Accordingly, revenues are recorded when persuasive evidence of an arrangement exists, delivery has occurred or services have been rendered, the Company's prices to buyers are fixed or determinable, and collectibility is reasonably assured.

The Company derives its revenues from the following four principal sources:

*Net sales* Represents sales from eye care products and related services;

*Franchise royalties* Represents continuing franchise royalty fees based upon a percentage of the gross revenues generated by each franchised location;

*Optical purchasing group sales* Represents product pricing extended to COM members associated with the sale of vendor's eye care products to such COM members;

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**Other franchise related fees** Represents the net gains from the sale of Company-owned store assets to franchisees; and certain fees collected by the Company under the terms of franchise agreements (including, but not limited to, initial franchise fees, transfer fees and renewal fees).

Continuing franchise royalties are based upon a percentage of the gross revenues generated by each franchised location. To the extent that collectibility of royalties is not reasonably assured, the Company recognizes such revenue when the cash is received. Initial franchise fees, which are non-refundable, are recognized when the related franchise agreement is signed. Membership fees generated by VisionCare of California, Inc. ( VCC ), a wholly owned subsidiary of the Company, are for optometric services provided to individual patients (members). A portion of membership fee revenues is deferred when billed and recognized ratably over the one-year term of the membership agreement. Interest on franchise notes represents interest charged to franchisees pursuant to promissory notes issued in connection with their acquisition of the assets of a Sterling Store or a qualified financing of their obligations to the Company. To the extent that collectibility of promissory note payments is not reasonably assured, the Company recognizes such income when the cash is received.

The Company also follows the provisions of Emerging Issue Task Force ( EITF ) Issue 01-09, Accounting for Consideration Given by a Vendor to a Customer (Including a Reseller of the Vendor's Products), and accordingly, accounts for discounts, coupons and promotions (that are offered to its customers) as a direct reduction of sales.

### **Cost of Sales**

Cost of sales include the sale of inventory items such as eyeglass frames, contact lenses, ophthalmic lenses, sunglasses and accessories as well as the respective shipping and freight costs for such items.

### **Selling, general and administrative expenses**

Selling, general and administrative expenses primarily include payroll and related benefits, franchise promotions and seminars, business travel, rent and related charges, advertising, professional fees, depreciation and amortization, bank and credit card fees and bad debt expense.

### **Advertising Costs**

The Company expenses advertising costs as incurred. Advertising costs for Company-owned stores aggregated approximately \$546,000, \$212,000 and \$185,000 for the years ended December 31, 2006, 2005 and 2004, respectively, and is reflected in selling, general and administrative expenses on the accompanying Consolidated Statements of Income. Advertising fees received from franchisees are not accounted for in the Consolidated Statements of Income as the Company acts in an agent capacity with respect to those funds. These funds are included in accounts payable and accrued liabilities on the accompanying Consolidated Balance Sheets until such time as the franchisee directs the spending of such funds.

### **Comprehensive Income**

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The Company follows the provisions of SFAS No. 130, Reporting Comprehensive Income, which establishes rules for the reporting of comprehensive income and its components. For the years ended December 31, 2006, 2005 and 2004, the Company's operations did not give rise to items includible in comprehensive income that were not already included in net income. Therefore, the Company's comprehensive income is the same as its net income for all periods presented.

### **Income Taxes**

The Company accounts for income taxes in accordance with SFAS No. 109, Accounting for Income Taxes. Under the asset and liability method specified by SFAS No. 109, the deferred income tax amounts included in the Consolidated Balance Sheets are determined based on the differences between the financial statement and tax basis of assets and liabilities, as measured by the enacted tax rates that will be in effect when these differences reverse. Differences between assets and liabilities for financial statement and tax return purposes are principally related to accrued expenses, the allowances on receivables, equity-based awards, depreciation expense, and net operating loss carry-forwards.

### **Operating Leases**

The Company accounts for all operating leases on a straight-line basis over the term of the lease. In accordance with the provisions of FASB SFAS No. 13, *Accounting for Leases*, any incentives or rent escalations are recorded as deferred rent and amortized as rent expense over the respective lease term.

### **Guarantee Disclosures**

The Company follows the provision of FASB Interpretation ( FIN ) No. 45, Guarantor s Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others, which clarifies the required disclosures to be made by a guarantor in their interim and annual consolidated financial statements about its obligations under certain guarantees that it has issued. FIN No. 45 also requires a guarantor to recognize, at the inception of the guarantee, a liability for the fair value of the obligation undertaken. The provisions of this Interpretation did not have a material impact on the Company s financial position or results of operations.

### **Stock-Based Compensation**

Beginning with stock options and warrants granted in 2003, the Company has accounted for stock-based compensation in accordance with the provisions of SFAS No. 123, Accounting for Stock-Based Compensation, which provided guidance for the recognition of compensation expense as it related to the issuance of stock options and warrants. In addition, the Company adopted the provisions of SFAS No. 148, Accounting for Stock-Based Compensation Transition and Disclosure an amendment of SFAS No. 123. SFAS No. 148 amended SFAS No. 123 to provide alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation provided by SFAS No. 123. As permitted by SFAS No. 148, the Company has adopted the fair value method recommended by SFAS No. 123 to effect a change in accounting for stock-based employee compensation. In addition, the Company adopted the provisions of SFAS No. 123R, Share-Based Payment, which revised SFAS No. 123 to require all share-based payments to employees, including grants of employee stock options, to be recognized based on their fair values.

Stock-based compensation cost of approximately \$534,000, \$176,000 and \$129,000 is reflected in selling, general and administrative expenses on the accompanying Consolidated Statement of Income for the years ended December 31, 2006, 2005 and 2004, respectively. The Company determined the fair value of options and warrants issued using the Black-Scholes option pricing model with the following assumptions: 1 to 2 year expected lives; 10-year expiration period, risk-free interest rate ranging from 3.00% to 5.00%, stock price volatility ranging from 62% to 98%, with no dividends over the expected life.

The Company recognized \$19,000 of expenses related to its issuance of stock options and warrants to certain non-employee consultants to the Company in 2004, which expenses are reflected in selling, general and administrative expenses on the accompanying Consolidated Statements of Income. No such expenses were incurred during the years ended December 31, 2006 and 2005.

### **Concentration of Credit Risk**

#### ***Cash***

The Company maintains cash balances with various financial institutions, which, at times, may exceed the Federal Deposit Insurance Corporation limit. The Company has not experienced any losses to date as a result of this policy, and management believes there is little risk of loss.

***Receivables***

The Company operates retail optical stores in North America, predominantly in the United States, and its receivables are primarily from franchisees that also operate retail optical stores in the United States. The Company estimates allowances for doubtful accounts based on its franchisees' financial condition and collection history. Management believes the Company's allowances are sufficient to cover any losses related to its inability to collect its accounts and notes receivables. Accounts are written-off when significantly past due and deemed uncollectible by management. At times, the Company experiences difficulties with the collection of amounts due from certain franchisees and with certain franchisees' reporting of revenues subject to royalties. This is a common problem for franchisors, and the Company has taken steps designed to improve the reporting by, and collection from, its franchisees.

***Vendors***

COM utilizes certain key vendors to provide its members with a broad spectrum of product purchasing options. If one of these key vendors ceases to do business with COM, or ceases to exist, COM could see a decrease in the amount of product purchased by its members, thus decreasing sales and net income. Management believes there is a sufficient number of competing vendors and enough of a product mix to mitigate any changes to the Company's key vendors.

**Segment Information**

The Company follows the provisions of SFAS No. 131, Disclosures about Segments of an Enterprise and Related

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Information, which establishes annual and interim reporting standards for an enterprise's operating segments, and related disclosures about its products, services, geographic areas and major customers. As defined in SFAS No. 131, for the years ended December 31, 2005, and 2004, the Company reviewed its business operations and determined that the Company's operations were classified into one principal industry segment; retail optical. During 2006, in connection with the Company acquiring substantially all of the tangible assets of Combine, the Company established a second operating segment (the optical group purchasing segment).

### Reclassifications

Certain reclassifications have been made to prior years' consolidated financial statements to conform to the current year presentation.

### **NOTE 2 ACQUISITION OF COMBINE OPTICAL MANAGEMENT CORP.:**

On September 29, 2006, effective August 1, 2006, the Company, through its wholly-owned subsidiary COM Acquisition, Inc. (COM), acquired substantially all of the tangible assets of Combine Optical Management Corp. (Combine) for an aggregate purchase price of \$2,410,000. Combine, which is based in Florida, operates an optical group purchasing business which provides its members vendor discounts on optical products. Also acquired in this transaction was a development stage nutraceutical business that is focused on the development and distribution of nutritional supplements targeted to consumers with pre-dispositions to certain optical diseases and conditions. COM had 909 active members in its optical group purchasing business as of December 31, 2006.

