1 800 CONTACTS INC
Form 10-Q
May 14, 2001

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549

FORM 10-Q

(Mark one)
[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended March 31, 2001

[_] 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: 0-23633

1-800 CONTACTS, INC.
(Exact name of registrant as specified in its charter)

Delaware	87-0571643
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
66 E. Wadsworth Park Drive, 3/rd/ Floor Draper, UT	84020
(Address of principal executive offices)	(Zip Code)

(801) 924-9800
(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.
[X] Yes [_] No

As of May 8, 2001, the Registrant had 11,566,033 shares of Common Stock, par value $0.01 per share outstanding.

1-800 CONTACTS, INC.

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

1-800 CONTACTS, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(Unaudited)

ASSETS

	December 30, 2000	March 31, 2001
CURRENT ASSETS:		
Cash and cash equivalents	$ 42,558	$ 3,678,
Inventories	20,402,076	21,553,
Deferred income taxes	673,710	718,
Other current assets	385,001	751,
Total current assets	21,503,345	26,702,
PROPERTY AND EQUIPMENT, net	2,843,103	3,119,
DEFERRED INCOME TAXES	203,620	333,
INTANGIBLE ASSETS, net	1,261,916	1,233,
OTHER ASSETS	295,775	69,

Total assets	$ 26,107,759	$ 31,458,

LIABILITIES AND STOCKHOLDERS' EQUITY

CURRENT LIABILITIES:		
Line of credit	$ 3,264,979	$
Accounts payable	3,646,578	8,378,
Accrued liabilities	3,541,463	4,479,
Income taxes payable	1,206,523	1,788,
Unearned revenue	483,812	306,
Total current liabilities	12,143,355	14,953,
STOCKHOLDERS' EQUITY:		
Common stock	128,611	128,
Additional paid-in capital	23,802,342	23,910,
Retained earnings	8,412,507	10,742,
Treasury stock at cost	(18,376,111)	(18,274,
Accumulated other comprehensive loss	(2,945)	(2,
Total stockholders' equity	13,964,404	16,505,
Total liabilities and stockholders' equity	$ 26,107,759	$ 31,458,

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

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1-800 CONTACTS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF INCOME
(Unaudited)

	Quarter Ended	
	April 1, 2000	March 200
NET SALES	$ 31,419,004	$ 42,8
COST OF GOODS SOLD	18,532,597	25,5
Gross profit	12,886,407	17,2
SELLING, GENERAL AND ADMINISTRATIVE EXPENSES:		
Advertising expense	6,502,196	8,2
Other selling, general and administrative expenses	3,604,764	4,9
Total selling, general and administrative expenses	10,106,960	13,2
INCOME FROM OPERATIONS	2,779,447	4,0
OTHER INCOME (EXPENSE), net	115,829	(2
INCOME BEFORE PROVISION FOR INCOME TAXES	2,895,276	3,8
PROVISION FOR INCOME TAXES	(1,082,727)	(1,5

NET INCOME	$ 1,812,549	$ 2,3
PER SHARE INFORMATION:		
Basic net income per common share	$ 0.15	$
Diluted net income per common share	$ 0.14	$

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

1-800 CONTACTS, INC.
CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY
For the Quarter Ended March 31, 2001
(Unaudited)

	Common Stock		Additional		Tre
	Shares	Amount	Paid-in Capital	Retained Earnings	Shares
BALANCE, December 30, 2000	12,861,136	$ 128,611	$23,802,342	$ 8,412,507	(1,289,555
Exercise of common stock options	-	-	(1,186)	-	16,842
Income tax benefit from common stock options exercised	-	-	108,874	-	-
Net income	-	-	-	2,329,984	-
Foreign currency translation adjustments	-	-	-	-	-
Comprehensive income					
BALANCE, March 31, 2001	12,861,136	$ 128,611	$23,910,030	$10,742,491	(1,272,713

	Total Stockholders' Equity	Comprehensive Income
BALANCE, December 30, 2000	$ 13,964,404	
Exercise of common stock options	100,909	
Income tax benefit from common stock options exercised	108,874	
Net income	2,329,984	$ 2,329,984
Foreign currency		

translation adjustments	940	940
Comprehensive income		$ 2,330,924
BALANCE, March 31, 2001	$ 16,505,111	

