

Edgar Filing: EMERGING VISION INC - Form 10-Q

EMERGING VISION INC  
Form 10-Q  
May 16, 2005

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

FORM 10-Q

(Mark one)

Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the quarterly period ended March 31, 2005

OR

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

Commission file number: 1-14128

EMERGING VISION, INC.  
(Exact name of Registrant as Specified in Its Charter)

-----  
New York  
-----  
(State of Incorporation)

-----  
11-3096941  
-----  
(IRS Employer Identification No.)

100 Quentin Roosevelt Boulevard  
Garden City, New York 11530  
-----  
(Address of Principal Executive Offices, Including Zip Code)

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

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

Yes  No

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act).

Yes  No

As of May 16, 2005, there were 70,323,698 outstanding shares of the registrant's Common Shares, par value \$0.01 per share.

PART I - FINANCIAL INFORMATION

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Item 1. Financial Statements

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

|  | Mar<br>2<br>-----<br>(Unaud |
|--|-----------------------------|
| ASSETS<br>-----  |                             |
| Current assets:  |                             |
| Cash and cash equivalents  | \$                          |
| Franchise receivables, net of allowance of \$85 and \$114, respectively  |                             |
| Other receivables, net of allowance of \$32 and \$47, respectively   |                             |
| Current portion of franchise notes receivable, net of allowance<br>of \$101 and \$58, respectively   |                             |
| Inventories, net   |                             |
| Prepaid expenses and other current assets  |                             |
|  | -----                       |
| Total current assets   | -----                       |
| Property and equipment, net  |                             |
| Franchise notes receivable, net of allowance of \$34 and \$22, respectively  |                             |
| Goodwill   |                             |
| Other assets   |                             |
|  | -----                       |
| Total assets   | \$<br>=====                 |
| LIABILITIES AND SHAREHOLDERS' EQUITY<br>-----  |                             |
| Current liabilities:   |                             |
| Accounts payable and accrued liabilities   | \$                          |
| Payables associated with proxy contest and related litigation  |                             |
| Accrual for store closings   |                             |
| Related party borrowings   |                             |
|  | -----                       |
| Total current liabilities  | -----                       |
| Long-term debt   | -----                       |
| Related party borrowings   | -----                       |
| Franchise deposits and other liabilities   | -----                       |
| Contingencies  |                             |
| Shareholders' equity:  |                             |
| Preferred stock, \$0.01 par value per share; 5,000,000 shares authorized:<br>Senior Convertible Preferred Stock, \$100,000 liquidation preference per share;<br>0.74 shares issued and outstanding |                             |
| Common stock, \$0.01 par value per share; 150,000,000 shares authorized; 70,506,035<br>shares issued, and 70,323,698 shares outstanding  |                             |
| Treasury stock, at cost, 182,337 shares  |                             |
| Additional paid-in capital   |                             |

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Accumulated deficit

Total shareholders' equity

Total liabilities and shareholders' equity

\$  
=====

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

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### EMERGING VISION, INC. AND SUBSIDIARIES CONSOLIDATED CONDENSED STATEMENTS OF INCOME (Unaudited) (In Thousands, Except Per Share Data)

|  | For the Three Months Ended<br>March 31, |          |
|--|---|----------|
|  | 2005                                    | 2004     |
| <b>Revenues:</b>   |   |          |
| Net sales  | \$ 1,925                                | \$ 1,987 |
| Franchise royalties  | 1,749                                   | 1,686    |
| Other franchise related fees                                 | 66                                      | 54       |
| Interest on franchise notes receivable                       | 23                                      | 17       |
| Other income   | 9                                       | 24       |
| Total revenues   | 3,772                                   | 3,768    |
| <b>Costs and expenses:</b>                                   |   |          |
| Cost of sales  | 262                                     | 271      |
| Selling, general and administrative expenses                 | 3,012                                   | 2,833    |
| Non-cash charges for issuance of options and warrants        | 36                                      | --       |
| Interest expense   | 15                                      | 16       |
| Total costs and expenses                                     | 3,325                                   | 3,120    |
| Income before provision for income taxes                     | 447                                     | 648      |
| Provision for income taxes                                   | --                                      | --       |
| Net income   | \$ 447                                  | \$ 648   |
| <b>Per share information - basic and diluted:</b>            |   |          |
| Net income, basic  | \$ 0.01                                 | \$ 0.01  |
| Net income, diluted  | \$ 0.00                                 | \$ 0.01  |
| <b>Weighted-average number of common shares outstanding:</b> |   |          |
| Basic  | 70,324                                  | 67,646   |
| Diluted  | 112,164                                 | 85,858   |