The purchase price consisted of cash payable as follows: (i) \$700,000 paid at closing; (ii) a promissory note (without interest) in the amount of \$1,273,000 with \$498,000 payable on October 1, 2007, \$300,000 payable on October 1, 2008, \$250,000 payable on October 1, 2009, and \$225,000 payable on October 1, 2010; and (iii) a promissory note in the amount of \$500,000 (with interest at 7% per annum) payable in sixty, equal monthly installments of \$9,900.60 commencing October 1, 2007; and consisted of 3,515,625 stock options to purchase shares of the Company's common stock. The options have an exercise price of \$0.15, which was the closing price on the date of grant. All of the options vested immediately and expire 10 years from the date of grant. Additionally, commencing on September 29, 2010, and expiring September 28, 2016, 2,187,500 options may be put back to the Company at a put price per share of \$0.32. The fair value of such options, approximately \$139,000, was calculated using the Black-Scholes method and was included as part of the purchase price.

In connection with this acquisition, the Company entered into a five-year Employment Agreement (the Agreement) with the existing President of Combine. The Agreement provides for an annual salary of \$210,000, certain other benefits, and an annual bonus based upon an established formula.

The acquisition was accounted for as a business purchase and recorded at the estimated fair value (based on an independent expert's valuation) of the assets acquired and liabilities assumed, as follows:

Working Capital	\$ 4,000
Property and Equipment	312,000
Intangible Assets, net	833,000
Goodwill	1,479,000
Net assets acquired	\$ 2,628,000

Property and equipment is being depreciated on a straight-line basis over the estimated useful lives of the respective classes of assets, which include a software system developed by COM having a five year useful life. The intangible assets consist of a covenant not-to-compete based on terms provided in the Agreement, which has a five year useful life, customer-related intangibles with an eleven year useful life, and a trade name with an indefinite life.

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The following table shows certain unaudited pro forma results of the Company, giving effect to the acquisition of substantially all of the assets of Combine, assuming the acquisition was consummated at the beginning of each of the three years ended December 31, 2006:

	(In thousands)		
	2006	2005	2004
<b>Business Segment Net Revenues:</b>			
Retail Optical Stores	\$ 14,526	\$ 13,757	\$ 14,314
Optical Group Purchasing Business	16,593	14,833	15,888
Net revenues	\$ 31,119	\$ 28,590	\$ 30,202
<b>Business Segment Income from Continuing Operations:</b>			
Retail Optical Stores	\$ 1,926	\$ 571	\$ 884
Optical Group Purchasing Business	411	444	281
Income from continuing operations	\$ 2,337	\$ 1,015	\$ 1,165

**NOTE 3 PER SHARE INFORMATION:**

In accordance with SFAS No. 128, Earnings Per Share, basic earnings per common share ( Basic EPS ) is computed by dividing the net income by the weighted-average number of common shares outstanding. Diluted earnings per common share ( Diluted EPS ) is computed by dividing the net income 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 Income. Consolidated stock equivalents totaling 1,886,020, 3,291,020 and 5,340,153 were excluded from the computation of Diluted EPS for the years ended December 31, 2006, 2005 and 2004, respectively, as their effect on the computation of Diluted EPS would have been anti-dilutive.

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

	(In thousands)		
	2006	2005	2004
<b><u>Numerator:</u></b>			
Income from continuing operations	\$ 2,019	\$ 571	\$ 884
(Loss) from discontinued operations	(159)	(305)	-
Net income	\$ 1,860	\$ 266	\$ 884
<b><u>Denominator:</u></b>			
Weighted average common shares outstanding	70,324	70,324	69,475
Dilutive effect of stock options and warrants	41,232	42,098	44,221
Weighted average common shares outstanding, assuming dilution	111,556	112,422	113,696
<b><u>Per Share Information - Basic:</u></b>			
Income from continuing operations	\$ 0.03	\$ 0.00	\$ 0.01
(Loss) from discontinued operations	(0.00)	(0.00)	-
Net income	\$ 0.03	\$ 0.00	\$ 0.01

**Per Share Information - Diluted:**

Income from continuing operations	\$ 0.02	\$ 0.00	\$ 0.01
(Loss) from discontinued operations	(0.00)	(0.00)	-
Net income	\$ 0.02	\$ 0.00	\$ 0.01

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**NOTE 4 FRANCHISE NOTES RECEIVABLE:**

Franchise notes held by the Company consist primarily of purchase money notes related to Company-financed conveyances of Company-owned store assets to franchisees, and certain franchise notes receivable obtained by the Company in connection with acquisitions in prior years. Substantially all notes are secured by the underlying assets of the related franchised store, as well as the personal guarantee of the principal owners of the franchise. As of December 31, 2006, these notes generally provided for interest ranging from 6% to 12%.

Scheduled maturities of notes receivable as of December 31, 2006, are as follows (in thousands):

2007	\$	123
2008		189
2009		21
2010		9
		342
Less: allowance for doubtful accounts		(49)
	\$	293

**NOTE 5 VALUATION AND QUALIFYING ACCOUNTS:**

Franchise receivables, franchise notes receivable, and other Company receivables, are shown on the Consolidated Balance Sheets net of allowances for doubtful accounts. The following is a breakdown, by major component, of the change in those allowances, along with the accruals for store closings:

(In thousands)

	As of December 31,		
	2006	2005	2004
<b>Franchise Receivables:</b>			
Balance, beginning of year	\$ 195	\$ 114	\$ 844
Charged to expense	2	238	206
Reductions, including write-offs	(262)	(162)	(975)
Additions and transfers	175	5	39
Balance, end of year	\$ 110	\$ 195	\$ 114
<b>Optical Purchasing Group Receivables:</b>			
Balance, beginning of year	\$ -	\$ -	\$ -
Charged to expense	40	-	-
Reductions, including write-offs	-	-	-
Additions and transfers	-	-	-
Balance, end of year	\$ 40	\$ -	\$ -
<b>Franchise Notes Receivables:</b>			
Balance, beginning of year	\$ 191	\$ 80	\$ 782
Charged to expense	59	206	37
Reductions, including write-offs	(26)	(90)	(739)
Additions and transfers	(175)	(5)	-
Balance, end of year	\$ 49	\$ 191	\$ 80
<b>Other Company Receivables:</b>			
Balance, beginning of year	\$ 2	\$ 47	\$ 118
Charged to expense	32	20	109
Reductions, including write-offs	(32)	(65)	(180)
Additions and transfers	-	-	-
Balance, end of year	\$ 2	\$ 2	\$ 47
<b>Accrual for Store Closings:</b>			
Balance, beginning of year	\$ 37	\$ 42	\$ 144
Reductions and transfers	-	(5)	(102)
Balance, end of year	\$ 37	\$ 37	\$ 42

**NOTE 6 PROPERTY AND EQUIPMENT, NET:**

Property and equipment, net, consists of the following:

	<b>(In thousands)</b>		<b>Estimated</b>
	<b>As of December 31,</b>		<b>Useful</b>
	<b>2006</b>	<b>2005</b>	<b>Lives</b>
Furniture and fixtures	\$ 277	\$ 265	5-7 years
Machinery and equipment	1,707	1,506	3-5 years
Software	685	324	3-5 years
Leasehold improvements	1,048	1,034	10 years*
	3,717	3,129	
Less: accumulated depreciation	(2,794)	(2,519)	
Property and equipment, net	\$ 923	\$ 610	

\* Based upon the lesser of the assets' useful lives or the term of the lease of the related property.

Depreciation expense for the years ended December 31, 2006, 2005 and 2004 was \$282,000, \$230,000 and \$227,000, respectively, and is reflected in selling, general and administrative expenses in the accompanying Consolidated Statements of Income.

**NOTE 7 INTANGIBLE ASSETS, NET:**

Intangible assets, net, consist of the following:

	<b>(In thousands)</b>		<b>Estimated</b>
	<b>As of December 31,</b>		<b>Useful</b>
	<b>2006</b>	<b>2005</b>	<b>Lives</b>
Customer lists	\$ 333	\$ -	11 years
Letter of credit fees	22	22	2 years
Non-compete agreement	290	-	5 years
Trade name	210	-	Indefinite
	855	22	
Less: accumulated amortization	(47)	(2)	
Intangible assets, net	\$ 808	\$ 20	

Amortization expense for the year ended December 31, 2006 and 2005 was \$45,000 and \$2,000, respectively, and is reflected in selling, general and administrative expenses in the accompanying Consolidated Statements of Income. No such expense was incurred during 2004.

**NOTE 8 ACCRUAL FOR STORE CLOSINGS:**

Effective January 1, 2003, the Company adopted the provisions of SFAS No. 146, Accounting for Costs Associated with Exit or Disposal Activities, which superceded EITF Issue 94-3, Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity. In accordance therewith, the Company records a liability for the cost associated with an exit or disposal activity when the liability is incurred. As of December 31, 2006 and 2005, \$37,000 and \$37,000, respectively, was accrued as accrual for store closings on the accompanying Consolidated Balance Sheets. No provision for store closings was provided for during the years ended December 31, 2006, 2005 and 2004.