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

1-800 CONTACTS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

	Quarter
	April 1, 2000
CASH FLOWS FROM OPERATING ACTIVITIES:	
Net income	$ 1,812,549
Adjustments to reconcile net income to net cash provided by operating activities:	
Depreciation and amortization	261,877
Gain on sale of property and equipment	(2,650)
Loss on impairment of non-marketable securities	-
Deferred income taxes	(32,235)
Changes in operating assets and liabilities:	
Inventories	1,417,372
Other current assets	55,888
Accounts payable	2,417,704
Accrued liabilities	930,660
Income taxes payable	714,962
Unearned revenue	147,303
Net cash provided by operating activities	7,723,430
CASH FLOWS FROM INVESTING ACTIVITIES:	
Purchase of property and equipment	(224,970)
Proceeds from sale of property and equipment	2,650
Purchase of intangible assets	(10,000)
Purchase of non-marketable securities	(220,000)
Deposits	(35,398)
Net cash used in investing activities	(487,718)
CASH FLOWS FROM FINANCING ACTIVITIES:	
Common stock repurchases	(4,280,588)
Proceeds from exercise of common stock options	150,464
Net repayments on line of credit	-
Principal payments on capital lease obligation	(9,795)
Net cash used in financing activities	(4,139,919)

NET INCREASE IN CASH AND CASH EQUIVALENTS		3,095,793
EFFECT OF FOREIGN EXCHANGE RATES ON CASH		-
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD		4,329,088
CASH AND CASH EQUIVALENTS AT END OF PERIOD	$	7,424,881
SUPPLEMENTAL CASH FLOW INFORMATION:		
Cash paid for interest	$	705
Cash paid for income taxes		300,000

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

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1-800 CONTACTS, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

NOTE 1. PRESENTATION OF CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

The accompanying condensed consolidated financial statements have been prepared by the Company, without audit, pursuant to the rules and regulations of the Securities and Exchange Commission. Certain information and disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to such rules and regulations. These condensed consolidated financial statements reflect all adjustments (consisting only of normal recurring adjustments), which in the opinion of management, are necessary to present fairly the results of operations of the Company for the periods presented. It is suggested that these condensed consolidated financial statements be read in conjunction with the audited financial statements and the notes thereto included in the Company's Annual Report to Shareholders on Form 10-K.

The results of operations for the interim periods presented are not necessarily indicative of the results to be expected for the full year.

NOTE 2. NET INCOME PER COMMON SHARE

Basic net income per common share ("Basic EPS") excludes dilution and is computed by dividing net income by the weighted-average number of common shares outstanding during the period. Diluted net income per common share ("Diluted EPS") reflects the potential dilution that could occur if stock options or other common stock equivalents were exercised or converted into common stock. The computation of Diluted EPS does not assume exercise or conversion of securities that would have an antidilutive effect on net income per common share.

The following is a reconciliation of the numerator and denominator used to calculate Basic and Diluted EPS:

	Quarter Ended April 1, 2000			Quarter Ended M	
	Net Income	Shares	Per-Share Amount	Net Income	Share
Basic EPS	$1,812,549	12,362,412	$ 0.15	$2,329,984	11,576,

Effect of stock options		194,702			223,
Diluted EPS	$1,812,549	12,557,114	$ 0.14	$2,329,984	11,800,

NOTE 3. COMMON STOCK TRANSACTIONS

During the quarter ended March 31, 2001, employees exercised stock options to purchase 16,842 shares of common stock for a total of $100,909.

During the quarter ended March 31, 2001 the Company granted nonqualified stock options to purchase 93,564 shares of common stock to employees and directors of the Company. The exercise prices of the options range from $21.25 to $34.938. The options vest equally over a four year period and expire in ten years.

On April 20, 2001, the Company's Board of Directors authorized an additional repurchase of up to 1,000,000 shares of its common stock, bringing the total authorization to 3,000,000 shares. A purchase of the full 3,000,000 shares would equal approximately 23.3 percent of the total shares issued. The repurchase of common stock is subject to market conditions and is accomplished through periodic purchases at prevailing prices on the open

market, by block purchases or in privately negotiated transactions. The repurchased shares will be retained as treasury stock to be used for corporate purposes. As of March 31, 2001, the Company had repurchased 1,484,000 shares for a total cost of $19,453,109. Subsequent to March 31, 2001, the Company repurchased 22,500 shares for a total cost of $438,125.