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

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

|  | For the |
|--|---------|
|  | -----   |
|  | 200     |
|  | -----   |
| Cash flows from operating activities:  |         |
| Net income   | \$      |
| Adjustments to reconcile net income to net cash provided by<br>(used in) operating activities: |         |
| Depreciation and amortization  |         |
| Provision for doubtful accounts  |         |
| Non-cash compensation charges related to options and warrants                                  |         |
| Changes in operating assets and liabilities:   |         |
| Franchise and other receivables  | (       |
| Inventories  |         |
| Prepaid expenses and other current assets  |         |
| Other assets   |         |
| Accounts payable and accrued liabilities   |         |
| Payables associated with proxy contest and related litigation                                  |         |
| Franchise deposits and other liabilities   |         |
| Accrual for store closings   |         |
| Net cash provided by (used in) operating activities  | -----   |
| Cash flows from investing activities:  |         |
| Franchise notes receivable issued  |         |
| Proceeds from franchise and other notes receivable   |         |
| Purchases of property and equipment  |         |
| Net cash provided by investing activities  | -----   |
| Cash flows from financing activities:  |         |
| Payments on borrowings   |         |
| Proceeds from issuance of common shares upon exercise of options and warrants                  |         |
| Net cash used in financing activities  | -----   |
| Net increase (decrease) in cash and cash equivalents   |         |
| Cash and cash equivalents - beginning of period  | -----   |
| Cash and cash equivalents - end of period  | \$ 1,   |
|  | =====   |

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Supplemental disclosures of cash flow information:

Cash paid during the period for:

Interest

\$

Taxes

\$

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

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EMERGING VISION, INC. AND SUBSIDIARIES  
CONSOLIDATED CONDENSED STATEMENT OF SHAREHOLDERS' EQUITY  
FOR THE THREE MONTHS ENDED MARCH 31, 2005  
(In Thousands, Except Share Data)

|  | Senior Convertible<br>Preferred Stock |        | Common Stock |        |
|--|---------------------------------------|--------|--------------|--------|
|  | Shares                                | Amount | Shares       | Amount |
| Balance - December 31, 2004 (Audited)  | 1                                     | \$ 74  | 70,506,035   | \$ 70  |
| Issuance of stock options and warrants | --                                    | --     | --           | --     |
| Net income                             | --                                    | --     | --           | --     |
| Balance - March 31, 2005 (Unaudited)   | 1                                     | \$ 74  | 70,506,035   | \$ 70  |

|  | Additional<br>Paid-In<br>Capital | Accumulated<br>Deficit | Total<br>Shareholders'<br>Equity |
|--|----------------------------------|------------------------|----------------------------------|
| Balance - December 31, 2004 (Audited)  | \$ 126,213                       | \$ (126,412)           | \$ 376                           |
| Issuance of stock options and warrants | 36                               | --                     | 36                               |
| Net income                             | --                               | 447                    | 447                              |
| Balance - March 31, 2005 (Unaudited)   | \$ 126,249                       | \$ (125,965)           | \$ 859                           |

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

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

#### NOTE 1 - BASIS OF PRESENTATION:

The accompanying Consolidated Condensed Financial Statements of Emerging Vision, Inc. and subsidiaries (collectively, the "Company") have been prepared in accordance with accounting principles generally accepted for interim financial statement presentation and in accordance with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted for complete financial statement presentation. In the opinion of management, all adjustments for a fair statement of the results of operations and financial position for the interim periods presented have been included. All such adjustments are of a normal recurring nature. This financial information should be read in conjunction with the Consolidated Financial Statements and Notes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2004. There have been no changes in significant accounting policies since December 31, 2004.

