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OPTICARE HEALTH SYSTEMS INC

Form 10-Q

August 14, 2002

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

FORM 10-Q

(MARK ONE)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES  
EXCHANGE ACT OF 1934

FOR THE QUARTERLY PERIOD ENDED JUNE 30, 2002

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES  
EXCHANGE ACT OF 1934

COMMISSION FILE NUMBER 1-15223

OPTICARE HEALTH SYSTEMS, INC.  
(Exact Name of Registrant as Specified in Its Charter)

DELAWARE  
(State or Other Jurisdiction of  
Incorporation or Organization)

76-0453392  
(I.R.S. Employer Identification No.)

87 GRANDVIEW AVENUE, WATERBURY, CONNECTICUT  
(Address of Principal Executive Offices)

06708  
(Zip Code)

Registrant's Telephone Number, Including Area Code:  
(203) 596-2236

Indicate by check X 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

The number of shares outstanding of the registrant's Common Stock, par value \$.001 per share, at August 1, 2002 was 12,783,192 shares.

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OPTICARE HEALTH SYSTEMS, INC. AND SUBSIDIARIES  
CONDENSED CONSOLIDATED BALANCE SHEETS  
(AMOUNTS IN THOUSANDS, EXCEPT SHARE DATA)  
(UNAUDITED)

JUNE 30, D  
2002  
-----

ASSETS

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CURRENT ASSETS:	
Cash and cash equivalents	\$ 3,035
Accounts receivable, net	6,729
Inventories	2,174
Deferred income taxes, current	2,700
Assets held for sale	2,656
Other current assets	943
	-----
Total Current Assets	18,237
Property and equipment, net	3,751
Intangible assets, net	1,442
Goodwill, net	20,516
Deferred income taxes, non-current	1,800
Assets held for sale, non-current	4,695
Other assets	3,529
	-----
TOTAL ASSETS	\$ 53,970
	=====
LIABILITIES AND STOCKHOLDERS' EQUITY	
CURRENT LIABILITIES:	
Accounts payable	\$ 4,124
Accrued expenses	6,372
Current portion of long-term debt	1,725
Liabilities of held for sale business	1,877
Other current liabilities	1,049
	-----
Total Current Liabilities	15,147
	-----
Long-term debt, less current portion	23,849
Liabilities of held for sale business	299
Other liabilities	1,091
	-----
Total non-current liabilities	25,239
	-----
Series B 12.5% voting, mandatorily redeemable , cumulative, convertible preferred stock, \$0.001 par value, 3,500,000 shares authorized, 3,204,959 shares issued and outstanding	4,487
	-----
STOCKHOLDERS' EQUITY:	
Series A Convertible Preferred Stock, \$.001 par value, 550,000 shares authorized; no shares outstanding at June 30, 2002; 418,803 shares outstanding at December 31, 2001.	-
Common Stock, \$0.001 par value; 75,000,000 shares authorized; 12,783,192 and 12,815,092 shares outstanding at June 30, 2002 and December 31, 2001, respectively.	13
Additional paid-in-capital	61,810
Accumulated deficit	(52,726)
	-----
Total Stockholders' Equity	9,097
	-----
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY (DEFICIT)	\$ 53,970
	=====

See notes to condensed consolidated financial statements.

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OPTICARE HEALTH SYSTEMS, INC. AND SUBSIDIARIES  
 CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS  
 (AMOUNTS IN THOUSANDS, EXCEPT SHARE DATA)  
 (UNAUDITED)

	FOR THE THREE MONTHS ENDED JUNE 30,	
	2002	2001
NET REVENUES:		
Managed care services	\$ 7,159	\$ 6,823
Product sales	10,894	12,316
Other services	5,490	5,540
Other income	646	-
Total net revenues	24,189	24,679
OPERATING EXPENSES:		
Medical claims expense	5,819	5,354
Cost of product sales	8,549	9,836
Cost of services	2,368	2,406
Selling, general and administrative	6,317	5,931
Depreciation	465	495
Amortization	45	332
Interest expense	834	739
Total operating expenses	24,397	25,093
Loss from continuing operations before income taxes	(208)	(414)
Income tax benefit	(83)	(27)
Loss from continuing operations	(125)	(387)
Income (loss) from discontinued operations, net of tax	(5)	40
Loss on disposal of discontinued operations	(3,940)	-
Loss before extraordinary gain	(4,070)	(347)
Extraordinary gain on early extinguishment of debt, net of income taxes of \$3,475	-	-
Net Income (loss)	\$ (4,070)	\$ (347)

EARNINGS (LOSS) PER SHARE--BASIC AND DILUTED:

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Loss from continuing operations available to common stockholders	\$ (0.02)	\$ (0.03)
Income (loss) from discontinued operations	(0.31)	-
Extraordinary gain	-	-
	-----	-----
Net income (loss) available to common stockholders	\$ (0.33)	\$ (0.03)
	=====	=====

See notes to condensed consolidated financial statements.

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OPTICARE HEALTH SYSTEMS, INC. AND SUBSIDIARIES  
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS  
(AMOUNTS IN THOUSANDS)  
(UNAUDITED)

		FOR THE SIX MONTHS ----- 2002 -----
<b>OPERATING ACTIVITIES:</b>		
Net income (loss)		\$ 985
Extraordinary gain on early extinguishment of debt		(5,314)
(Income) loss on discontinued operations		3,756
		-----
Loss from continuing operations		(573)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Depreciation		939
Amortization		89
Changes in operating assets and liabilities		
Accounts receivable		186
Inventories		(387)
Other assets		(549)
Accounts payable and accrued expenses		(1,553)
Other liabilities		18
		-----
Net cash provided by (used in) operating activities		(1,830)
		-----
<b>INVESTING ACTIVITIES:</b>		
Purchase of notes receivable		(1,350)
Purchases of equipment		(90)
		-----
Net cash (used in) investing activities		(1,440)
		-----
<b>FINANCING ACTIVITIES:</b>		
Proceeds from long-term debt		23,474

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Increase in revolving credit facility	617
Proceeds from issuance of preferred stock	4,000
Principal payments on long-term debt	(24,322)
	-----
Net cash provided by financing activities	3,769
	-----
Increase (decrease) in cash and cash equivalents	499
Cash and cash equivalents at beginning of period	2,536
	-----
Cash and cash equivalents at end of period	\$ 3,035
	=====
 SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:	
Cash paid for interest	\$ 476
Cash paid (received) for income taxes	\$ -

See notes to condensed consolidated financial statements.

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OPTICARE HEALTH SYSTEMS, INC. AND SUBSIDIARIES  
 NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
 (Amounts in thousands except share data)

### 1. BASIS OF PRESENTATION

The accompanying condensed consolidated financial statements of OptiCare Health Systems, Inc., a Delaware corporation, and subsidiaries (the "Company") for the three and six months ended June 30, 2002 and 2001 have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and the instructions to Form 10-Q and Article 10 of Regulation S-X of the Securities Exchange Act of 1934 and are unaudited. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements. In the opinion of management, all adjustments (consisting of only normal recurring accruals) necessary for a fair presentation of the consolidated financial statements have been included. The results of operations for the three and six months ended June 30, 2002 are not necessarily indicative of the results to be expected for the full year. The condensed consolidated balance sheet as of December 31, 2001 was derived from the Company's audited financial statements, but does not include all disclosures required by accounting principles generally accepted in the United States of America.