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**NOTE 9 ACCOUNTS PAYABLE AND ACCRUED LIABILITIES:**

Accounts payable and accrued liabilities consist of the following (in thousands):

	<b>December 31,</b>	
	<b>2006</b>	<b>2005</b>
Accounts payable	\$ 1,945	\$ 1,796
Accrued payroll and fringe benefits	477	400
Accrued professional fees	120	195
Accrued advertising	1,328	1,204
Accrued rent under sublease	218	230
Accrued interest	117	86
Other accrued expenses	390	138
	<b>\$ 4,595</b>	<b>\$ 4,049</b>

**NOTE 10 INCOME TAXES:**

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As of December 31, 2006 and 2005, net deferred tax assets were approximately \$17,000,000 and \$19,000,000, respectively, resulting primarily from the future tax benefit of net operating loss carry-forwards. In accordance with SFAS No. 109, the Company has provided a valuation allowance against its net deferred tax assets of approximately \$15,600,000 and \$19,000,000 as of December 31, 2006 and 2005, respectively. The valuation allowance against the net deferred tax assets decreased by approximately \$3,400,000, \$500,000 and \$2,100,000 during the years ended December 31, 2006, 2005 and 2004, respectively.

The tax effect of temporary differences that give rise to the deferred tax asset as of December 31, 2006 and 2005, are presented below (in thousands):

	<b>2006</b>	<b>2005</b>
<b>Deferred tax assets:</b>		
Reserves and allowances	\$ 904	\$ 936
Net operating loss carryforwards	17,999	18,267
Valuation allowance	(17,195)	(18,919)
<b>Total deferred tax assets</b>	<b>1,708</b>	<b>284</b>
<b>Deferred tax liabilities:</b>		
Property, plant and equipment	(193)	(193)
Deferred revenue	(24)	(23)
Accrued and other expenses	(91)	(68)
Total deferred tax liabilities	(308)	(284)
<b>Net deferred tax asset</b>	<b>\$ 1,400</b>	<b>\$ -</b>

As of December 31, 2006, the Company had net operating loss carryforwards for regular tax and alternative minimum taxable income purposes available to reduce future taxable income, which may be limited in accordance with Section 382 of the Internal Revenue Code of 1986, as amended, based on certain changes in ownership that have occurred, or could occur in the future. These carryforwards expire as follows (in thousands):

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	<b>Net Operating Loss</b>	<b>AMT Operating Loss</b>
2011	\$ 1,648	\$ 1,564
2012	3,845	3,932
2018	10,927	10,959
2019	1,358	1,358
2020	20,309	20,309
2021	2,369	1,808
2022	4,375	4,310
2023	166	166
	\$ 44,997	\$ 44,406

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The Company's effective tax rate differs from the statutory Federal income tax rate of 34%, primarily due to the effect of state and income taxes and the impact of recording a valuation allowance to offset the potential future tax benefit resulting from net operating loss carry-forwards for all years presented. The following is a reconciliation of the U.S. Federal statutory income tax rate to the Company's effective income tax rate for the years ended December 31, 2006, 2005 and 2004:

	<b>2006</b>	<b>2005</b>	<b>2004</b>
Federal statutory rate	34.0%	34.0%	34.0%
State and local income taxes, net of federal tax benefit	6.0%	6.0%	6.0%
Net operating loss carryforwards	(40.0%)	(40.0%)	(40.0%)
Effective tax rate	0.0%	0.0%	0.0%

**NOTE 11 LONG-TERM DEBT (INCLUDING RELATED PARTY BORROWINGS):**

As of December 31, 2006, principal payments due on the Company's long-term debt and related party borrowings are as follows (in thousands):

<b>Year</b>	<b>Related Party</b>	
	<b>Borrowings</b>	<b>Other Debt</b>
	<b>(1) (2)</b>	<b>(2) (3)</b>
2007	\$ 183	\$ 991
2008	8	415
2009	-	352
2010	-	335
2011	-	83
	\$ 191	\$ 2,176

- 1) On December 31, 2002, the Company refinanced certain past due amounts owed to Cohen's Fashion Optical (CF), a retail optical chain owned by certain of the principal shareholders and directors of the Company (Note 15). As a result, the Company signed a 5-year, \$200,000 promissory note, in favor of CF, bearing interest at a rate of 10% per annum.
- 2) Effective April 14, 2003, in connection with certain Rescission Transactions consummated by the Company on December 31, 2003 (Note 16), the Company signed numerous promissory notes with certain of its shareholders, two of whom are also directors of the Company. The notes, which aggregate \$520,000, bear interest at a rate of 6% per annum, and all sums (principal and interest) under the notes are due and payable in April 2007.
- 3) In connection with the acquisition of all of the net tangible assets of Combine, the Company entered into two promissory notes with Combine. The first note provides for four annual installment commencing October 1, 2007, totaling \$1,273,000 (without interest). The second note, which commenced October 1, 2006, provides for sixty month installments totaling \$500,000 at 7% interest per annum.

**NOTE 12 CREDIT FACILITY:**

On August 19, 2005, the Company entered into a Credit Agreement (the *Credit Agreement*) with Manufacturers and Traders Trust Corporation (*M&T*), establishing a revolving credit facility (the *Credit Facility*), for aggregate borrowings of up to \$2,000,000, which may be used for general working capital needs and certain permitted acquisitions. The initial term of the *Credit Facility* expires in August 2007, but the term may be renewed in accordance with the terms of the *Credit Agreement*. Borrowing are payable in August 2007 with interest accruing at the variable rate of LIBOR plus 2.75% per annum in accordance with the terms of a *Grid Note*. The *Credit Facility* includes various financial covenants including minimum net worth, maximum funded debt and debt service ratio requirements. As of December 31, 2006, the Company had no outstanding borrowings under the *Credit Facility* and was in compliance with all financial covenants.

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The Company and its wholly-owned subsidiary, VCC, have entered into Security Agreements to ensure repayment of borrowings made under the Credit Facility. Under the terms of the Security Agreements, the Company and VCC have granted M&T a security interest in substantially all of their assets. In addition VCC has guaranteed the repayment of the Company's obligations under the Credit Facility.

**NOTE 13 SEGMENT REPORTING**

The Company follows the provisions of FASB Statement 131, Disclosures about Segments of a Business Enterprise and Related Information. During September 2006, the Company acquired substantially all of the tangible assets of Combine, which created two operating segments: Retail Optical Stores and Optical Group Purchasing Business.

The Retail Optical Store segment consists of Company-owned and franchise retail optical stores that offer eye care products and services such as prescription and non-prescription eyeglasses, eyeglass frames, ophthalmic lenses, contact lenses, sunglasses and a broad range of ancillary items. Additionally, the segment also consists of optometric services provided by VCC to members (patients) of certain of those franchise retail optical stores.

The Optical Group Purchasing Business (COM) segment extends product pricing to its members on vendor's eye care products.

Certain business segment information for continuing operations is as follows:

	(In thousands)		
	2006	2005	2004
<b>Business Segment Net Revenues:</b>			
Retail Optical Stores	\$ 14,526	\$ 13,757	\$ 14,314
Optical Group Purchasing Business	7,186	-	-
Net revenues	\$ 21,712	\$ 13,757	\$ 14,314
<b>Business Segment Income from Continuing Operations:</b>			
Retail Optical Stores	\$ 1,926	\$ 571	\$ 884
Optical Group Purchasing Business	93	-	-
Income from continuing operations	\$ 2,019	\$ 571	\$ 884

The Optical Group Purchasing Business segment includes business activity from August 1, 2006 through December 31, 2006.

Additional business segment information is summarized as follows for the year ended December 31, 2006 (in thousands):

<b>Retail Optical Stores</b>	<b>Total</b>
------------------------------	--------------

		<b>Optical Group Purchasing Business</b>	
Total Assets	\$ 7,674	\$ 4,923	\$ 12,597
Depreciation and Amortization	264	63	327
Capital Expenditures	388	-	388
Interest Expense	39	9	48

**NOTE 14 COMMITMENTS AND CONTINGENCIES:**

**Operating Lease Commitments**

The Company leases locations for both its Company-owned and franchised stores, as well as its executive and administrative offices. As of December 31, 2006, minimum future rental payments for Company-owned stores and the Company's executive and administrative offices, as well as for stores leased by the Company and subleased to franchisees, in the aggregate, are as follows (in thousands):

	<b>Total Lease Obligations</b>	<b>Sublease Rentals</b>	<b>Net Company Obligations</b>
2007	\$ 4,427	\$ 3,703	\$ 724
2008	2,130	1,748	382
2009	1,918	1,562	356
2010	1,452	1,160	292
2011	1,229	959	270
Thereafter	4,567	4,301	266
	\$ 15,723	\$ 13,433	\$ 2,290

The Company holds the master lease on certain of its franchised locations and, as part of the franchise agreement, sublets the subject premises to the franchisee. In addition to the fixed rent payable under such master leases, most master leases require payment of a pro rata portion of common area maintenance expenses and real estate taxes, as well as percentage rent based upon the sales volume of the store in question. As required by SFAS No. 13 Accounting for Leases, the Company recognizes its rent expense on a straight-line basis over the life of the related lease. In most cases, however, the Company's obligations are limited due to the holding of leases in a leasehold corporation with limited guarantees from the Company. Rent expense (which was net of sublease rentals of approximately \$4,714,000, \$4,977,000 and \$6,561,000, respectively) was approximately \$1,149,000, \$1,085,000 and \$921,000 for the years ended December 31, 2006, 2005 and 2004, respectively. Contingent rents include, amongst other items, percentage rent and certain year-end common area and real estate tax adjustments. The Company currently does not anticipate that such charges would be material in nature for the Company-owned stores and franchise locations. With respect to franchise locations, the Company acts in an agent capacity with respect to those charges. Additionally, the Company does not hold any of the leases on COM Member locations.