#### NOTE 2 - SIGNIFICANT ACCOUNTING POLICIES:

##### Stock-Based Compensation

Beginning with stock options and warrants granted in 2004, the Company began accounting for stock-based compensation in accordance with the provisions of Statement of Financial Accounting Standards ("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 intends to adopt the provisions of SFAS No. 123R, "Share-Based Payment," which revises SFAS No. 123 "Accounting for Stock-Based Compensation," 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 \$36,000 is reflected in net income for the three months ended March 31, 2005. No such costs were incurred during the three months ended March 31, 2004.

Stock options granted to employees in 2001 were accounted for using the intrinsic value method permitted under Accounting Principle Board ("APB") Opinion No. 25, "Accounting for Stock Issued to Employees." For the three months ended March 31, 2005 and 2004, the pro forma effect on the Company's income, related to such grants made in 2001, was \$0 and \$23,000, respectively.

##### Revenue Recognition

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The Company recognizes revenues in accordance with SEC Staff Accounting Bulletin ("SAB") No. 104, "Revenue Recognition," which superceded SAB No. 101, "Revenue Recognition in Financial Statements." 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 three 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;

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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 and/or interest on franchise notes is not reasonably assured, the Company recognizes such revenue when the cash is received. Initial franchise fees are recognized at the time all material services required to be provided by the Company have been substantially performed.

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.

### NOTE 3 - PER SHARE INFORMATION:

In accordance with SFAS No. 128, "Earnings Per Share", basic net income per common share ("Basic EPS") is computed by dividing the net income attributable to common shareholders by the weighted-average number of common shares outstanding. Diluted net income per common share ("Diluted EPS") is computed by dividing the net income attributable to common shareholders by the weighted-average number of common shares and dilutive common share equivalents and convertible securities then outstanding. SFAS No. 128 requires the presentation of both Basic EPS and Diluted EPS on the face of the Company's Consolidated Statements of Operations. Common share equivalents totaling 3,160,653 and 7,813,658, respectively, were excluded from the computation for the three months ended March 31, 2005 and 2004, as their impact would have been anti-dilutive.

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

| For the<br>Three Months Ended<br>March 31,<br>(In thousands) |      |
|--|------|
| -----  |      |
| 2005   | 2004 |

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|  |         |         |
|--|---------|---------|
| Numerator:   | -----   | -----   |
| Net income   | \$ 447  | \$ 648  |
|  | =====   | =====   |
| Denominator:   |         |         |
| Weighted-average common shares outstanding                       | 70,324  | 67,646  |
| Dilutive effect of:  |         |         |
| Stock options and warrants                                       | 41,840  | 18,212  |
|  | -----   | -----   |
| Weighted-average common shares outstanding,<br>assuming dilution | 112,164 | 85,858  |
|  | =====   | =====   |
| Basic and Diluted Per Share Information:                         |         |         |
| Net income - basic   | \$ 0.01 | \$ 0.01 |
|  | =====   | =====   |
| Net income - diluted   | \$ 0.00 | \$ 0.01 |
|  | =====   | =====   |

NOTE 4 - CONTINGENCIES:

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,

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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. A trial on this motion has been postponed by the Court.

In 1999, Berenter Greenhouse and Webster, the 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.

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 well as their purchase of the assets of, and a Sterling Optical Center Franchise for, four of the Company's retail optical stores then



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located in Ontario, Canada. In response, the defendants counterclaimed for damages, in the amount of \$1,500,000, based upon, among other items, alleged misrepresentations made by representatives of the Company in connection with these transactions. The Company believes that it has a meritorious defense to each counterclaim. As of the date hereof, these proceedings were in the discovery stage.

In February 2002, Kaye Scholer, LLP, the law firm previously retained by the Company as its outside counsel, commenced an action in the New York State Supreme Court seeking unpaid legal fees 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 to such claim.

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.

In October 2003, Luzerne Optical Laboratories, Ltd. ("Luzerne") commenced an action against the Company in the Court of Common Pleas of the County of Luzerne, State of Pennsylvania, which action was thereafter removed to the Federal Court, Middle District of Pennsylvania. In this action, plaintiff seeks to recover, from the Company, the approximate sum of \$240,000 for certain laboratory services allegedly provided to the Company. The Company believes that it has a meritorious defense to such action. As of the date hereof, these proceedings were in the discovery stage.