Certain prior period amounts have been reclassified to conform to the current period presentation.

### 2. DISCONTINUED OPERATIONS

In May 2002, the Company's Board of Directors approved management's plan to dispose of the Company's North Carolina retail optometry division and is

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accounted for as a disposal group under Statement of Financial Accounting Standards ("SFAS") No. 144. Accordingly, amounts in the financial statements and related notes for all periods presented have been reclassified to reflect SFAS No. 144 treatment. As described in Note 9, the Company's North Carolina retail optometry operations were sold on August 12, 2002.

The carrying amount of the assets and liabilities of the disposal group held for sale at June 30, 2002 and December 31, 2001 were as follows:

	June 30, 2002	December 31, 2001
	-----	-----
<b>Assets:</b>		
Accounts receivable	\$ 1,025	\$ 1,350
Inventory	1,441	1,259
Property and equipment, net	1,677	1,569
Intangible assets, net	-	6,608
Other assets	3,208	669
	-----	-----
<b>Total assets</b>	<b>\$ 7,351</b>	<b>\$11,455</b>
	=====	=====
<b>Liabilities:</b>		
Accounts Payable	\$ 955	\$ 963
Accrued Expenses	740	938
Other liabilities	481	334
	-----	-----
<b>Total liabilities</b>	<b>\$ 2,176</b>	<b>\$ 2,235</b>
	=====	=====

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OPTICARE HEALTH SYSTEMS, INC. AND SUBSIDIARIES  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
(Amounts in thousands except share data)

Operating results of the discontinued operations are as follows:

	Three Months Ended June 30,		Si
	-----	-----	-----
	2002	2001	2002
	-----	-----	-----
Net revenues	\$ 6,996	\$ 7,062	\$ 14,4
	=====	=====	=====
Income (loss) from discontinued operations before taxes	\$ (8)	\$ 67	\$ 3
Income tax expense (benefit)	(3)	27	1
	-----	-----	-----

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Income (loss) from discontinued operations	(5)	40	
Loss on disposal of discontinued operations	(3,940)	-	(3,940)
	-----	-----	-----
Total income (loss) from discontinued operations	\$ (3,945)	\$ 40	\$ (3,905)
	=====	=====	=====
Income (loss) per share from discontinued operations	\$ (0.31)	-	\$ (0.31)
	=====	=====	=====

### 3. CAPITAL RESTRUCTURING

On January 25, 2002, the Company closed a series of transactions which resulted in a major restructuring of its debt, equity and voting capital stock (the "Capital Restructuring Transactions"). The Capital Restructuring Transactions included, among other things, the following:

Palisade Concentrated Equity Partnership, L.P., a fund manager and stockholder of the Company, purchased, for \$3,600 in cash, 2,571,429 shares of the Company's Series B 12.5% Voting Cumulative Convertible Participating Preferred Stock, par value \$.001 per share and Linda Yimoyines, wife of Dr. Yimoyines, purchased for a \$400 cash payment 285,714 shares of Series B Preferred Stock. Each share of Series B Preferred Stock is immediately convertible into ten shares of common stock and has the voting power equivalent to ten shares of common stock; accrues cumulative dividends at an annual rate of 12.5%; must be redeemed in full by the Company on December 31, 2008; and with respect to dividends, redemption rights, and rights on liquidation, winding up, corporate reorganization and dissolution, ranks senior to the Company's common stock.

Bank Austria Creditanstalt Corporate Finance, Inc., which was, until January 25, 2002, the Company's senior secured lender, forgave approximately \$10,000 of debt and accrued interest due to it and sold the loans and other obligations of the Company which Bank Austria then held, including security agreements, pledges of stock by certain of the Company's subsidiaries and guarantees of loans and other obligations, to CapitalSource Finance LLC, an asset-based lender specializing in the health care industry.

CapitalSource, as lender, and the Company, as borrower, amended and restated the terms of the indebtedness acquired by CapitalSource from Bank Austria by entering into an Amended and Restated Revolving Credit, Term Loan and Security Agreement, referred to as the Loan and Security Agreement or Credit Facility.

Palisade made a subordinated loan to the Company of \$13,900, and Linda Yimoyines, wife of Dean J. Yimoyines, M.D., Chairman of the Board, Chief Executive Officer and President of the Company, made a subordinated loan to the Company of \$100 which loans are evidenced by senior subordinated secured notes. These notes are subordinate to the Company's indebtedness to its senior lender, CapitalSource, and are secured by second-priority security interests in substantially all of the Company's assets (the first-priority security interest is held by CapitalSource).



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### NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Amounts in thousands except share data)

In connection with providing the \$13,900 subordinated loan to the Company, Palisade received warrants to purchase up to 17,375,000 shares of common stock. In connection with providing the \$100 subordinated loan to the Company, Ms. Yimoyines received warrants to purchase up to 125,000 shares of common stock. In conjunction with the amendment and restatement of the credit facility, CapitalSource received warrants to purchase 250,000 shares of common stock. The warrants were issued at an exercise price of \$0.14 per share and are exercisable during a ten-year period expiring January 24, 2012. The estimated fair value of the warrants of approximately \$1,380 was recorded as a debt discount and is being amortized on the interest method over the term of the related debt .

The bridge loan from Alexander Enterprise Holdings Corp. was satisfied in full, as follows: (i) \$2,534 in cash was paid to Alexander Enterprise in full satisfaction of the \$2,300 of principal and \$234 of accrued interest due to Alexander Enterprise under the Bridge Loan. Alexander Enterprise relinquished its security interest in the assets of the company and has no further claims against the Company. The cash was provided by the \$3,600 purchase by Palisade of Series B Preferred Stock; (ii) The Company issued 309,170.5 shares of Series B Preferred Stock to Palisade to satisfy the \$400 of principal and \$33 of accrued interest due to Palisade as a participant under the Bridge Loan; and (iii) the Company issued 38,646.3 shares of Series B Preferred Stock to Ms. Yimoyines to satisfy the \$50 of principal and \$4 of accrued interest due to Ms. Yimoyines as a participant under the bridge loan.

The Company reacquired from Bank Austria, for a cash payment of \$1,350, certain notes and contractual rights originally issued or made to the company in connection with the Company's transfers of certain medical practice assets to physicians engaged in such practices.

Without further consideration, Bank Austria surrendered warrants previously issued to it to purchase 100,000 shares of the Company's common stock; surrendered to the Company (for retirement) 418,803 shares of Series A convertible preferred stock of the Company; and surrendered to the Company (for the Company to retire) 56,900 shares of common stock.

In connection with the Capital Restructuring Transactions, the number of shares of authorized common stock was increased from 50,000,000 to 75,000,000. The additional authorized shares provide, among other things, for the availability of common stock to be issued upon conversion of the Series B Preferred Stock and exercise of the warrants issued.

The following table sets forth the long-term debt of the Company:

Term note payable to CapitalSource in principal amounts of \$50 per quarter. The final principal payment is payable for the outstanding principal balance and is due and payable on June 1, 2004. Principal and interest is due and payable monthly in arrears. The interest rate equals the Prime Rate plus 3.5%. Maturity date is January 22, 2004. The term note is collateralized by substantially all assets of the Company.