NOTE 4. IMPAIRMENT OF INVESTMENT

During the quarter ended March 31, 2001, the Company determined that its investment in the stock of an entity in which a member of the Company's Board of Directors holds a significant ownership interest and serves as an officer and director was impaired. The Company recorded a $220,000 loss to adjust the investment to its determined net realizable value of $0.

NOTE 5. LEGAL MATTERS

On July 14, 1998, Craig S. Steinberg, O.D., a professional corporation d.b.a. City Eyes Optometry Center, filed a purported class action on behalf of all California optometrists against the Company and its directors in Los Angeles County Superior Court. In April 2001, the Company settled this claim. The settlement did not materially impact the Company's results of operations.

On April 7, 1999, the Kansas Board of Examiners in Optometry ("KBEO") commenced a civil action against the Company. The action was filed in the District Court of Shawnee County, Kansas, Division 6. The complaint was amended on May 28, 1999. The amended complaint alleges that "on one or more occasions" the Company sold contact lenses in the state of Kansas without receipt of a prescription. The amended complaint seeks an order enjoining the Company from further engaging in the alleged activity. The amended complaint does not seek monetary damages. In response to the amended complaint, the Company has retained counsel, and intends to vigorously defend itself in this action. The Company has filed an answer to the amended complaint and, at the request of the Court, filed a motion for summary judgment. In November 2000, the Court issued an order denying the summary judgment motion, finding that there were factual issues regarding whether the KBEO can meet the requirements necessary to obtain injunctive relief, and whether the Kansas law violates the Commerce Clause of the United States Constitution. The parties are now engaging in fact and expert discovery in preparation for trial.

On or about November 2, 1999, the Company received a complaint from the Texas Optometry Board seeking injunctive relief and civil penalties against the Company for alleged violation of the Texas Optometry Act. The complaint alleges that the Company (1) failed to state explicitly in its advertisements that a written prescription is required to purchase contact lenses and (2) dispensed contact lenses without such a prescription. The Company has filed an answer to the complaint and plans to vigorously defend this action.

The Company entered into a written settlement agreement with the Texas Department of Health ("TDH"), the regulatory authority in Texas for sellers of contact lenses, which became effective February 29, 2000, relating to the Company's sales practices in Texas. The implementation of this agreement began November 2000. The agreement allows for a review of and, if necessary, changes to the Company's practices during a six month period. The TDH issued a Notice of Violation against the Company on or about February 26, 2001, alleging that the Company failed to comply with certain provisions of the agreement. The Company will be engaging in discussions with the TDH regarding this notice.

From time to time the Company is involved in other legal matters generally incidental to its business.

It is the opinion of management, after discussion with legal counsel, that the ultimate dispositions of all of these matters will not likely have a material impact on the financial condition, liquidity or results of operations of the Company. However, there can be no assurance that the Company will be successful in its efforts to satisfactorily resolve these matters and the ultimate outcome could result in a material negative impact on the Company's results of operations and financial position.

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

Overview

The Company is a leading direct marketer of replacement contact lenses. The Company was formed in February 1995 and is the successor to the mail order business founded by the Company's Vice President of Sales in March 1991. Since its formation, the Company's net sales have grown rapidly, from $3.6 million in fiscal 1996 to $145.0 million in fiscal 2000 and from $31.4 million in the first quarter of fiscal 2000 to $42.8 million in the first quarter of fiscal 2001. Internet sales have grown from an insignificant amount in fiscal 1996 to approximately $53.8 million in fiscal 2000 and from $9.2 million in the first quarter of fiscal 2000 to $16.3 million in the first quarter of fiscal 2001.

The Company's fiscal year consists of a 52/53 week period ending on the Saturday nearest to December 31.

The Company expenses all advertising costs when the advertising first takes place. As a result, quarter-to-quarter comparisons are impacted within and between quarters by the timing of television, radio and Internet advertisements and by the mailing of the Company's printed advertisements. The volume of mailings and other advertising may vary in different quarters and from year to year depending on the Company's assessment of prevailing market opportunities.