In December 2003, Westminster Mall Company commenced an action against the Company and Sterling Vision of Westminster, Inc., the Company's wholly-owned subsidiary, in the District Court of the County of Jefferson, State of Colorado, in which the plaintiff, as the Landlord of the Company's former Sterling Optical store located in Westminster, Colorado, is seeking, among other things, damages against such subsidiary under the lease for such store in the approximate amount of \$229,000, and damages against the Company under its guaranty of such lease, in the approximate amount of \$110,000. The Landlord was granted a default judgment against such subsidiary, which default judgment was uncontested by such subsidiary. On April 18, 2005, this action proceeded to trial and, on April 19, 2005, the Court entered judgment against the Company, in the amount of \$84,000, plus fees and costs.

In January 2005, the Company commenced an action against Cherello, Inc., Theodore Cherofsky and Jimmy Choello, in the Supreme Court of the State of New York, County of Nassau, seeking, among other things, injunctive relief and monetary damages, in an amount not less than \$100,000, 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 under such Franchise Agreement, as a result of the Company's alleged violation of such Franchise Agreements. The Company believes that it has a meritorious defense to such claims. As of the date hereof, these proceedings were in the discovery stage.

In February 2005, the Company commenced an action against Abell Vision, Inc., Excel of Beaver Dam, Inc., The Visions Group, Inc., John Bellotti and Anne Bellotti, in the Supreme Court of the State of New York, County of Nassau, seeking, among other things, monetary damages, in the approximate amount of \$100,000, as a result of the defendants' alleged breach of the terms of the

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Sterling Optical Center Franchise Agreements (and related documents) with the Company to which they are parties. The Defendants then asserted counterclaims against the Company, seeking, among other things, rescission of such Franchise Agreements, and money damages thereunder, as a result of the Company's alleged violation of such Franchise Agreements, as well as applicable franchise laws. The Company believes that it has a meritorious defense to such claims. As of the date hereof, these proceedings were in the discovery stage.

In April 2005, 22 Light Street, Inc. commenced an action against the Company in the Circuit Court for Baltimore City, Baltimore, Maryland, in which the plaintiff, as the landlord of Sterling Optical of Light Street, Inc.'s (an affiliate of the Company) Sterling Optical store located in Baltimore, Maryland, is seeking, among other things, damages against the Company under the guaranty of lease for such store, in the approximate amount of \$56,000. The Company believes that it has a meritorious defense in action. As of the date hereof, the plaintiff has filed a motion for summary judgment on its Complaint, and the Company has filed an answer to said complaint, and an opposition to such motion for summary judgment.

In April 2005, New Arcade, LLC commenced an action against the Company in the Small Claims Court, Milwaukee County, Wisconsin, in which the plaintiff, as the landlord of Sterling Optical of Grand Avenue, Inc.'s (an affiliate of the Company) Sterling Optical store located in Milwaukee, Wisconsin, is seeking, among other things, damages against the Company under the lease for such store, in an amount yet to be determined. The Company believes that it has a meritorious defense in action. As of the date hereof, the Company's time to answer the plaintiff's complaint has not yet expired.

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.

Additionally, with respect to the landlord-tenant actions described herein, the Company has already accounted for the estimated possible costs (including possible judgments) associated with such actions as part of accounts payable and accrued liabilities, and the accrual for store closings as of March 31, 2005.

### Guarantees

As of March 31, 2005, the Company was a guarantor of certain leases of retail optical stores franchised and subleased to its franchisees, and, in the event that all of such franchisees defaulted on their respective subleases, the Company would be obligated for aggregate lease obligations of approximately \$3,264,000. 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.

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### 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. These risks and uncertainties may include, among other items: potential conflicts of interest that could occur with certain of our directors; the retention of certain members of our management team; our inability to control the management of our franchised stores; the effects of new federal, state and local regulations that affect the health care industry; insured health plan reimbursement policies and practices with respect to our products and services; our ability to continue to enter favorable arrangements with health care providers; increased competition from other eyewear providers; the general consumer acceptance of refractive laser surgery; product demand and market acceptance risks; the effect of general economic conditions; the impact of competitive products, services and pricing; product development, commercialization and technological difficulties; our ability, or lack thereof, to secure additional equity or debt financing in the future, if necessary, due to the potential lack of liquidity of our common shares; the potential limitation on the use of our net operating loss carry-forwards 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 in the future occur; the possibility that we will be unable to successfully execute our business plan; and the outcome of pending and future litigation. Should one or more of these risks or uncertainties materialize, or should underlying assumptions prove incorrect, actual results may vary materially from those described herein with the forward-looking statements referred to above. The Company does not intend to update these forward-looking statements for the occurrence of events or developments not within the Company's control.