Revolving credit note to CapitalSource, due January 22, 2005, interest is due and payable monthly in arrears on the first of the month at an annual rate of Prime Rate plus 1.5% and is collateralized by substantially all assets of the Company.

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Senior subordinated secured notes payable due January 24, 2012. The interest rate is 11.50% payable on the last day of each calendar quarter. The notes are secured by second-priority security interests in substantially all the company's assets (the first-priority security interest is held by CapitalSource). The outstanding loan balance at June 30, 2002 includes \$711 of paid in-kind interest.

Subordinated notes payable due at various dates through 2004. Principal and interest payments are due monthly or annually. Interest is payable at rates ranging from 7% to 11.4%.

Unamortized discounts

Total

Less current portion

Long-term portion

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OPTICARE HEALTH SYSTEMS, INC. AND SUBSIDIARIES  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
(Amounts in thousands except share data)

#### 4. EXTRAORDINARY ITEM

On January 25, 2002, the Company recorded a gain on the early extinguishment of debt of \$8,789 before income tax of \$3,475 as a result of the Company's Capital Restructuring Transactions. The \$8,789 gain was comprised principally of approximately \$10,000 of debt and interest forgiveness by Bank Austria, the Company's former senior secured lender, which was partially offset by \$1,200 of unamortized deferred financing fees and debt discount.

#### 5. SEGMENT INFORMATION

The Company currently manages the operations of the business through three operating segments: (1) Managed Care Services (2) Professional Services and (3) Other Integrated Services. The managed care segment contracts with insurers, managed care plans and other third party payors to manage claims payment administration of eye health benefits for those contracting parties. The professional services segment provides laser and ambulatory surgery facilities, develops and sells integrated practice management systems and provides support services to eye care professionals. The other integrated services segment owns, operates and/or contracts with fully integrated eye health centers and professional optometric practices and provides wholesale buying services to eye care professionals nationwide. Management assesses the performance of its segments based on income before income taxes, interest expense, depreciation and amortization, and other corporate overhead.

Summarized financial information, by segment, for the three and six months ended June 30, 2002 and 2001 is as follows:

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	THREE MONTHS ENDED JUNE 30,		SIX MO JU
	2002	2001	2002
<b>REVENUES:</b>			
Managed care services	\$ 7,241	\$ 6,870	\$14,754
Professional services	1,531	1,958	2,960
Other integrated services	16,031	17,207	31,720
Segment totals	24,803	26,035	49,434
Other revenue	646	-	646
Elimination of inter-segment revenues	(1,260)	(1,356)	(2,512)
Total net revenue	\$24,189	\$24,679	\$47,568
<b>INCOME (LOSS) FROM CONTINUING OPERATIONS BEFORE TAX:</b>			
Managed care services	\$ 298	\$ 545	\$ 850
Professional services	394	638	594
Other integrated services	573	560	969
Segment totals	1,265	1,743	2,413
Other income	646	-	646
Depreciation	(465)	(495)	(938)
Amortization	(45)	(332)	(89)
Interest expense	(834)	(739)	(1,531)
Corporate	(775)	(591)	(1,456)
Loss from continuing operations before income taxes	\$ (208)	\$ (414)	\$ (955)

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OPTICARE HEALTH SYSTEMS, INC. AND SUBSIDIARIES  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
(Amounts in thousands except share data)

6. EARNINGS (LOSS) PER SHARE

The following tables sets forth the computation of basic and diluted earnings (loss) per share:

	THREE MONTHS ENDED JUNE 30,	
	2002	2001

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Loss from continuing operations	\$ (125)	\$ (387)	
Preferred stock dividend	(142)	-	
	-----	-----	-----
Loss from continuing operations available to common stockholders	(267)	(387)	
Income (loss) from discontinued operations	(3,945)	40	
Extraordinary gain	-	-	
	-----	-----	-----
Net income (loss) available to common stockholders	\$ (4,212)	\$ (347)	
	=====	=====	=====
Weighted average common shares outstanding - Basic and diluted	12,783,192	12,799,300	12
	=====	=====	=====
Earnings (loss) per share - basic and diluted:			
-----			
Loss from continuing operations available to common stockholders	\$ (0.02)	\$ (0.03)	
Discontinued Operations	(0.31)	-	
Extraordinary item	-	-	
	-----	-----	-----
Net income (loss) per common share	\$ (0.33)	\$ (0.03)	
	=====	=====	=====

The following table reflects the potential common shares of the Company at June 30, 2002 and 2001. These potential shares have been excluded from the calculation of diluted earnings per share because the Company incurred a loss from continuing operations in those periods and their effect would be antidilutive.

	2002	2001
	-----	-----
Options	4,646,045	920,458
Warrants	21,196,198	3,501,198
Convertible Preferred Stock	32,049,598	418,803
	-----	-----
	57,891,841	4,840,459
	=====	=====

7. CONTINGENCIES

The Company is both a plaintiff and defendant in lawsuits incidental to its current and former operations. Such matters are subject to many uncertainties and outcomes are not predictable with assurance. Consequently, the ultimate aggregate amount of monetary liability or financial impact with respect to these matters at June 30, 2002 cannot be ascertained. Management is of the opinion that, after taking into account the merits of defenses and established reserves, the ultimate resolution of these matters will not have a material adverse impact on the Company's consolidated financial position or results of operations.

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OPTICARE HEALTH SYSTEMS, INC. AND SUBSIDIARIES  
 NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
 (Amounts in thousands except share data)

### 8. NEW ACCOUNTING PRONOUNCEMENTS

Effective January 1, 2002, the Company adopted Financial Accounting Standard ("FAS") No. 142, "Goodwill and Other Intangible Assets". The standard changes the accounting for goodwill and intangible assets with an indefinite life whereby such assets will no longer be amortized; however the standard does require evaluation for impairment, and a corresponding writedown, if appropriate. FAS No. 142 requires the Company to complete a transitional goodwill impairment test six months from the date of adoption. The Company completed its transitional impairment test during the quarter ended June 30, 2002 and no impairment write-down was required.

Comparative information as if goodwill had not been amortized is as follows:

	Three Months Ended June 30,		
	2002	2001	20
Net income (loss) as reported	\$ (4,070)	\$ (347)	
Add back: goodwill amortization	-	287	
Adjusted net income (loss)	(4,070)	(60)	
Preferred stock dividend	(142)	-	
Adjusted net income (loss) available to common stockholders	\$ (4,212)	\$ (60)	
Earnings (loss) per common share - basic and diluted:			
Net income (loss) available to common stockholders	\$ (0.33)	\$ (0.03)	\$
Goodwill amortization	-	0.02	
Adjusted net income (loss) per share	\$ (0.33)	\$ (0.01)	\$

Intangible assets subject to amortization are as follows:

	At June 30, 2002	At December 31, 2001
Gross Carrying Amount	\$ 1,923	\$ 1,923
Accumulated Amortization	(481)	(392)
Total	\$ 1,442	\$ 1,531

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Amortization of intangibles was \$45 for the three months ended June 30, 2002 and 2001, and \$89 for the six months ended June 30, 2002 and 2001. Estimated annual amortization expense is expected to be \$178, \$172, \$111, \$111 and \$111 for the years 2002, 2003, 2004, 2005 and 2006, respectively.