The sale and delivery of contact lenses are governed by both federal and state laws and regulations. The Company sells to customers in all 50 states, and each sale is likely to be subject to the laws of the state where the customer is located. In some states, the Company operates according to agreements it has entered into with local regulatory authorities or medical boards or agencies. The Company's general operating practice is to attempt to obtain a valid prescription from each of its customers or his/her eye care practitioner. If the customer does not have a copy of his/her prescription but does have the prescription information obtained directly from the customer's eye care practitioner, the Company attempts to contact the customer's eye care practitioner to obtain a copy of or verify the customer's prescription. If the Company is unable to obtain a copy of or verify the customer's prescription, it is the Company's general practice to complete the sale and ship the lenses to the customer based on the prescription information provided by the customer. The Company retains copies of the written prescriptions that it receives and maintains records of its communications with the customer's prescriber.

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Results of Operations

The following table presents the Company's results of operations expressed as a percentage of net sales for the periods indicated:

	Quarter Ended	
	April 1, 2000	March 31, 2001
Net sales	100.0%	100.0%
Cost of goods sold	59.0	59.6
Gross profit	41.0	40.4
Advertising expense	20.7	19.3
Other selling, general and administrative expenses	11.5	11.6
Total selling, general and administrative expenses	32.2	30.9
Income from operations	8.8	9.5
Other income (expense), net	0.4	(0.5)
Income before provision for income taxes	9.2	9.0
Provision for income taxes	(3.4)	(3.6)
Net income	5.8%	5.4%

Net sales. Net sales for the quarter ended March 31, 2001 increased 36% to \$42.8 million from \$31.4 million for the quarter ended April 1, 2000. The Company added more than 160,000 new customers during the first quarter of fiscal 2001. The Company is realizing the benefits of repeat sales from a growing customer base. Repeat sales for the first quarter of fiscal 2001 increased 54% to \$28.1 million, or 66% of net sales, from \$18.2 million, or 58% of net sales, for the first quarter of fiscal 2000. The Company also believes that this increase in net sales reflects some of the benefits of the more than \$82 million it has invested in its national advertising campaign over the last several years and its commitment to customer service. In addition to refining its marketing efforts to its customer base, the Company has also enhanced its website and has increased the exposure of its website in its advertising. Internet sales for the first quarter of fiscal 2001 were $16.3 million, or 38% of net sales, as compared to $9.2 million, or 29% of net sales, for the first quarter of fiscal 2000. Although the Company believes that sales will increase substantially in fiscal 2001 as compared to fiscal 2000, the Company expects the rate of growth in net sales to decrease.

Gross profit. Gross profit as a percentage of net sales decreased to 40.4% for the quarter ended March 31, 2001 from 41.0% for the quarter ended April 1, 2000. The increase in Internet sales as a percentage of net sales impacts gross profit as a percentage of net sales since Internet orders generate lower gross profit due to free shipping on those orders. The Company believes that gross profit as a percentage of net sales may continue to decrease slightly as Internet sales as a percentage of net sales continues to increase.

Advertising expense. Advertising expense for the quarter ended March 31, 2001 increased $1.8 million, or 27%, from the quarter ended April 1, 2000. As a percentage of net sales, advertising expense decreased to 19.3% for the first quarter of fiscal 2001 from 20.7% for the first quarter of fiscal 2000. The Company plans to increase advertising spending in fiscal 2001 by approximately 20% from its fiscal 2000 spending. However, if opportunities present themselves, the Company may increase advertising spending above currently planned levels.

Other selling, general and administrative expenses. Other selling, general and administrative expenses for the quarter ended March 31, 2001 increased $1.4 million, or 38%, from the quarter ended April 1, 2000. As a percentage of net sales, other selling, general and administrative expenses increased slightly to 11.6% for the first quarter of fiscal 2001 from 11.5% for the first quarter of fiscal 2000.

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Other income (expense), net. Other income (expense) decreased to approximately ($205,000) for the quarter ended March 31, 2001 from approximately $116,000 for the quarter ended April 1, 2000. Interest income decreased due to lower cash balances throughout the quarter. In addition, during the first quarter of fiscal 2001, the Company recorded a $220,000 loss related to the impairment of non-marketable securities.

Income taxes. The Company's effective tax rate for the quarter ended March 31, 2001 was 39.4%. For the quarter ended April 1, 2000, the Company's effective tax rate was 37.4%. As of March 31, 2001, the Company had not provided a valuation allowance on deferred tax assets. The Company's future effective tax rate will depend upon future taxable income. The Company anticipates that its fiscal 2001 effective income tax rate will be approximately 39%.