### Results of Operations

For the Three Months Ended March 31, 2005, as Compared to the Comparable Period in 2004

Net sales for Company-owned stores increased by approximately \$31,000, or 3.0%, to \$1,068,000 for the three months ended March 31, 2005, as compared to \$1,037,000 for the comparable period in 2004. This increase was due to a higher average number of Company-owned stores in operation during the same comparable periods.

As of March 31, 2005, there were 11 Company-owned stores (including 2 Company-owned stores being managed by franchisees), as compared to 11 Company-owned stores (including 3 Company-owned stores being managed by franchisees) as of March 31, 2004. On a same store basis (for those stores that the Company will continue to operate as Company-owned stores), comparative net sales decreased by \$92,000, or 9.6%, to \$869,000 for the three months ended March 31, 2005, as compared to \$961,000 for the comparable period in 2004. Management believes that this decrease was a direct result of generally weak sales levels experienced in the upstate New York market, where the majority of the Company-owned stores are located, combined with the effects of employee turnover in certain of the stores.

Revenues generated by the Company's wholly-owned subsidiary, VisionCare of California, Inc. ("VCC"), a specialized health care maintenance organization

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licensed by the State of California Department of Managed Health Care, decreased by approximately \$78,000, or 8.3%, to \$860,000 for the three months ended March 31, 2005, as compared to \$938,000 for the comparable period in 2004. This decrease was primarily due to a decrease in membership fees generated by VCC during the three months ended March 31, 2005, as compared to the same period in 2004.

Franchise royalties increased by \$64,000, or 3.8%, to \$1,750,000 for the three months ended March 31, 2005, as compared to \$1,686,000 for the comparable period in 2004. Management believes this increase was a result of increased levels of field support to franchisees and the success of the Company's audits of franchise locations, which generated additional revenues, offset by a decrease in franchise sales for the stores that were open during both of the comparable periods and a lower average number of stores in operation during the same comparable periods. As of March 31, 2005, there were 155 franchised stores, as compared to 157 stores in operation as of March 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) increased by \$12,000, or 22.2%, to \$66,000 for the three months ended March 31, 2005, as compared to \$54,000 for the comparable period in 2004. This increase was a direct result of the Company entering into three new franchise agreements for the three months ended March 31, 2005 compared to two for the comparable period in 2004.

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Excluding revenues generated by VCC, the Company's gross profit margin increased by 1.0%, to 71.4%, for the three months ended March 31, 2005, as compared to 70.4% for the comparable period in 2004. This increase was mainly a result of improved inventory management and control, improved purchasing at lower average product costs, and improved discounts obtained from certain of the Company's vendors. 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 by \$179,000, or 6.3%, to \$3,012,000 for the three months ended March 31, 2005, as compared to \$2,833,000 for the comparable period in 2004. This increase was mainly a result of increases in salaries and related expenses of \$98,000, and facility and other overhead charges of \$70,000, as the Company had a higher average number of Company-owned stores in operation during the three months ended March 31, 2005.

### Liquidity and Capital Resources

As of March 31, 2005, the Company had negative working capital of \$62,000 and cash on hand of \$1,148,000. During the three months ended March 31, 2005, cash flows provided by its operating activities were \$260,000. This was principally due to net income of \$447,000, offset, in part, by an increase in accounts receivable of \$355,000, and a decrease in accounts payable and accrued liabilities of \$36,000.

For the three months ended March 31, 2005, cash flows provided by investing activities were \$17,000, as compared to \$69,000 for the comparable period in 2004. This was principally due to proceeds received on the Company's franchise notes receivable, offset, in part, by limited capital expenditures.

For the three months ended March 31, 2005, cash flows used in financing activities were \$9,000, principally due to the repayment of the Company's related party borrowings.