In June 2001, the FASB issued SFAS 143, "Accounting For Asset Retirement Obligations". This statement addresses financial accounting and reporting for obligations associated with the retirement of tangible long-lived assets and the associated asset retirement costs. The Company is required to adopt the provisions of SFAS No. 143 at the beginning of fiscal 2003. The Company has determined that the adoption of this statement will not have a material impact on its financial position or results of operations.

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### OPTICARE HEALTH SYSTEMS, INC. AND SUBSIDIARIES NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Amounts in thousands except share data)

In August 2001, the FASB issued SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets". This statement requires that one accounting model be used for long-lived assets to be disposed of by sale, whether previously held and used or newly acquired. This statement also broadens the definition of discontinued operations to include more disposal transactions. The provisions of this statement were adopted by the Company on January 1, 2002. The Company applied SFAS No. 144 to the sale of its North Carolina Optometry operations and reported a loss on disposal of \$3,940 for the quarter ended June 30, 2002.

In April 2002, the FASB issued SFAS 145, "Recission of FASB Statements 4, 44 and 64, Amendment of FASB Statement 13, and Technical Corrections". SFAS No. 145 rescinds the provisions of SFAS No. 4 that requires companies to classify certain gains and losses from debt extinguishments as extraordinary items, eliminates the provisions of SFAS No. 44 regarding transition to the Motor Carrier Act of 1980 and amends the provisions of SFAS No. 13 to require that certain lease modifications be treated as sale leaseback transactions. The provisions of SFAS No. 145 related to classification of debt extinguishment are effective for fiscal years beginning after May 15, 2002. In future periods, the Company will classify debt extinguishment costs within income from operations and will reclassify previously reported debt extinguishments as such. The provisions of SFAS No. 145 related to lease modification are effective for transactions occurring after May 15, 2002. Upon adoption the Company will reclassify its previously reported gain from extinguishment of debt of \$8,789 and related income tax expense of \$3,475 from an extraordinary item to continuing operations.

In June 2002, the FASB issued Statement No. 146, Accounting for Costs Associated with Exit or Disposal Activities (SFAS No.146) and nullifies EITF Issue No. 94-3. SFAS No. 146 requires that a liability for a cost associated with an exit or disposal activity be recognized when the liability is incurred, whereas EITF No 94-3 had recognized the liability at the commitment date of an exit plan. The Company is required to adopt the provisions of SFAS No. 146 effective for exit or disposal activities initiated after December 31, 2002. The

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Company does not expect the provisions of SFAS No.146 to have a material impact on its financial position or results of operations.

### 9. SUBSEQUENT EVENT

On August 12, 2002, the Company sold substantially all of the net assets of its North Carolina retail optometry division to Optometric Eye Care Center, P.A., an independent professional association owned by two former officers of the Company. In the sale, the Company received \$4.2 million in cash, a \$1.0 million secured promissory note, 1.3 million shares of the Company's common stock formerly held by the owners of Optometric Eye Care Center, P.A. and the purchaser's assumption of certain liabilities for an aggregate consideration of approximately \$5.7 million. (See also Note 2)

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### ITEM 2: MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion may be understood more fully by reference to the financial statements, notes to the financial statements, and management's discussion and analysis contained in the company's Annual Report on Form 10-K for the year ended December 31, 2001, as filed with the Securities and Exchange Commission.

Overview. OptiCare Health Systems, Inc. (the "company") is an integrated eye care services company that delivers a range of services and systems for eye health professionals and consumers, including managed care and professional eye care services. The company executes its business through three business segments: (1) managed care services (2) professional services and (3) other integrated services. The managed care services segment contracts with insurers, managed care plans and other third party payors to manage claims payment administration of eye health benefits for those contracting parties. The professional services segment provides laser and ambulatory surgery facilities; develops and sells integrated practice management systems and provides support services to eye care professionals throughout the country. The other integrated services segment owns, operates and/or contracts with integrated eye health centers and professional optometric practices in Connecticut and North Carolina, and provides wholesale buying services to eye care professionals nationwide.

In May 2002, the company's Board of Directors approved management's plan to dispose of the company's North Carolina retail optometry division and is accounted for as a disposal group under Statement of Financial Accounting Standards ("SFAS") No. 144. Accordingly, amounts in the financial statements (and described below) for all periods presented have been reclassified to reflect SFAS No. 144 treatment. On August 12, 2002 the company consummated the sale of its North Carolina retail optometry operations and will file a report on Form 8-K with respect to this transaction shortly.

### RESULTS OF OPERATIONS

Three Months Ended June 30, 2002 Compared to the Three Months Ended June 30, 2001

Managed care services revenue. Managed care services revenue increased to \$7.2 million for the three months ended June 30, 2002 from \$6.8 million for the three months ended June 30, 2001, an increase of \$0.4 million. This increase was

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primarily due to negotiated increases in capitation rates and growth in existing contracts. Increases in revenue associated with new contracts were offset by decreases in revenue associated with contracts that are no longer being serviced by the company.

Product sales revenue. Product sales revenue decreased to \$10.9 million for the three months ended June 30, 2002 compared to \$12.3 million for the three months ended June 30, 2001, a decrease of \$1.4 million. This decrease primarily represents a decrease in buying group revenue resulting from decreases in purchasing volume. The decrease in volume is primarily due to consolidation in the eyecare industry whereby smaller independent eyecare businesses are being replaced by larger eyecare chains that purchase directly from vendors. The company expects this shift to continue and potentially further reduce the buying group's market share and revenue; however the company does not expect this trend to have a material impact on its overall profitability.

Other services revenue. Optometry and ophthalmology services revenue increased \$0.4 million from three months ended June 30, 2002 compared to the three months ended June 30, 2001 due to increased productivity. These increases were offset by a \$0.4 decrease in Health Service Organization revenue for the quarter ended June 30, 2002 compared to the quarter ended June 30, 2001. The company's revenue stream from fees collected under its Health Service Organization agreements has been decreasing due to disputes with certain physician practices who are parties to these agreements. The company is in litigation with several of these practices and intends to pursue settlement of these matters in the future. While a continued decrease in these contractual fees could negatively impact our cash flows, the company is currently focusing on resolving the disputes with these practices and believes the company will receive cash payments and/or other consideration in settlement of these disputes.

Other income. Other income for the three months ended June 30, 2002 was \$0.6 million and was comprised of settlements of contracts.

Medical claims expense. Medical claims expense increased to \$5.8 million for the three months ended June 30, 2002 from \$5.4 million for the three months ended June 30, 2001, an increase of \$0.4 million. The medical claims expense loss ratio (MLR), representing medical claims expense as a percentage of managed care revenue, was 81.3% for the three

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months ended June 30, 2002 compared to 78.5% for the same period in 2001. The increase in MLR was primarily due to the lost margins on profitable contracts which are no longer serviced by the company.

Cost of product sales. Cost of product sales decreased to \$8.5 million for the three months ended June 30, 2002 from \$9.8 million for the three months ended June 30, 2001, a decrease of \$1.3 million. This decrease represented a reduction in cost of sales related to the buying group program as a result of the decrease in sales volume.

Cost of services. Cost of services remained relatively unchanged at \$2.4 million for the three months ended June 30, 2002 and 2001.

Selling, general and administrative. Selling, general and administrative expenses increased to \$6.3 million for the three months ended June 30, 2002 from \$5.9 million for the three months ended June 30, 2001, an increase of \$0.4



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million. This increase primarily represents an increase in professional fees, including legal and consulting fees.