### **Litigation**

In 1999, Apryl Robinson commenced an action in Kentucky against, among others, the Company, seeking an unspecified amount of damages and alleging numerous claims, including fraud and misrepresentation. The claims that are the subject of this action were subsequently tried in an action in New York that resulted in a judgment in favor of the Company, and against Ms. Robinson and Dr. Larry Joel, a co-defendant in such action. Subsequently, Ms. Robinson and Dr. Joel filed for bankruptcy in Kentucky, and received a discharge from the trustee. Presently, there is a motion pending in the U.S. Bankruptcy Court to vacate Dr. Joel's discharge based upon, among other things, fraud on the Bankruptcy Court. The Court has postponed a trial on this motion.

In 1999, Berenter Greenhouse and Webster, an advertising agency previously utilized by the Company, commenced an action, against the Company, in the New York State Supreme Court, New York County, for amounts alleged to be due for advertising and related fees. The amounts claimed by the plaintiff are in excess of \$200,000. In response to this action, the Company filed counterclaims of approximately \$500,000, based upon estimated overpayments allegedly made by the Company pursuant to the agreement previously entered into between the parties. As of the date hereof, these proceedings were still in the discovery stage. The Company has not recorded an accrual for a loss in this action, as the Company does not believe it is probable that the Company will be held liable in respect of plaintiff's claims.

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 the makers' acquisition of a Master Franchise Agreement for the Province of Ontario, Canada, as

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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. The Company has not recorded an accrual for probable losses in the event that the Company shall be held liable in respect of defendant's counterclaims, as the Company does not believe that any such loss is reasonably possible.

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 of approximately \$122,000. The Company answered the complaint in such action, and has heard nothing since. The Company believes that it has a meritorious defense

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to such claim. Although the Company has recorded an accrual for probable losses in the event that the Company shall be held liable in respect of plaintiff's claims, the Company does not believe that any such loss is reasonably possible, or, if there is a loss, the Company does not believe that it is reasonably possible that such loss would exceed the amount recorded.

On May 20, 2003, Irondequoit Mall, LLC commenced an action against the Company and Sterling Vision of Irondequoit, Inc. ( SVI ) alleging, among other things, that the Company had breached its obligations under its guaranty of the lease for the former Sterling Optical store located in Rochester, New York. The Company and SVI believe that they have a meritorious defense to such action. As of the date hereof, these proceedings were in the discovery stage. Although the Company has recorded an accrual for probable losses in the event that the Company shall be held liable in respect of plaintiff's claims, the Company does not believe that any such loss is reasonably possible, or, if there is a loss, the Company does not believe that it is reasonably possible that such loss would exceed the amount recorded.

In August 2005, the Company commenced an action against H&M Optical, Ltd. and Michael Ausiello, in the Supreme Court of the State of New York, County of Nassau, seeking, among other things, monetary damages, in the approximate amount of \$110,000, as a result of the defendants' alleged breach of the terms of the Sterling Optical Center Franchise Agreement (and related documents) with the Company to which they are parties. The defendants then asserted counterclaims against the Company, seeking, among other things, money damages arising under the Franchise Agreement and Sublease with the Company, as a result of the Company's alleged violation of such Franchise Agreement and Sublease. In October 2006, the defendant, on his own accord, voluntarily withdrew all of his counterclaims, with prejudice, and without consideration, of any kind, from the Company. In March 2007, the defendant consented to judgment, against the defendant, for liability on the Company's claims against the defendant.

In May 2006, the Company commenced an action against I and A Optical, Inc., Mark Shuff and Felicia Shuff, in the Supreme Court of the State of New York, County of Nassau, seeking, among other things, monetary damages as a result of the defendants' alleged breach of the terms of the Sterling Optical Center Franchise Agreement (and related documents) with the Company to which they are parties. The defendants then asserted counterclaims against the Company, seeking, among other things, money damages arising under the Franchise Agreement with the Company as a result of the Company's alleged violation of such Franchise Agreement. The Company believes that it has a meritorious defense to such claims. As of the date hereof, these proceedings were in the discovery stage. The Company has not recorded an accrual for a loss in this action, as the Company does not believe it is probable that the Company will be held liable in respect of defendants' counterclaims.

In June 2006, Seacliff Village Shopping Center, Inc. commenced an action against the Company and its subsidiary, Sterling Vision of Seacliff Village, Inc., in the Superior Court of the State of California, Orange County, alleging, among other things, that the Company had breached its obligations under its guaranty of the lease for the former Sterling Optical store located at Seacliff Village. In March, 2007, the parties agreed in principal to the terms of a settlement of this action.

In August 2006, Amy Platt, a former employee of the Company, commenced an action against the Company, in the United States District Court, Eastern District of New York, alleging, among other things, that the Company violated Title VII of the Civil Rights Act of 1964, as amended, 42 U.S.C. 2000e, *et seq.*, the Pregnancy Discrimination Act of 1978, and the New York Executive Law, Human Rights Law, Section 290 *et seq.*, and seeks an unspecified monetary sum as damages resulting therefrom. The Company believes that it has a meritorious defense to plaintiff's claims in this action. As of the date hereof, these proceedings were in the discovery stage. Although the Company has recorded an accrual for probable losses in the event that the Company shall be held liable in respect of plaintiff's claims, the Company does not believe that any such loss is reasonably possible, or, if there is a loss, the Company does not believe that it is reasonably possible that such loss would exceed the amount recorded.

In January 2007, PR Prince Georges Plaza, LLC commenced an action against the Company, in the Circuit Court of the State of Maryland, Prince George's County, alleging, among other things, that the Company had breached its obligations under its guaranty of the lease for the former Sterling Optical store located at The Mall at Prince Georges, 3500 East West Highway, Hyattsville, Prince George's County, Maryland.

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The Company believes that it has a meritorious defense to this action. The action is presently in the discovery stage. Although the Company has recorded an accrual for probable losses in the event that the Company shall be held liable in respect of the plaintiff's claims, the Company does not believe that any such loss is reasonably possible, or, if there is a loss, the Company does not believe that it is reasonably possible that such loss would exceed the amount recorded.

In January 2007, Laurelrising as Owner, LLC commenced an action against the Company, in the Circuit Court of the State of Maryland, Prince Georges County, alleging, among other things, that the Company had breached its obligations under its lease for the former Sterling Optical store located at Laurel Centre Mall, Laurel, Maryland. The Company believes that it has a meritorious defense to this action. The defendant's time to answer the complaint has not expired as of the date hereof. Although the Company has recorded an accrual for probable losses in the event that the Company shall be held liable in respect of the plaintiff's claims, the Company does not believe that any such loss is reasonably possible, or, if there is a loss, the Company does not believe that it is reasonably possible that such loss would exceed the amount recorded.



In January 2007, Leon Simon, d/b/a Simon Properties commenced an action against the Company, in the District Court of the State of North Dakota, Cass County, alleging, among other things, that the Company had breached its obligations under its lease for the former Sterling Optical store located at 3301 13th Avenue South, Fargo, North Dakota. The Company believes that it has a meritorious defense to this action. The defendant's time to answer the complaint has not expired as of the date hereof. Although the Company has recorded an accrual for probable losses in the event that the Company shall be held liable in respect of the plaintiff's claims, the Company does not believe that any such loss is reasonably possible, or, if there is a loss, the Company does not believe that it is reasonably possible that such loss would exceed the amount recorded.

Although the Company, where indicated herein, believes that it has a meritorious defense to the claims asserted against it (and its affiliates), given the uncertain outcomes generally associated with litigation, there can be no assurance that the Company's (and its affiliates') defense of such claims will be successful.

In addition to the foregoing, in the ordinary course of business, the Company is a defendant in certain lawsuits alleging various claims incurred, 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 to, which, in the opinion of management, will have a material adverse effect on the Company.

### **Guarantees**

In connection with the Company's sale of one of its laser vision correction centers, Insight Laser Centers N.Y.I., Inc. (the Ambulatory Center) on May 31, 2001, the Company agreed to guarantee certain of the potential ongoing liabilities of the Ambulatory Center. No such guaranteed liabilities were accrued for as of December 31, 2006 and 2005.

In September 2003, the Company entered into a series of agreements, with the owner of the Ambulatory Center and the landlord of the premises, pursuant to which the Company's future guarantee is now expressly limited to that of the minimum base rent and additional rent, payable under the lease for the premises, as adjusted in accordance with the agreements. In connection with the agreements, the Company agreed to settle its outstanding liabilities allegedly due under its guarantee, which liabilities were settled at lower amounts than the Company had originally accrued for. As of December 31, 2006 and 2005, the Company had no remaining amounts owed relating to this guarantee. However, there can be no assurance that future liabilities will not arise in connection with this guarantee.