Liquidity and Capital Resources

For the quarters ended March 31, 2001 and April 1, 2000, net cash provided by operating activities was approximately $7.4 million and $7.7 million, respectively. In the fiscal 2001 period, cash was provided primarily by net income and increases in accounts payable, accrued liabilities and income taxes payable offset by an increase in inventories. In the fiscal 2000 period, cash was provided primarily by net income and increases in accounts payable, accrued liabilities and income taxes payable as well as a decrease in inventories. In order to help ensure sufficient supply of inventory, the Company generally carries a higher level of inventory than if it were able to purchase directly from all contact lens manufacturers.

The Company used approximately $567,000 and $488,000 for investing activities in the quarters ended March 31, 2001 and April 1, 2000, respectively. The majority of these amounts relate to capital expenditures for infrastructure improvements. Capital expenditures for the fiscal 2001 period were approximately $517,000. A significant portion of these expenditures relate to the expansion of the Company's leased distribution center and leased space used for its management and call center operations. Capital expenditures for the fiscal 2000 period were approximately $260,000 (including approximately $35,000 in deposits). In addition, in March 2000, the Company made a $220,000 investment in the stock of an entity in which a member of the Company's Board of Directors holds a significant ownership interest and serves as an officer and director. The Company anticipates additional capital expenditures for infrastructure as it continues to expand and improve operating facilities, telecommunications systems and management information systems in order to handle future growth. The Company presently anticipates that capital expenditures in fiscal 2001 will be approximately $1.6 million.

As of March 31, 2001, the Company had certain noncancelable commitments to purchase approximately $9.4 million of broadcast advertising through September 2001. In addition, the Company has entered into certain noncancelable commitments with various advertising companies that will require the Company to pay approximately $6.4 million from January 1, 2001 through December 31, 2001.

During the quarters ended March 31, 2001 and April 1, 2000, the Company used approximately $3.2 million and $4.1 million for financing activities. During the fiscal 2001 period, the Company repaid the amount owed on its credit facility. The net repayments on the credit facility totaled approximately $3.3 million. During the fiscal 2000 period, the Company repurchased a total of 316,000 shares of its common stock for a total cost of approximately $4.3 million. In both the fiscal 2001 and 2000 periods, these amounts were offset slightly by proceeds from the exercise of common stock options.

On April 20, 2001, the Company's Board of Directors authorized an additional repurchase of up to 1,000,000 shares of its common stock, bringing the total authorization to 3,000,000 shares. A purchase of the full 3,000,000 shares would equal approximately 23.3 percent of the total shares issued. The repurchase of common stock is subject to market conditions and is accomplished through periodic purchases at prevailing prices on the open market, by block purchases or in privately negotiated transactions. The repurchased shares will be retained as treasury stock to be used for corporate purposes. As of March 31, 2001, the Company had repurchased 1,484,000

shares for a total cost of approximately $19.5 million. Subsequent to March 31, 2001, the Company repurchased 22,500 shares for a total cost of approximately $438,000.

The Company has a revolving credit facility to provide for working capital requirements and other corporate purposes. The credit facility provides for borrowings equal to the lesser of $10.0 million or 50 percent of eligible inventory and bears interest at a floating rate equal to the lender's prime interest rate (8.0 percent as of March 31, 2001). As of March 31, 2001, the Company had no outstanding borrowings on the credit facility. The credit facility is secured by substantially all of the Company's assets and contains financial covenants customary for this type of financing. The credit facility was to expire on April 30, 2001 but has been extended until May 30, 2001. The Company is in the process of replacing the facility.

The Company believes that its cash on hand, together with cash generated from operations and the cash available through the credit facility, will be sufficient to support current operations and future growth through the next year. The Company may be required to seek additional sources of funds for accelerated growth or continued growth after that point, and there can be no assurance that such funds will be available on satisfactory terms. Failure to obtain such financing could delay or prevent the Company's planned growth, which could adversely affect the Company's business, financial condition and results of operations.

As a result of state regulatory requirements, the Company's liquidity, capital resources and results of operations may be negatively impacted in the future if the Company incurs increased costs or fines, is prohibited from selling its products in a particular state(s) or experiences losses of a substantial portion of the Company's customers for whom the Company is unable to obtain or verify a prescription due to the enforcement of requirements by state regulatory agencies.