Amortization expense. Amortization expense decreased to less than \$0.1 million for the three months ended June 30, 2002 from \$0.3 million for the three months ended June 30, 2001 due to the discontinuation of the amortization of goodwill effective January 1, 2002 in accordance with Statement of Financial Accounting Standard (SFAS) No. 142, "Goodwill and Other Intangible Assets".

Income tax benefit. The company reported a \$0.1 million income tax benefit for the three months ended June 30, 2002, representing an effective tax rate of approximately 40%. For the three months ended June 30, 2001, the company reported a tax benefit of less than \$0.1 million on a loss from continuing operations of \$0.4 million, primarily due to the uncertainty surrounding the company's ability to utilize its net operating loss carryforwards at that time.

Discontinued operations. In May 2002, the company's Board of Directors approved management's plan to dispose of the company's North Carolina retail optometry division. Accordingly, during the quarter ended June 30, 2002 the company recorded a \$3.9 million loss on disposal of discontinued operations based on the estimated fair value of the net assets held for sale. On August 12, 2002 the company consummated the sale of its North Carolina retail optometry operations.

Net income (loss). The company reported a net loss of \$4.1 million for the three months ended June 30, 2002 compared to a net loss of \$0.3 million for the three months ended June 30, 2001, representing a change of \$3.8 million. This change was primarily due to the loss on discontinued operations in 2002 as described above.

Six Months Ended June 30, 2002 Compared to the Six Months Ended June 30, 2001

Managed care services revenue. Managed care services revenue remained relatively unchanged at \$14.6 million for the six months ended June 30, 2002 compared to \$14.7 million for the six months ended June 30, 2001. Managed care revenue increased slightly due to negotiated increases in capitation revenue and growth in existing contracts, which was offset by a decrease in revenue primarily on three contracts that were not renewed.

Product sales revenue. Product sales revenue decreased to \$21.7 million for the six months ended June 30, 2002 compared to \$24.3 million for the six months ended June 30, 2001, a decrease of \$2.6 million. This decrease primarily represents a decrease in buying group revenue resulting from decreases in purchasing volume. The decrease in volume was due to consolidation in the eyecare industry toward direct purchase from vendors. The company expects this shift to continue and potentially further reduce the buying group's market share and revenue; however the company does not expect this trend to have a material impact on its overall profitability.

Other services revenue. Other services revenue increased to \$10.7 million for the six months ended June 30, 2002 compared to \$10.4 million for the six months ended June 30, 2001, an increase of \$0.3 million. This increase includes a \$0.9 million increase in optometry and ophthalmology services revenue and a \$0.5 million increase in sales of software systems. These increases were partially offset by a \$0.3 million decrease in revenue from ambulatory surgery center services due to a decrease in volume and an \$0.8 million decrease in Health Service Organization revenue. The company's revenue stream from fees collected under its Health Service Organization agreements has been decreasing due to disputes with certain physician practices who are parties to these agreements. The company is in litigation with several of these practices and intends to pursue settlement of these matters in the future. While a continued decrease in these contractual fees could negatively impact our cash flows, the

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company is currently focusing on resolving the disputes with these practices and believes the company will receive cash payments and/or other consideration in settlement of these disputes.

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Other income. Other income for the six months ended June 30, 2002 was \$0.6 million and was comprised of settlements of contracts.

Medical claims expense. Medical claims expense remained relatively stable at \$11.7 million for the six months ended June 30, 2002 and June 30, 2001. The medical claims expense loss ratio (MLR), representing medical claims expense as a percentage of managed care revenue, was 79.8% in 2002 compared to 79.6% in 2001.

Cost of product sales. Cost of product sales decreased to \$17.2 million for the six months ended June 30, 2002 from \$19.4 million for the six months ended June 30, 2001, a decrease of \$2.2 million. This decrease primarily represents a reduction in cost of sales related to the buying group program as a result of the decrease in sales volume.

Cost of services. Cost of services remained relatively unchanged at \$4.6 million for the six months ended June 30, 2002 and 2001.

Selling, general and administrative. Selling, general and administrative expenses increased to \$12.5 million for the six months ended June 30, 2002 from \$12.2 million for the six months ended June 30, 2001, an increase of \$0.3 million. This increase is primarily due to increases in professional fees.

Amortization expense. Amortization expense decreased from \$0.1 million for the six months ended June 30, 2002 from \$0.6 million for the six months ended June 30, 2001 due to the discontinuation of the amortization of goodwill effective January 1, 2002 in accordance with Statement of Financial Accounting Standard (SFAS) No. 142, "Goodwill and Other Intangible Assets".

Income tax benefit. The company reported a \$0.4 million income tax benefit on continuing operations for the six months ended June 30, 2002, representing an effective tax rate of approximately 40%. For the six months ended June 30, 2001, the company only reported a tax benefit of \$0.2 million on a loss from continuing operations of \$1.6 million, primarily due to the uncertainty surrounding the company's ability to utilize its net operating loss carryforwards at that time.

Discontinued operations. In May 2002, the company's Board of Directors approved management's plan to dispose of the company's North Carolina retail optometry division. Accordingly, during the quarter ended June 30, 2002 the company recorded a \$3.9 million loss on disposal of discontinued operations based on the estimated fair value of the net assets held for sale. On August 12, 2002 the company consummated the sale of its North Carolina retail optometry operations.

Extraordinary item. The company reported a \$5.3 million net gain on early extinguishment of debt for the six months ended June 30, 2002. The gain was reported in the first quarter of 2002 and was comprised of approximately \$10.0 million of forgiveness of principal and interest by Bank Austria, the company's former senior secured lender, and was partially offset by the write-off of \$1.2 million of related unamortized deferred financing fees and debt discount, and

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\$3.5 million of income taxes.

Net income (loss). The company reported net income of \$1.0 million for the six months ended June 30, 2002 compared to a net loss of \$1.2 million for the six months ended June 30, 2001, an increase in net income of \$2.2 million. The increase was primarily due to the \$5.3 million gain on the extinguishment of debt and an \$0.8 million improvement in continuing operations, which was partially offset by a \$3.9 million loss on the disposal of discontinued operations.

### LIQUIDITY AND CAPITAL RESOURCES

The company's primary sources of liquidity are cash flows generated from operations and borrowings under its credit facility. The company's principal uses of liquidity are to provide working capital, meet debt service requirements and finance capital expenditures. We believe that our cash flow from operations, borrowings under our credit facility, and operating and capital lease financing will provide us with sufficient funds to finance our operations for the next 12 months.

As of June 30, 2002, we had approximately \$3.0 million of cash and cash equivalents, \$2.9 million of borrowings outstanding under a term loan, and \$7.1 million outstanding under our revolving credit agreement. Although we have a \$10 million revolving credit facility, the amount available to be borrowed at any time is based on the value of the

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collateral underlying the facility and on the amount outstanding under the facility at such time. As of June 30, 2002, we had \$0.1 million of available credit under our revolving credit facility.

Net cash used in operating activities of \$1.8 million for the six months ended June 30, 2002 included a \$0.6 million loss from continuing operations, a \$1.5 million decrease in accounts payable and accrued expenses and \$0.7 million of other changes in operating assets and liabilities. These uses of cash were offset by non-cash charges of \$1.0 million for depreciation and amortization. Net cash provided by operating activities for the six months ended June 30, 2001 of \$0.9 million included a \$1.4 million loss from continuing operations offset by \$1.6 million of non-cash charges for depreciation and amortization a \$0.5 million increase in accounts payable and accrued expenses and \$0.2 million of other changes in operating assets and liabilities.