As of December 31, 2006, the Company was a guarantor of certain leases of retail optical stores franchised and subleased to its franchisees. In the event that all of such franchisees defaulted on their respective subleases, the Company would be obligated for aggregate lease obligations of approximately \$2,721,000. The Company continually evaluates the credit-worthiness of its franchisees in order to determine their ability to continue to perform under their respective subleases. Additionally, in the event that a franchisee defaults under its sublease, the Company has the right to take over operation of the respective location.

### **Letter of Credit**

The Company, through COM, holds a letter of credit with a financial institution in favor of a key vendor of COM to ensure payment of any outstanding invoices not paid by COM. The letter of credit has a one-year term that expires in December 2007. As of December 31, 2006, the letter of credit totaled \$250,000, and was secured by a certificate of deposit (totaling \$250,000) at the same financial institution, which was included in Prepaid Expenses and Other Current Assets on the accompanying Consolidated Balance Sheets.

**NOTE 15 EXECUTIVE COMPENSATION:**

The Company's Chief Executive Officer ( CEO ) has an employment agreement with one of its key executives, which extends through November 2009. The agreement provides for an annual salary of \$275,000, certain other benefits, and may be eligible for bonus compensation to be determined by the Company's Board of Directors based on the Company's previous calendar's year performance. Additionally, the Company's Chief Operating Officer and Chief Marketing Officer were eligible to receive an incentive bonus based on substantially the same terms as provided to the CEO, under the terms of the CEO's previous employment agreement. No such bonuses were achieved for the years ended December 31, 2006, 2005 and 2004, respectively.

Additionally, in connection with the acquisition of Combine, the Company entered into a five-year Employment Agreement (the Agreement ) with the existing President of Combine. The Agreement provides for an annual salary of \$210,000, certain other benefits, and an annual bonus based upon an established formula. For the year ended December 31, 2006, there was

approximately \$21,000 of such bonus reflected in the accompanying Consolidated Statement of Income. Such bonus achieved will be paid in April 2007.

**NOTE 16 RELATED PARTY TRANSACTIONS:**

On January 10, 2002, the Company relocated to an office building located in Garden City, New York, and entered into a sublease with CF for one of the two floors then being subleased to CF. Occupancy costs were being allocated between the Company and CF based upon the respective square footages being occupied. For the years ended December 31, 2006, 2005 and 2004, the Company paid approximately \$156,000, \$148,000 and \$156,000, respectively, for rent and related charges under this sublease. Management believes that the sublease was at fair market value. Such sublease expired in November 2006. Effective December 1, 2006, the Company entered into a new sublease for such location, which was with an unrelated party.

On December 31, 2002, the Company refinanced certain past due amounts, owed to CF. In connection therewith, the Company signed a 5-year, \$200,000 promissory note, in favor of CF, bearing interest at a rate of 10% per annum. As of December 31, 2006, \$56,000 remained on the accompanying Consolidated Balance Sheet.

Effective April 14, 2003, in connection with certain Rescission Transactions consummated by the Company on December 31, 2003, the Company signed promissory notes with two of its current directors, who are also shareholders, of the Company. The notes, which aggregate \$135,000, bear interest at a rate of 6% per annum, and all sums (principal and interest) under the notes are due and payable in April 2007. As of December 31, 2006 and 2005, the Company had \$30,000 and \$22,000, respectively, of interest accrued for in accounts payable and accrued liabilities on the accompanying Consolidated Balance Sheets. In each of the years ended December 31, 2006, 2005 and 2004, the Company incurred \$8,000 of interest expense on the accompanying Consolidated Statements of Operations.

The Company's Chief Executive Officer serves on the Board of Directors of Newtek Business Services, Inc. ( NBSI ), a company that provides various financial services to both small and mid-sized businesses. The Company utilizes the bank and non-bank card processing services of one of NBSI's affiliated companies. For the years ended December 31, 2006, 2005 and 2004, the Company paid approximately \$71,000, \$66,000 and \$65,000, respectively, to such affiliate for such services provided. Additionally, the Company utilizes insurance administrative services of one of NBSI's affiliated companies. No payments are made directly to that affiliate. The Company believes that the cost of such services were as favorable to the Company as those which could have been obtained from an unrelated third party.

During 2006, 2005 and 2004, the Company purchased eyeglass frames from Viva International Group ( Viva ), a frame manufacturing and distribution company that was owned by one of the directors of the Company until March 2005. The director was elected to the Board of Directors in July 2004. For the years ended December 31, 2006, 2005 and 2004, the total cost of such eyeglass frames was approximately \$62,000, \$61,000 and \$103,000. The Company believes that the cost of such product was as favorable to the Company as those which could have been obtained from an unrelated third party.

During the ordinary course of business, primarily due to the fact that the entities occupied office space in the same building, and in an effort to obtain savings with respect to certain administrative costs, the Company and CF 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 the Company's management, all of the above transactions were conducted at arms-length.

**NOTE 17 SHAREHOLDERS EQUITY:**

**Conversion of Senior Convertible Preferred Stock**

As of December 31, 2006, there were approximately 0.74 shares of Senior Convertible Preferred Stock outstanding with a stated value of approximately \$74,000, convertible into Common Stock at a rate of \$0.75. The sole remaining holder of the Company's Senior Convertible Preferred Stock has the right to vote, as a single class, with the Common Stock, on an as-converted basis, on all matters on which the holders of the Company's Common Stock are entitled to vote.

**Issuance of Common Stock for Consulting Services**

On September 7, 2004, the Company's Board of Directors approved the terms of an agreement whereby it agreed to issue to Greenberg Traurig LLP, in exchange for certain legal services rendered in connection with the Company's proxy contest (Note 18), warrants to purchase up to 100,000 shares of the Company's Common Stock at an exercise price per share of

\$0.25. The warrants are immediately exercisable and will expire on September 6, 2014. As a result of this issuance, the Company incurred a charge to earnings of approximately \$5,000, representing the fair value of the warrants issued, which is reflected in selling, general and administrative expenses on the accompanying Consolidated Statements of Income for the year ended December 31, 2004.

### **Shareholder Rights Offering**

On April 29, 2002, the Board unanimously approved of the Company's initiation of a shareholder rights offering (the Rights Offering), whereby the Company would attempt to raise approximately \$2,000,000 of gross proceeds.

On February 12, 2003, a registration statement filed by the Company in connection with its Rights Offering was declared effective by the Securities and Exchange Commission. The Rights Offering consisted of 50,000,000 units, with each unit consisting of one share of the Company's Common Stock, and a warrant, having a term of 12 months, to purchase one additional share of Common Stock at an exercise price of \$0.05, which was determined based on certain closing price and volume requirements during the subscription period. The terms of the Rights Offering provided that each shareholder was granted 1.67 non-transferable rights for every share of Common Stock owned as of the record date, February 25, 2003. Each right was exercisable for one unit at a price of \$0.04.

On April 14, 2003, the subscription period ended and the Company completed the Rights Offering. Approximately 92,700,000 units were subscribed for in the Rights Offering, and, as a result, 50,000,000 new shares of Common Stock, and warrants to purchase 50,000,000 additional shares of Common Stock, were issued, resulting in gross proceeds of \$2,000,000. The issuance costs associated with the Rights Offering were approximately \$141,000. The net proceeds received in the Rights Offering (approximately \$1,859,000) were allocated based on the relative fair values of the Common Stock and the warrants. Accordingly, approximately \$1,338,000 was allocated to the Common Stock and approximately \$521,000 was allocated to the warrants. On December 31, 2003, effective April 14, 2003, 13,000,000 of the units were rescinded by the Company, and the Company made promissory notes of \$520,000 in the aggregate to such shareholders to repay the original subscription price paid (see Rescission of Units and Warrants below).

On various dates prior to April 14, 2004, holders of warrants issued in connection with the Rights Offering exercised 1,886,510 warrants at an exercise price of \$0.05.

### **Rescission of Units and Warrants**

Subsequent to the Rights Offering, the Company determined that the use of certain of its tax attributes, including its net operating loss carry-forwards, may have been substantially restricted as a result of the consummation of certain transactions in the Rights Offering. In an effort to avoid such restrictions, on December 31, 2003 (effective April 14, 2003), the Company and certain of its shareholders (the Subject Shareholders) agreed to, and effectuated, (a) the rescission *ab initio*, of the exercise, by the Subject Shareholders, of 13,000,000 of the oversubscription rights of the Subject Shareholders (and, accordingly, of the issuance, to such Subject Shareholders, of the units associated therewith), and (b) the rescission, surrender and cancellation of all of the remaining warrants (33,210,028 in the aggregate) that were acquired by the Subject Shareholders in the Rights Offering (collectively, the Rescission Transactions). In connection with the Rescission Transactions, the Company agreed to repay each Subject Shareholder the original subscription amount of \$0.04 (previously paid by each Subject Shareholder) for each of the rescinded units (together with interest at a rate of 6% per annum from the date of the original acquisition thereof), which, in the aggregate for all of the Subject Shareholders, totaled \$520,000. This sum (plus interest) is payable, by the Company, on or before April 14, 2007, pursuant to a series of promissory notes issued to the Subject Shareholders. Additionally, as a result of the Rescission Transactions, the Company's outstanding Common Stock decreased by 13,000,000 shares.