Forward-Looking Statements

Except for the historical information contained herein, the matters discussed in this Form 10-Q are forward-looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended, and Section 27A of the Securities Act of 1933, as amended. These forward-looking statements involve risks and uncertainties and often depend on assumptions, data or methods that may be incorrect or imprecise. The Company's future operating results may differ materially from the results discussed in, or implied by, forward-looking statements made by the Company. Factors that may cause such differences include, but are not limited to, those discussed below and the other risks detailed in the Company's other reports filed with the Securities and Exchange Commission. The words such as "believes," "anticipates," "expects," "future," "intends," "would," "may" and similar expressions are intended to identify forward-looking statements. The Company undertakes no obligation to revise any of these forward-looking statements to reflect events or circumstances after the date hereof.

Factors That May Affect Future Results

- The Company's sales growth will not continue at historical rates and it may encounter unforeseen difficulties in managing its future growth;

- A significant portion of the Company's sales do not comply with applicable state laws and regulations governing the delivery and sale of contact lenses;

- Because the Company doesn't manufacture contact lenses, it cannot ensure that the contact lenses it sells meet all federal regulatory requirements;

- It is possible that the FDA will consider certain of the contact lenses the Company sells to be misbranded;

- The Company currently purchases a substantial portion of its products from unauthorized distributors and is not an authorized distributor for some of the products that it sells;

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- The Company obtains a large percentage of its inventory from a limited number of suppliers, with a single distributor accounting for 47%, 38% and 35% of the Company's inventory purchases in fiscal 1998, 1999 and 2000, respectively;

- The Company's quarterly results are likely to vary based upon the level of sales and marketing activity in any particular quarter;

- The Company is dependent on its telephone, Internet and management information systems for the sale and distribution of contact lenses;

- The Company has limited operating history and, as a result, there is only limited financial information and operating information available for a potential investor to evaluate the Company;

- The retail sale of contact lenses is highly competitive; certain of the Company's competitors are large, national optical chains that have greater resources than the Company has;

- The demand for contact lenses could be substantially reduced if alternative technologies to permanently correct vision gain in popularity;

- The Company does not have any property rights in the 1-800 CONTACTS telephone number or the Internet addresses that it uses;

- Increases in the cost of shipping, postage or credit card processing could harm the Company's business;

- The Company's business could be harmed if it is required to collect state sales tax on the sale of products;

- The Company faces an inherent risk of exposure to product liability claims in the event that the use of the products it sells results in personal injury;

- The Company conducts its operations through a single distribution facility;

- The Company's success is dependent, in part, on continued growth in use of the Internet;

- Government regulation and legal uncertainties relating to the Internet and online commerce could negatively impact the Company's business operations; and

- Changing technology could adversely affect the operation of the Company's website.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

The Company is exposed to changes in interest rates primarily related to its revolving credit facility. As of March 31, 2001, the Company had no outstanding borrowings on the credit facility. The credit facility bears interest at a variable rate. The Company is exposed to foreign currency risk due to cash held by its foreign subsidiary. As of March 31, 2001, the Company's total cash in foreign currencies was approximately $14,000. In addition, all of the Company's revenue transactions are in U.S. dollars.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

See notes to condensed consolidated financial statements.

Item 2. Changes in Securities and Use of Proceeds

None.

Item 3. Defaults upon Senior Securities

None.

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

None.

Item 5. Other Information

From time to time the Company receives notices, inquiries or other correspondence from states or its regulatory bodies charged with overseeing the sale of contact lenses. The Company's practice is to review such notices with legal counsel to determine the appropriate response on a case-by-case basis. It is the opinion of management, after discussion with legal counsel, that the Company is taking the appropriate steps to address the various notices received.

Item 6. Exhibits and Reports on Form 8-K

(A) Exhibits

None.

(B) Reports on From 8-K

No reports on Form 8-K were filed by the Registrant during the quarter ended March 31, 2001.

SIGNATURES

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

1-800 CONTACTS, INC.

Dated: May 15, 2001

By: /s/ Jonathan C. Coon
Name: Jonathan C. Coon
Title: President and Chief Executive Officer

By: /s/ Scott S. Tanner
Name: Scott S. Tanner
Title: Chief Operating Officer and Chief Financial Officer