Net cash used in investing activities was \$1.4 million for the six months ended June 30, 2002 compared to \$0.1 million for the six months ended June 30, 2001. Net cash used in financing activities in 2002 consisted principally of \$1.4 million paid to reacquire certain notes receivable and contractual rights as part of the Capital Restructuring Transactions.

Net cash provided by financing activities was \$3.8 million for the six months ended June 30, 2002 compared to \$0.3 million for the six months ended June 30, 2001. Net cash provided by financing activities in 2002 consisted of approximately \$27.5 million from the issuance of debt and preferred stock and \$0.6 million from net borrowings under the company's revolving credit facility. These increases were partially offset by approximately \$24.3 million of principal payments on long-term debt, primarily related to the company's capital restructuring in January 2002. The primary sources of net cash from financing

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activities for the six months ended June 30, 2001 was \$0.5 million of net proceeds from funds borrowed under the company's amended bridge loan which was partially offset by approximately \$0.2 million of principal payments on long-term debt.

Under an agreement with the Texas Department of Insurance, the company is required to maintain a restricted investment of \$250,000. The company does not believe the requirements of the Texas Department of Insurance will have a material impact on the company's liquidity.

### The Capital Restructuring Transactions

On January 25, 2002, the company completed a series of transactions that resulted in a major reduction in, and restructuring of, the debt described above as well as our issuance of voting capital stock. The transactions included, among other things, the following:

1. Palisade Concentrated Equity Partnership, L.P., a fund manager and stockholder of the company, purchased, for \$3.6 million in cash, 2,571,429 shares of the company's Series B 12.5% Voting Cumulative Convertible Participating Preferred Stock, par value \$.001 per share, referred to as the Series B Preferred Stock, convertible into 25,714,290 shares of common stock. Linda Yimoyines, wife of Dr. Yimoyines, purchased for a cash payment of \$0.4 million, 285,714 shares of Series B Preferred Stock. The Series B Preferred Stock is described in more detail below.
2. Bank Austria forgave the portion of our indebtedness to it in excess of \$21.8 million and sold the loans and other obligations of the company which Bank Austria then held, including security agreements, pledges of stock by certain of our subsidiaries and guarantees of loans and other obligations, to CapitalSource Finance LLC, a Delaware limited liability company.
3. CapitalSource, as lender, and the company, as borrower, amended and restated the terms of the indebtedness acquired by CapitalSource from Bank Austria by entering into an Amended and Restated Revolving Credit, Term Loan and Security Agreement, referred to as the Loan and Security Agreement or the Credit Facility.
4. Palisade made a subordinated loan to us of \$13.9 million, and Linda Yimoyines, wife of Dean J. Yimoyines, made a subordinated loan to us of \$100,000, which loans are evidenced by senior subordinated secured notes, the terms of which are described in more detail below.

5. In connection with providing its \$13.9 million subordinated loan to the company, Palisade received warrants entitling Palisade to purchase up to 17,375,000 shares of common stock at an exercise price of \$0.14 per share (subject to anti-dilution provisions). In connection with her providing a \$100,000 subordinated loan to the company, Ms. Yimoyines received warrants entitling her to purchase up to 125,000 shares of common stock at an exercise price of \$0.14 per share (subject to anti-dilution provisions). The warrants issued to Palisade and to Ms. Yimoyines are exercisable during a ten-year period expiring January 24,

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2012.

6. In conjunction with the amendment and restatement of the credit facility, we issued 10-year warrants to CapitalSource to purchase 250,000 shares of our common stock at an exercise price of \$0.14 per share (subject to anti-dilution provisions).
7. The company applied a portion of the proceeds of the Palisade loan to pay down the indebtedness under our credit facility now held by CapitalSource.
8. Our bridge loan from Alexander Enterprise was satisfied in full, as follows:
  - a. \$2.5 million in cash was paid to Alexander Enterprise in full satisfaction of the principal and interest owed to Alexander Enterprise under the bridge loan. Alexander Enterprise relinquished its security interest in the assets of the company and has no further claims against us. The cash was provided by the \$3.6 million purchase by Palisade of Series B Preferred Stock.
  - b. We satisfied our obligations to Palisade as a participant under the bridge loan by issuing to Palisade 309,170.5 shares of Series B Preferred Stock. The amount of such participation, including accrued but unpaid interest, was \$432,839.
  - c. We satisfied our obligations to Ms. Yimoyines as a participant under the bridge loan by issuing to Ms. Yimoyines 38,646.3 shares of Series B Preferred Stock. The amount of such participation, including accrued but unpaid interest, was \$54,104.
9. We reacquired from Bank Austria, for a cash payment of \$1.35 million, certain notes and contractual rights originally issued or made to the company in connection with the company's transfers of certain medical practice assets to physicians engaged in such practices.
10. Without further consideration, Bank Austria surrendered to the company warrants previously issued to it to purchase 100,000 shares of the company's common stock; surrendered to the company (for retirement) 418,803 shares of Series A convertible preferred stock of the company; and surrendered to the company (for retirement) 56,900 shares of common stock.
11. As of the closing of the Capital Restructuring Transactions on January 25, 2002, Palisade held (i) 2,000,000 shares of our common stock which were previously acquired, (ii) 2,880,599.5 shares of Series B Preferred Stock, immediately convertible into 28,805,995 shares of common stock, and (iii) immediately exercisable warrants to purchase up to an additional 17,775,000 shares of common stock, of which warrants to purchase 400,000 shares at \$0.40 per share were previously acquired. Thus, 44,864,690 shares of our common stock (including 12,815,092 shares of common stock outstanding as of January 25, 2002 (i.e., prior to the Capital Restructuring Transactions), and 32,049,598 shares of common stock issuable upon conversion of the Series B Preferred Stock held by Palisade and Ms. Yimoyines) would be outstanding in the event that all of the shares of Series B Preferred Stock are converted. Without giving effect to any warrants, Palisade may be deemed to beneficially own 74.0% of our common stock. Giving effect to the warrants held by Palisade, Palisade may be deemed to beneficially own 81.8% of our common stock.

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In connection with the Capital Restructuring Transactions, we agreed that, so long as Palisade owns more than 50% of the voting power of the company, Palisade shall have the right to designate a majority of our board of directors. Pursuant to this provision, three nominees of Palisade were elected to the company's board of directors effective January 25, 2002.

In connection with the Capital Restructuring Transactions, our stockholders approved various equity-related proposals by written consent in a solicitation process which commenced on January 4, 2002. Among those was a proposal to increase the number of shares of authorized common stock from 50,000,000 to 75,000,000. The additional

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authorized shares provide the availability of common stock to be issued upon conversion of the Series B Preferred Stock and exercise of the warrants which were issued to Palisade, Ms. Yimoyines and CapitalSource.

Subject to the reservation shares of common stock for such conversion and exercise of warrants, the additional shares will be available for issuance from time to time by the company at the discretion of the board of directors, normally without further stockholder action or notification (except as may be required for a particular transaction by applicable law, requirements of regulatory agencies or by stock exchange rules) to provide for future equity and convertible debt financings, acquisitions of property or securities of other corporations, debt conversions and exchanges, exercise of current and future options and warrants, and for issuance under our current or future employee benefit plans, stock dividends and stock splits.