Furthermore, in order to limit the potential that future transactions could have a similar effect on the Company's tax attributes, the Company amended its by-laws to provide the Board of Directors with the ability to void certain transactions in Company securities that may impair or limit the future utilization of its tax attributes, including its net operating loss carry-forwards.

Notwithstanding the consummation of the Rescission Transactions and the amendment of the by-laws, there can be no assurance that the Company has been, or will in the future be, successful in preventing an event which could materially impair or limit the Company's utilization of its net operating loss carry-forwards and other tax attributes.

#### **Settlement with Subject Shareholders**

Recognizing that the Subject Shareholders that participated in the Rescission Transactions (see "Rescission of Units and Warrants" above) suffered certain damages in connection therewith, on December 31, 2003, the Company granted to the Subject Shareholders, in the aggregate, new warrants to purchase 59,210,028 shares of Company Common Stock. The exercise prices of the new warrants issued to each of the Subject Shareholders ranged from \$0.0465 to \$0.0489. These exercise prices were calculated with the intention of allowing the Subject Shareholders to purchase equity of the Company on

substantially the same economic terms that they would have been originally entitled pursuant to the Rights Offering, but for the Rescission Transactions. The new warrants became exercisable on April 15, 2006 and expire on April 14, 2008.

**NOTE 18 STOCK OPTIONS AND WARRANTS:**

**Sterling Stock Option Plan**

In February 2005, the Company amended its 1995 Stock Incentive Plan (the Plan) to increase the number of shares of Common Stock permitted to issue thereunder from 7,000,000 to 25,000,000. The Plan permits the issuance of options to selected employees and directors of, and consultants to, the Company and provides that the term of each award be determined by the Compensation Committee (the Committee), which is charged with administering the Plan. The Plan provides the Board with the ability to grant options in excess of the number of shares reserved for issuance in connection with the Plan, provided that the Board obtains shareholder approval to amend the Plan to increase the shares reserved for issuance underlying option grants within 12 months of the date of grant. Under the terms of the Plan, options may be qualified or non-qualified and granted at exercise prices and for terms to be determined by the Committee. Additionally, certain options previously issued under the Plan provide that notwithstanding the termination of the Company's employment of any such employee/holder, he/she will retain the right to exercise those options that have previously vested in his/her favor until such time that the options expire in accordance with the terms of the original grant.

A summary of the options issued under the Plan is presented in the table below:

	2006		2005		2004	
	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price
Options outstanding, beginning of period	17,151,615	\$ 0.55	16,648,748	\$ 0.62	4,605,635	\$ 3.69
Granted	3,815,625	\$ 0.15	985,000	\$ 0.16	13,284,114	\$ 0.14
Exercised	-	\$ -	-	\$ -	(100,000)	\$ 0.05
Canceled, forfeited or expired	(835,000)	\$ 1.44	(482,133)	\$ 5.97	(1,141,001)	\$ 5.85
Options outstanding, end of period	20,132,240	\$ 0.44	17,151,615	\$ 0.55	16,648,748	\$ 0.62
Options exercisable, end of period	19,942,240	\$ 0.44	8,270,834	\$ 0.99	5,769,634	\$ 1.79

Of the total options outstanding as of December 31, 2006, there were 17,704,739 held by current employees of the Company, and 2,427,501 held by outside directors of the Company, outside consultants and former employees. Of the total options granted during 2006, 3,515,625 were granted to the former President of Combine (currently an employee of the Company), and 300,000 were granted to certain members of the board of directors of the Company. There were no grants during 2006 to outside consultants or former employees.

On December 29, 2004, the Committee granted an aggregate of 13,284,114 stock options to the Company's executive officers, all at an exercise price of \$0.14, which was the closing price on the date of grant. The stock options vested according to the following schedule: (1) 2,405,000 on December 29, 2004; (2) 2,405,000 on December 29, 2005; (3) 6,069,114 on April 16, 2006; and (4) 2,405,000 on December 29, 2006. For the years ended December 31, 2006, 2005 and 2004, the Company incurred a non-cash charge to earnings of approximately \$458,000, \$129,000 and

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\$129,000, respectively, reflected in the selling, general and administrative expenses on the accompanying Consolidated Statements of Operations representing the fair value of the immediately vested options. All of these options expire 10 years from the date of grant.

On September 29, 2005, the Committee granted an aggregate of 375,000 stock options to the Company's non-employee directors, all at an exercise price of \$0.15, which was the closing price on the date of grant. The stock options vested immediately. During the year ended December 31, 2005, the Company incurred a non-cash charge to earnings of approximately \$18,000, reflected in selling, general and administrative expenses on the accompanying Consolidated Statements of Operations representing the fair value of the options. All of these options expire 10 years from the date of grant.

On November 22, 2005, the Committee granted an aggregate of 610,000 stock options to certain of the Company's employees, all at an exercise price of \$0.16, which was the closing price on the date of grant. The stock options vest according to the following

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schedule: (1) 203,333 vested immediately; (2) 203,333 vested on November 22, 2006; and (3) 203,334 vest on November 22, 2007. During the year ended December 31, 2006 and 2005, the Company incurred a non-cash charge to earnings of approximately \$16,000 and \$15,000, respectively, reflected in selling, general and administrative expenses on the accompanying Consolidated Statements of Operations representing the fair value of the options. There remains approximately \$10,000 of non-cash charges to earnings for the portion of the options that are not vested as of December 31, 2006, which charges will be reflected in future Consolidated Statements of Operations. All of these options expire 10 years from the date of grant.

On April 27, 2006, the Company's Compensation Committee granted an aggregate of 300,000 stock options to certain of the Company's independent, non-employee directors, all at an exercise price of \$0.12, which was the closing price on the date of grant. The stock options vested immediately. During the year ended December 31, 2006, the Company incurred a non-cash charge to earnings of approximately \$12,000, reflected in selling, general and administrative expenses on the accompanying Consolidated Statements of Operations representing the fair value of the options. All of these options expire 10 years from the date of grant.

On September 29, 2006, in connection with the acquisition of Combine, the Company granted 3,515,625 stock options to the President of Combine (currently an employee of the Company) all at an exercise price of \$0.15, which was the closing price on the date of grant. The stock options vested immediately. The fair value of such options, approximately \$139,000, was calculated using the Black-Scholes method, was included as part of the purchase price and is reflected in excess costs over net assets acquired on the accompanying Consolidated Balance Sheets as of December 31, 2006. All of these options expire 10 years from the date of grant. Additionally, commencing on September 29, 2010, and expiring September 28, 2016, 2,187,500 options may be put back to the Company at a put price per share of \$0.32.

The following table summarizes information about stock options outstanding and exercisable as of December 31, 2006:

Range of Exercise Prices	Options Outstanding		Options Exercisable		
	Outstanding	Weighted-Average Remaining Contractual Life	Weighted-Average Exercise Price	Exercisable	Weighted-Average Exercise Price
\$0.05 to \$0.08	400,000	6.41	\$ 0.05	400,000	\$ 0.05
\$0.09 to \$0.14	13,584,114	8.15	\$ 0.14	13,584,114	\$ 0.14
\$0.15 to \$0.23	4,610,625	8.61	\$ 0.15	4,420,625	\$ 0.15
\$0.24 to \$0.36	670,000	4.34	\$ 0.32	670,000	\$ 0.32
\$1.32 to \$1.98	5,000	2.83	\$ 1.88	5,000	\$ 1.88
\$3.00 to \$4.50	95,000	2.45	\$ 3.37	95,000	\$ 3.37
\$4.51 to \$6.77	250,834	2.34	\$ 5.91	250,834	\$ 5.91
\$6.78 to \$8.25	516,667	2.44	\$ 8.09	516,667	\$ 8.09

The fair value of each option grant is estimated on the date of grant using the Black-Scholes option-pricing model with the following assumptions:

	2006	2005	2004
Expected life (years)	1-2	1-2	1
Interest rate	5.00%	3.97%-4.32%	3.00%
Volatility	62%-80%	80%	98%

Dividend yield - - -

**Stock Purchase Warrants**

As a result of certain Rescission Transactions entered into by the Company on December 31, 2003 (Note 17), the Company issued warrants to purchase 59,210,028 shares of Company Common Stock to certain Subject Shareholders. The exercise prices of the warrants issued ranged from \$0.0465 to \$0.0489, became exercisable on April 15, 2006, and expire on April 14, 2008. As of December 31, 2006, no such warrants were exercised.

In September 2004, the Company issued 100,000 warrants to Greenberg Traurig LLP (Note 17) at an exercise price of \$0.25, all of which were immediately exercisable and will expire on September 6, 2014.

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On December 30, 2004, the Committee made two issuances, to the Company's general counsel, of warrants to purchase an aggregate of 1,380,885 shares of Common Stock at an exercise price of \$0.14, which was the closing price on the date of grant. The warrants vested according to the following schedule: (1) warrants to purchase 250,000 shares vested immediately; (2) warrants to purchase an additional 250,000 shares vested on December 30, 2005; (3) warrants to purchase an additional 630,885 shares vested on April 16, 2006; and (4) warrants to purchase an additional 250,000 vested on December 30, 2006. For the years ended December 31, 2006, 2005 and 2004, the Company incurred a non-cash charge to earnings of approximately \$48,000, \$14,000 and \$14,000, respectively, reflected in selling, general and administrative expenses on the accompanying Consolidated Statements of Operations representing the fair value of the warrants vested. All such warrants expire 10 years from the date of issuance.