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### Future Contractual Obligations

Payments due under contractual obligations as of March 31, 2005 were as follows (in thousands):

|                                | Within<br>1 year | 1-3<br>years | After<br>3 years | Total  |
|--------------------------------|------------------|--------------|------------------|--------|
| Long-term debt (a)             | \$ 40            | \$ 609       | \$ --            | \$ 649 |
| Interest on long-term debt (a) | --               | 125          | --               | 125    |
| Operating leases               | 4,567            | 5,795        | 2,745            | 13,107 |
|                                | 4,607            | 6,529        | 2,745            | 13,881 |

- (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.

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### Item 3. Quantitative and Qualitative Disclosures about Market Risk

The Company presently has outstanding certain equity instruments with beneficial conversion terms. Accordingly, in the future, the Company 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.

### Item 4. Controls and Procedures

#### (a) Evaluation of Disclosure Controls and Procedures

Based on their evaluation of the Company's disclosure controls and procedures as of the end of the period covered by this Quarterly Report on Form 10-Q, the Company's Chief Executive Officer ("CEO") and Chief Financial Officer ("CFO") have concluded that the Company's disclosure controls and procedures are effective to ensure that information required to be disclosed by the Company in reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms, and include controls and procedures designed to ensure that information required to be disclosed by the Company in such reports is accumulated and communicated to the Company's management, including the CEO and CFO, as appropriate to allow timely decisions regarding required disclosure. The Company's management has not yet completed, and is not yet required to have completed, the assessment about the effectiveness of internal controls over financial reporting required by Section 404 of the Sarbanes-Oxley Act.

#### (b) Changes in Internal Controls

There were no changes that occurred during the fiscal quarter covered by this Quarterly Report on Form 10-Q that have materially affected, or are reasonably

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likely to materially affect, the Company's internal controls over financial reporting.

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### PART II - OTHER INFORMATION

#### Item 1. Legal Proceedings

In December 2003, Westminster Mall Company commenced an action against the Company and Sterling Vision of Westminster, Inc., the Company's wholly-owned subsidiary, in the District Court of the County of Jefferson, State of Colorado, in which the plaintiff, as the Landlord of the Company's former Sterling Optical store located in Westminster, Colorado, is seeking, among other things, damages against such subsidiary under the lease for such store in the approximate amount of \$229,000, and damages against the Company under its guaranty of such lease, in the approximate amount of \$110,000. The Landlord was granted a default judgment against such subsidiary, which default judgment was uncontested by such subsidiary. On April 18, 2005, this action proceeded to trial and, on April 19, 2005, the Court entered judgment against the Company, in the amount of \$84,000, plus fees and costs.

In April 2005, 22 Light Street, Inc. commenced an action against the Company in the Circuit Court for Baltimore City, Baltimore, Maryland, in which the plaintiff, as the landlord of Sterling Optical of Light Street, Inc.'s (an affiliate of the Company) Sterling Optical store located in Baltimore, Maryland, is seeking, among other things, damages against the Company under the guaranty of lease for such store, in the approximate amount of \$56,000. The Company believes that it has a meritorious defense in action. As of the date hereof, the plaintiff has filed a motion for summary judgment on its Complaint, and the Company has filed an answer to said complaint, and an opposition to such motion for summary judgment.

In April 2005, New Arcade, LLC commenced an action against the Company in the Small Claims Court, Milwaukee County, Wisconsin, in which the plaintiff, as the landlord of Sterling Optical of Grand Avenue, Inc.'s (an affiliate of the Company) Sterling Optical store located in Milwaukee, Wisconsin, is seeking, among other things, damages against the Company under the lease for such store, in an amount yet to be determined. The Company believes that it has a meritorious defense in action. As of the date hereof, the Company's time to answer the plaintiff's complaint has not yet expired.

#### Item 2. Changes in Securities, Use of Proceeds and Issuer Purchases of Equity Securities

Not applicable.

#### Item 3. Defaults Upon Senior Securities

Not applicable.

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

Not applicable.

#### Item 5. Other Information

Not applicable.

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Item 6. Exhibits

- 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

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SIGNATURES

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

EMERGING VISION, INC.  
(Registrant)

BY: /s/ Christopher G. Payan

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Christopher G. Payan  
Chief Executive Officer  
(Principal Executive Officer)

BY: /s/ Brian P. Alessi

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Brian P. Alessi  
Chief Financial Officer  
(Principal Financial and Accounting Officer)

Dated: May 16, 2005

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