In conjunction with the Capital Restructuring Transactions the company adopted a by-law amendment which provides that, for so long as Palisade holds more than 50% of our voting power, the approval of the majority of the company's independent directors (as that term is defined by the American Stock Exchange) is required to, among other things, redeem the Series B Preferred Stock; issue any new class or series of preferred stock to Palisade; issue a security convertible into preferred stock to Palisade; declare or pay any dividend in cash, property or securities of the company; or amend the special voting provision of the company's by-laws.

### The CapitalSource Credit Facility

The amended and restated credit facility with CapitalSource is comprised of a \$3 million term loan and up to a \$10 million revolving credit facility.

The principal terms of the term loan with CapitalSource are:

- o The maximum amount of the term loan is 40% of the value of our capital equipment, as determined by CapitalSource in its absolute discretion; the current balance drawn down on the term loan is \$3 million.
- o The interest rate is 3.5 percentage points over the announced prime rate of Citibank, N.A., but not less than 9%.
- o Principal and interest are payable monthly, on the basis of a 15-year amortization, with payment in full of the balance due on

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January 25, 2004, two years from the closing of the Loan and Security Agreement.

The principal terms of the revolving credit facility with CapitalSource are:

o The maximum amount which may be advanced under the revolving credit facility is the lesser of (i) \$10 million or (ii) 80% of eligible accounts receivable and inventory of the company, plus up to an additional \$750,000. In addition, prior to April 1, 2002, the amount available was up to 85% of eligible accounts receivable and inventory, plus an additional \$750,000. If the outstanding balance as of April 1, 2002 is in excess of 80% of eligible accounts receivable and inventory, the excess must be paid down in monthly installments over the four months ending July 31, 2002.

-- Eligible accounts receivable are accounts receivable not more than 120 days old, subject to certain cross-aging requirements, and subject to determination by CapitalSource.

-- Eligible inventory is inventory meeting a number of detailed requirements of CapitalSource and valued at the company's cost less all discounts.

o The interest rate on the revolving credit facility is 1.5 percentage points above the announced prime rate of Citibank, N.A., but not less than 7% per year. Interest is payable monthly in arrears.

o All accounts receivable of the company shall be paid into lockbox accounts and immediately transferred from such lockbox accounts into a depository account maintained by CapitalSource on a daily basis.

o The revolving credit facility expires and the outstanding balance of the revolving credit facility, together with accrued but unpaid interest, comes due in full on January 25, 2005, three years from the closing of the amended and restated Loan and Security Agreement.

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With respect to both the term loan and the revolving credit facility, we must also pay a monthly "unused line fee" that equals the excess, if any, of \$3,000 over all interest accrued for such month.

The Loan and Security Agreement contains certain restrictions on the conduct of our business, including, among other things, restrictions on incurring debt, purchasing or investing in the securities of, or acquiring any other interest in, all or substantially all of the assets of any person or joint venture, declaring or paying any cash dividends or making any other payment or distribution on our capital stock, and creating or suffering liens on our assets. We are required to maintain certain financial covenants, including a minimum fixed charge ratio and a minimum net worth.

The company's subsidiaries have guaranteed payments and other obligations under the credit facility and the company (including certain subsidiaries) has granted a security interest in substantially all its assets in favor of

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CapitalSource. The company also pledged the capital stock of certain of its subsidiaries to CapitalSource.

The occurrence of certain events or conditions described in the Loan and Security Agreement (subject to grace periods in certain cases) constitutes an "event of default." If an event of default occurs, the entire outstanding balance of principal and interest would become immediately due and payable. Events of default include:

- o Our failure to pay any principal or interest when due;
- o Our failure to pay any indebtedness to persons other than CapitalSource in excess of \$250,000 (including amounts payable to Palisade under the note issued to Palisade);
- o Our failure to observe any covenant under the credit facility (including, e.g., the financial covenants);
- o Bankruptcy, insolvency or receivership proceedings with respect to the company;
- o Certain changes of control of the company (as defined in the Loan and Security Agreement);
- o Our inability to pay our debts generally as they come due; and
- o The occurrence or expectation of any material adverse change with respect to the company.

### The Palisade and Yimoyines Senior Subordinated Secured Loans

Palisade made a subordinated loan to us of \$13.9 million, and Ms. Yimoyines made a subordinated loan to us of \$100,000, which loans are evidenced by senior subordinated secured notes. The senior subordinated secured notes issued to Palisade and to Ms. Yimoyines rank pari passu with each other. The notes are subordinate to our indebtedness to CapitalSource and are secured by second-priority security interests in substantially all the company's assets (the first-priority security interest is held by CapitalSource).

Principal is due to be paid in 10 years (i.e., on January 25, 2012) and interest is payable quarterly at the rate of 11.5%. In the first and second years, the company has the right to defer 100% and 50%, respectively, of interest to maturity by increasing the principal amount of the note by the amount of interest so deferred. In the third through tenth years, the holder of the note has the right to require the company to defer interest to maturity by increasing the principal amount of the note by the amount of interest so deferred. As of March 31, 2002, the Company deferred the first payment of interest on these senior notes to maturity by increasing the principal balance of these notes by \$295,000 (the amount of interest due on the notes at March 31, 2002).

The notes contain certain restrictions on the conduct of our business, including, among other things, restrictions on incurring debt, becoming a party to a merger, selling or transferring substantially all of the assets of the company, declaring or paying any cash dividends or making any other payment or distribution on the company's capital stock or purchasing or redeeming such stock, entering into any agreements inconsistent with the company's obligations under the notes, making any redemption or prepayment of any subordinated debt, creating or suffering liens on the company's assets, or materially changing the nature of the company's business.

The occurrence of certain events or conditions described in the Notes



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(subject to grace periods in certain cases) constitutes a "default." If a default occurs, the entire outstanding balance of principal and interest would become immediately due and payable. Such defaults include, but are not limited to, failure to pay any principal or interest under the notes when due; failure to pay any principal or interest when due with respect to the CapitalSource credit facility; failure to perform or comply with any obligation under the notes; entry of a final judgment against

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the company, which, together with all other final judgments, exceeds in the aggregate \$250,000, and which judgment is not stayed, paid or discharged; and bankruptcy, insolvency or receivership proceedings with respect to the company.

### The Series B Preferred Stock

The company issued 3,204,959 shares of Series B 12.5% Voting Cumulative Convertible Participating Preferred Stock. The Preferred Stock accrues cumulative dividends at an annual rate of 12.5%. As of March 31, 2002, accrued and unpaid dividends on the Preferred Stock were approximately \$103,000.

Each share of Series B Preferred Stock is immediately convertible into ten shares of common stock and has the voting power equivalent to ten shares of common stock, subject to certain anti-dilution adjustments. The Preferred Stock is redeemable at any time by the company on 30 days' notice and must be redeemed in full by the company on December 31, 2008, at a price equal to the greater of the aggregate adjusted redemption value of the Series B Preferred Stock plus accrued but unpaid dividends or the amount the preferred stockholders would be entitled to receive if the Series B Preferred Stock plus accrued dividends were converted at that time into common stock and the company were to liquidate and distribute all of its assets to its common stockholders.