A summary of the warrants issued is presented in the table below:

	2006		2005		2004	
	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price
Options outstanding, beginning of period	60,690,913	\$ 0.05	62,867,913	\$ 0.31	54,831,949	\$ 0.40
Granted	-	\$ -	-	\$ -	60,690,913	\$ 0.05
Exercised	-	\$ -	-	\$ -	(2,723,993)	\$ 0.04
Canceled, forfeited or expired	-	\$ -	(2,177,000)	\$ 7.59	(49,930,956)	\$ 0.05
Options outstanding, end of period	60,690,913	\$ 0.05	60,690,913	\$ 0.05	62,867,913	\$ 0.31
Options exercisable, end of period	60,690,913	\$ 0.05	600,000	\$ 0.16	3,407,885	\$ 6.56

The following table summarizes information about warrants outstanding and exercisable as of December 31, 2006:

Range of Exercise Prices	Options Outstanding		Options Exercisable		
	Outstanding	Weighted-Average Remaining Contractual Life	Weighted-Average Exercise Price	Exercisable	Weighted-Average Exercise Price
\$0.01 to \$0.04	59,210,028	1.29	\$ 0.05	59,210,028	\$ 0.05
\$0.09 to \$0.14	1,380,885	8.00	\$ 0.14	1,380,885	\$ 0.14
\$0.24 to \$0.36	100,000	7.69	\$ 0.25	100,000	\$ 0.25

The fair value of each warrant granted during 2004 was estimated on the date of grant using the Black-Scholes option-pricing model with the following assumptions:

2004

Expected life (years)	1
Interest rate	2.20-3.00%
Volatility	98%
Dividend yield	-

**NOTE 19 - THE PROXY CONTEST AND RELATED LITIGATION**

In May 2004, Benito R. Fernandez, a former director of the Company, and Horizons Investors Corporation ( Horizons ), a company controlled by Mr. Fernandez, commenced an action in New York Supreme Court against the Company and four of his then fellow directors, which action was removed by the Company to the United States District Court for the Eastern District of New York. In their action, the plaintiffs alleged violations of state law arising the Company s purported failure to

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provide plaintiffs with a complete and current list of the Company's shareholders, and alleged breaches of fiduciary duty by directors of the Company in connection with the setting of the record date and Annual Meeting.

On June 2, 2004, Mr. Fernandez, through Horizons, filed a preliminary proxy statement with the SEC in opposition to the Company's director nominees, soliciting proxies in support of a slate of six insurgent director nominees hand-picked by Fernandez. On June 16, 2004, Fernandez amended his preliminary proxy statement to, among other things, exclude one of his original nominees from his slate and ultimately filed a definitive proxy statement with the SEC on June 25, 2004.

The Company's 2004 Annual Meeting of Shareholders (the Annual Meeting) was held on July 14, 2004 and, on July 26, 2004, the independent inspectors of election, IVS Associates, Inc., certified the voting results. The Company's nominees received 36,013,976 (approximately 56.6%) of the votes cast for the contested election of directors. There were 63,582,913 (approximately 90.3%) votes cast at the Annual Meeting out of a possible 70,422,217 voting shares. The insurgent nominees of Horizons, the owner of 23,726,531 (approximately 33.7%) shares of the Company, received only 3,796,925 (approximately 6.0% of the total votes cast) additional votes, for a total of 27,523,456 (approximately 43.3%) of the votes cast.

Accordingly, the Company's director nominees, Seymour G. Siegel, Alan Cohen and Harvey Ross, were elected to serve as Class I directors of the Company, for a term of one year expiring in 2005 (such directors were re-elected for an additional two years at the Company's 2005 Annual Meeting), and Joel L. Gold, Robert Cohen and Christopher G. Payan were elected as Class II directors of the Company, for a term of two years expiring in 2006 (such directors were re-elected for an additional two years at the Company's 2006 Annual Meeting).

On July 28, 2004, the aforementioned action was dismissed by Horizons, without prejudice, on consent.

During the year ended December 31, 2004, the Company incurred approximately \$581,000 of costs associated with the proxy contest and related litigation.

### **NOTE 20 401(K) EMPLOYEE SAVINGS PLANS:**

Emerging Vision, Inc. and VisionCare of California, Inc., each sponsor a 401(k) Employee Savings Plan (the 401(k) Plan) to provide all qualified employees of these entities with retirement benefits. Presently, the administrative costs of each 401(k) Plan are paid entirely by such qualified employees, with no matching contributions having been provided by the Company.

### **NOTE 21 FOURTH QUARTER CHARGES:**

In the fourth quarter of 2006, the Company recognized non-cash equity compensation charges of approximately \$40,000 related to the issuance of stock options and warrants, incurred \$131,000 of depreciation and amortizations expense (\$63,000 related to the assets acquired from Combine), recorded bad debt expense of approximately \$51,000 related to certain of its franchise and notes receivables that management deemed uncollectible, in addition to establishing an allowance of approximately \$40,000 on optical purchasing group receivables, incurred

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approximately \$177,000 of advertising expenses related to the Company's new marketing campaign for Company-owned stores, and incurred approximately \$101,000 of expenses related to the Company's franchise convention.

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***Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure***

Not applicable.

***Item 9A. Controls and Procedures***

The Company's Chief Executive Officer ( CEO ) and Chief Financial Officer ( CFO ) conducted an evaluation of the effectiveness of the Company's disclosure controls and procedures. Based on this evaluation, the Company's CEO and CFO concluded that the Company's disclosure controls and procedures were effective as of December 31, 2006 in alerting them in a timely manner to material information required to be included in our SEC reports. In addition, no change in the Company's internal control over financial reporting occurred during the fourth quarter of the fiscal year ended December 31, 2006 that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

***Item 9B. Other Information***

Not applicable.

***PART III***

***Item 10. Directors and Executive Officers of the Registrant***

The information required by this Item is incorporated into this Annual Report on Form 10-K by reference to the Proxy Statement for our 2007 Annual Meeting of Stockholders, but not to be filed later than April 30, 2007 (120 days after the close of our fiscal year ended December 31, 2006).

***Item 11. Executive Compensation***

The information required by this Item is incorporated into this Annual Report on Form 10-K by reference to the Proxy Statement for our 2007 Annual Meeting of Stockholders, but not to be filed later than April 30, 2007 (120 days after the close of our fiscal year ended December 31, 2006).

***Item 12. Security Ownership of Certain Beneficial Owners, Management and Related Stockholder Matters***

The information required by this Item is incorporated into this Annual Report on Form 10-K by reference to the Proxy Statement for our 2007 Annual Meeting of Stockholders, but not to be filed later than April 30, 2007 (120 days after the close of our fiscal year ended December 31, 2006).

***Item 13. Certain Relationships and Related Transactions***

The information required by this Item is incorporated into this Annual Report on Form 10-K by reference to the Proxy Statement for our 2007 Annual Meeting of Stockholders, but not to be filed later than April 30, 2007 (120 days after the close of our fiscal year ended December 31, 2006).

***Item 14. Principal Accountant Fees and Services***

The information required by this Item is incorporated into this Annual Report on Form 10-K by reference to the Proxy Statement for our 2007 Annual Meeting of Stockholders, but not to be filed later than April 30, 2007 (120 days after the close of our fiscal year ended December 31, 2006).





## ***PART IV***

### ***Item 15. Exhibits and Financial Statement Schedules***

(a) The following documents are filed as a part of this Report:

1. Financial Statements.

Consolidated Balance Sheets as of December 31, 2006 and 2005

Consolidated Statements of Income for the Years Ended December 31, 2006, 2005 and 2004

Consolidated Statements of Shareholders' Equity (Deficit) for the Years Ended December 31, 2006, 2005 and 2004

Consolidated Statements of Cash Flows for the Years Ended December 31, 2006, 2005 and 2004

Notes to Consolidated Financial Statements

2. Financial Statement Schedules:

All financial statement schedules have been omitted because they are not applicable, are not required, or the information required to be set forth therein is included in the Consolidated Financial Statements or Notes thereto.

3. Exhibits

### **EXHIBIT INDEX**

#### **Exhibit**

#### **Number**

(2.1) Asset Purchase Agreement, dated September 29, 2006, among Emerging Vision, Inc., COM Acquisition, Inc., Combine Optical Management Corp. and Neil Glachman (incorporated by reference to Exhibit 2.1 to the Company's Quarterly Report on Form 10-Q, dated November 14, 2006)

(2.2) Promissory Note, dated September 29, 2006, made payable by COM Acquisition, Inc. and Emerging Vision, Inc. to the order of Combine Optical Management Corp., in the original principal amount of \$1,273,000 (incorporated by reference to Exhibit 2.2 to the Company's Quarterly Report on Form 10-Q, dated November 14, 2006)

(2.3) Promissory Note, dated September 29, 2006, made payable by COM Acquisition, Inc. and Emerging Vision, Inc. to the order of Combine Optical Management Corp., in the original principal amount of \$500,000 (incorporated by reference to Exhibit 2.3 to the Company's Quarterly Report on Form 10-Q, dated November 14, 2006)

(3.1) Restated Certificate of Incorporation of Sterling Vision, Inc., filed on December 20, 1995 (incorporated by reference to Exhibit 3.1 to the Company's Annual Report on Form 10-K/A for the year ended December 31, 1995)

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(3.2) Amended and Restated By-Laws of Sterling Vision, Inc., dated December 18, 1995 (incorporated by reference to Exhibit 3.2 to the Company's Annual Report on Form 10-K/A for the year ended December 31, 1995)

(3.3) Certificate of Amendment of the Certificate of Incorporation of Sterling Vision, Inc., filed on January 26, 2000 (incorporated by reference to Exhibit 3.3 to the Company's Annual Report on Form 10-K for the year ended December 31, 2002)

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- (3.4) Form of Certificate of Amendment of the Certificate of Incorporation of Sterling Vision, Inc., filed on February 8, 2000 (incorporated by reference to Exhibit 10.94 to the Company's Current Report on Form 8-K, dated February 8, 2000)
- (3.5) Form of Certificate of Amendment of the Certificate of Incorporation of Sterling Vision, Inc., filed on February 10, 2000 (incorporated by reference to Exhibit 10.96 to the Company's Current Report on Form 8-K, dated February 8, 2000)
- (3.6) Certificate of Amendment of the Certificate of Incorporation of Sterling Vision, Inc., filed on April 17, 2000 (incorporated by reference to Exhibit 3.6 to the Company's Annual Report on Form 10-K for the year ended December 31, 2002)
- (3.7) Certificate of Amendment of the Certificate of Incorporation of Emerging Vision, Inc., filed on July 15, 2002 (incorporated by reference to Exhibit 3.7 to the Company's Annual Report on Form 10-K for the year ended December 31, 2002)
- (3.8) First Amendment to Amended and Restated By-Laws of Emerging Vision Inc., dated November 13, 2003 (incorporated by reference to Exhibit 3.8 to the Company's Current Report in Form 8-K, dated December 31, 2003.)
- (4.1) Specimen of Common Stock Certificate (incorporated by reference to Exhibit 4.1 to the Company's Registration Statement No. 33-98368)
- (4.2) Form of Warrant issued to Subject Shareholders in connection with Settlement Agreements (incorporated by reference to Exhibit 4.8 to the Company's Annual Report on Form 10-K for the year ended December 31, 2003)
- (10.1) Sterling Vision, Inc.'s 1995 Stock Incentive Plan (incorporated by reference to Exhibit 10.2 to the Company's Registration Statement No. 33-98368)
- (10.2) Form of Sterling Vision, Inc.'s Franchise Agreement (incorporated by reference to Exhibit 10.3 to the Company's Registration Statement No. 33-98368)
- (10.3) Form of Franchisee Stockholder Agreement to be entered into between Sterling Vision, Inc. and certain of its Franchisees (incorporated by reference to Exhibit 10.47 to the Company's Registration Statement No. 33-98368)
- (10.4) First Amendment to Sterling Vision, Inc.'s 1995 Stock Incentive Plan (incorporated by reference to Exhibit 10.63 to the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 1996, File No. 1-14128)
- (10.5) Exchange Agreement, dated April 14, 1998, between the Company and the Original Holders of the Registrant's Convertible Debentures Due February 17, 1999 (incorporated by reference to Exhibit 10.78 to the Company's Current Form on 8-K, dated April 14, 1998)
- (10.6) First Amendment to Convertible Preferred Stock and Warrants Subscription Agreement, dated January 4, 1999 (incorporated by reference to Exhibit 10.78 to the Company's Current Report on Form 8-K, dated January 4, 1999)
- (10.7) Second Amendment to Convertible Preferred Stock and Warrants Subscription Agreement, dated March 4, 1999 (incorporated by reference to Exhibit 10.79 to the Company's Current Report on Form 8-K, dated March 4, 1999)
- (10.8) Third Amendment to Convertible Preferred Stock and Warrants Subscription Agreement, dated December 7, 1999 (incorporated by reference to Exhibit 10.90 to the Company's Current Report on Form 8-K, dated December 7, 1999)
- (10.9) Asset Purchase Agreement, dated as of May 31, 2001, by and among Insight Laser Centers N.Y.I, Inc., Insight Amsurg Centers, Inc., Emerging Vision, Inc. and Amsurg Acquisition Corp. (incorporated by reference to Exhibit 10.114 to the Company's Current Report on Form 8-K, dated June 13, 2001)
- (10.10) Form of Settlement Agreement and General Release, dated as of April 1, 2002, between Emerging Vision, Inc. and each of V.C. Enterprises, Inc., Bridget Licht, Sitescope, Inc., Eyemagination Eyeworks, Inc. and Susan Assael, including the form of Area Representation Agreement annexed thereto as an Exhibit (incorporated by reference to Exhibit 10.37 to the Company's Annual Report on Form 10-K for the year ended December 31, 2001)
- (10.11) Form of Rescission Agreement between the Company and certain Subject Shareholders (incorporated by reference to Exhibit 10.13 to the Company's Annual Report on Form 10-K for the year ended December 31, 2003)

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(10.12) Form of Promissory Note made by the Company in favor of Subject Shareholders in connection with Rescission Agreements (incorporated by reference to Exhibit 10.14 to the Company's Annual Report on Form 10-K for the year ended December 31, 2003)

(10.13) Form of Settlement Agreement between the Company and certain Subject Shareholders as a result of Rescission Transactions (incorporated by reference to Exhibit 10.15 to the Company's Annual Report on Form 10-K for the year ended December 31, 2003)

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- (10.14) Credit Agreement, dated August 19, 2005, between Emerging Vision, Inc. and Manufacturers and Traders Trust Corporation (incorporated by reference to Exhibit 10.14 to the Company's Annual Report on Form 10-K for the year ended December 31, 2005)
- (10.15) Standard LIBOR Grid Note, dated August 19, 2005, between Emerging Vision, Inc. and Manufacturers and Traders Trust Corporation (incorporated by reference to Exhibit 10.15 to the Company's Annual Report on Form 10-K for the year ended December 31, 2005)
- (10.16) Security Agreement, dated August 19, 2005, between Emerging Vision, Inc. and Manufacturers and Traders Trust Corporation (incorporated by reference to Exhibit 10.16 to the Company's Annual Report on Form 10-K for the year ended December 31, 2005)
- (10.17) Trademark Security Agreement, dated August 19, 2005, between Emerging Vision, Inc. and Manufacturers and Traders Trust Corporation (incorporated by reference to Exhibit 10.17 to the Company's Annual Report on Form 10-K for the year ended December 31, 2005)
- (10.18) VisionCare Guaranty, dated August 19, 2005, between Emerging Vision, Inc. and Manufacturers and Traders Trust Corporation (incorporated by reference to Exhibit 10.18 to the Company's Annual Report on Form 10-K for the year ended December 31, 2005)
- (10.19) \* Employment Agreement, dated September 29, 2006, between Emerging Vision, Inc. and Neil Glachman
- (10.20) \* Employment Agreement, dated December 1, 2006, between Emerging Vision, Inc. and Christopher G. Payan
- (14.1) Corporate Code of Ethics of Emerging Vision, Inc., dated November 14, 2005 (incorporated by reference to Exhibit 14.1 to the Company's Annual Report on Form 10-K for the year ended December 31, 2005)
- (21.1) \* List of Subsidiaries
- (31.1) \* Certification of Chief Executive Officer pursuant to Securities Exchange Act Rules 13a-14 and 15d-14
- (31.2) \* Certification of Chief Financial Officer pursuant to Securities Exchange Act Rules 13a-14 and 15d-14
- (32.1) \* Certification of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

\* Exhibit being filed herewith

**SIGNATURES**

Pursuant to the requirements of Section 13 or 15(d) 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, thereunto duly authorized.

**EMERGING VISION, INC.**

By: /s/ Christopher G. Payan  
Christopher G. Payan  
Chief Executive Officer

Date: April 2, 2007

Pursuant to the requirements of the Securities Exchange Act of 1934, as amended, this Report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated.

<u>Signature</u>	<u>Title</u>	<u>Date</u>
<u>/s/ Christopher G. Payan</u>	Chief Executive Officer and Director	April 2, 2007
Christopher G. Payan	(Principal Executive Officer)	
<u>/s/ Brian P. Alessi</u>	Chief Financial Officer and Treasurer	April 2, 2007
Brian P. Alessi	(Principal Financial and Accounting Officer)	
<u>/s/ Dr. Alan Cohen</u>	Chairman of the Board of Directors	April 2, 2007
Dr. Alan Cohen		
<u>/s/ Dr. Robert Cohen</u>	Director	April 2, 2007
Dr. Robert Cohen		

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/s/ Joel L. Gold Director April 2, 2007

Joel L. Gold

/s/ Harvey Ross Director April 2, 2007

Harvey Ross

/s/ Seymour G. Siegel Director April 2, 2007

Seymour G. Siegel

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