### RECENT ACCOUNTING CHANGES

Effective January 1, 2002, the company adopted Statement of Financial Accounting Standard ("SFAS") No. 142, "Goodwill and Other Intangible Assets". The standard changes the accounting for goodwill and intangible assets with an indefinite life whereby such assets will no longer be amortized; however the standard does require evaluation for impairment, and a corresponding writedown, if appropriate. SFAS No. 142 requires a transitional goodwill impairment test six months from the date of adoption. The company completed its transitional impairment test during the quarter ended June 30, 2002 and no impairment write-down was required.

In June 2001, the Financial Accounting Standards Board ("FASB") issued SFAS No. 143, "Accounting For Asset Retirement Obligations". This statement addresses financial accounting and reporting for obligations associated with the retirement of tangible long-lived assets and the associated asset retirement costs. The company is required to adopt the provisions of SFAS No. 143 at the beginning of fiscal 2003. The company has determined that the adoption of this statement will not have a material impact on its financial position or results of operations

.. In August 2001, the FASB issued No. SFAS 144, "Accounting for the Impairment or Disposal of Long-Lived Assets". This statement requires that one accounting model be used for long-lived assets to be disposed of by sale, whether previously held and used or newly acquired. This statement also broadens the

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definition of discontinued operations to include more disposal transactions. The provisions of this statement were adopted by the company on January 1, 2002. The Company applied SFAS No. 144 to the sale of its North Carolina Optometry operations and reported a loss on disposal of \$3,940 for the quarter ended June 30, 2002.

In April 2002, the FASB issued SFAS No. 145, "Recission of FASB Statements 4, 44 and 64, Amendment of FASB Statement 13, and Technical Corrections". SFAS No. 145 rescinds the provisions of SFAS No. 4 that requires companies to classify certain gains and losses from debt extinguishments as extraordinary items, eliminates the provisions of SFAS No. 44 regarding transition to the Motor Carrier Act of 1980 and amends the provisions of SFAS No.13 to require that certain lease modifications be treated as sale leaseback transactions. The provisions of SFAS No.145 related to classification of debt extinguishment are effective for fiscal years beginning after May 15, 2002. In future periods, the company will classify debt extinguishment costs within income from operations and will reclassify previously reported debt extinguishments as such. The provisions of SFAS No.145 related to lease modification are effective for transactions occurring after May 15, 2002. Upon adoption the Company will reclassify its previously reported gain from extinguishment of debt of \$8,789 and related income tax expense of \$3,475 from an extraordinary item to continuing operations.

In June 2002, the FASB issued Statement No. 146, Accounting for Costs Associated with Exit or Disposal Activities (SFAS No. 146) and nullifies EITF Issue No. 94-3. SFAS No.146 requires that a liability for a cost associated with an exit or disposal activity be recognized when the liability is incurred, whereas EITF No 94-3 had recognized the liability at the commitment date of an exit plan. The company is required to adopt the provisions of SFAS No. 146 effective for exit or disposal activities initiated after December 31, 2002. The company does not expect the provisions of SFAS No. 146 to have a material impact on its financial position or results of operations.

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### IMPACT OF INFLATION AND CHANGING PRICES

The company is subject to pre-determined Medicare reimbursement rates which, for certain products and services, have decreased over the past three years. A decrease in Medicare reimbursement rates could have an adverse effect on the company's results of operations if it can not manage these reductions through increases in revenues or decreases in operating costs. To some degree, prices for health care are driven by Medicare reimbursement rates, so that the company's non-Medicare business is also affected by changes in Medicare reimbursement rates.

Management believes that inflation has not had a material effect on the company's revenues for the three and six-month periods ended June 30, 2002 and 2001.

### FORWARD-LOOKING INFORMATION AND RISK FACTORS

The statements in this Form 10-Q and elsewhere (such as in other filings by the company with the Securities and Exchange Commission, press releases, presentations by the company or its management and oral statements) that relate to matters that are not historical facts are "forward-looking statements" within the meaning of Section 27A of the Securities Exchange Act of 1934. When used in

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this document and elsewhere, words such as "anticipate," "believe," "expect," "plan," "intend," "estimate," "project," "will," "could," "may," "predict" and similar expressions are intended to identify forward-looking statements. Such forward-looking statements include those relating to:

- o Future opportunities;
- o The outlook of customers;
- o The reception of new services, technologies and pricing methods;
- o Existing and potential strategic alliances;
- o The likelihood of incremental revenues offsetting expense related to new initiatives; and
- o Expected improvements in the company's financial condition as a result of the new capital structure.

In addition, such forward-looking statements involve known and unknown risks, uncertainties, and other factors which may cause the actual results, performance or achievements of the company to be materially different from any future results expressed or implied by such forward-looking statements. Also, our business could be materially adversely affected and the trading price of our common stock could decline if any of the following risks and uncertainties develop into actual events. Such risk factors, uncertainties and the other factors include:

- o Changes in the regulatory environment applicable to the company's business, including health-care cost containment efforts by Medicare, Medicaid and other third-party payers;
- o Demand and competition for the company's products and services;
- o General economic conditions;
- o Risks related to the eye care industry, including the cost and availability of medical malpractice insurance, and adverse long-term experience with laser and other surgical vision correction;
- o Risks related to the managed care and insurance industries, including risks relating to class action litigation seeking to broaden the scope of covered services;
- o Our ability to successfully integrate and profitably manage our operations;
- o Loss of the services of key management personnel;
- o Our ability to execute our growth strategy, without which we may not become profitable or sustain our profitability;
- o Our ability to obtain additional capital, without which our growth could be limited;
- o The fact that we have a history of losses and may incur further losses in the future;
- o The fact that if we default on our debt, our creditors could foreclose on our assets;
- o The possibility that we may not compete effectively with other eye

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care services companies which have more resources and experience than us;

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- o Failure to negotiate profitable capitated fee arrangements;
- o The possibility that we may have potential conflicts of interests with respect to related party transactions which could result in certain of our officers, directors and key employees having interests that differ from us and our stockholders;
- o Health care regulations or health care reform initiatives, which could materially adversely affect our business, financial condition and results of operations;
- o The fact that the nature of our business could subject us to potential malpractice, product liability and other claims;
- o The fact that managed care companies face increasing threats of private-party litigation, including class actions, over the scope of care that the managed care companies must pay for;
- o The fact that the company is dependent upon letters of credit or other forms of third party security in connection with certain of its contractual arrangements and, thus, would be adversely affected in the event it was unable to obtain such credit as needed;
- o The fact that certain parties are challenging the validity of and/or the company's compliance with Health Services Organization contracts and have ceased or may cease making payments under such contracts, jeopardizing the company's cash flow; and
- o Other risks and uncertainties discussed in this Form 10-Q and detailed from time to time in the company's periodic earnings releases and reports filed with the Securities and Exchange Commission.

We undertake no obligation to publicly update or revise forward looking statements to reflect events or circumstances after the date of this Form 10-Q or to reflect the occurrence of unanticipated events.

### ITEM 3: QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The company is subject to market risk from exposure to changes in interest rates based on its financing activities under its credit facility with CapitalSource, due to its variable interest rate. The nature and amount of the company's indebtedness may vary as a result of future business requirements, market conditions and other factors. The extent of the company's interest rate risk is not quantifiable or predictable due to the variability of future interest rates and financing needs. The company does not expect changes in interest rates to have a material effect on income or cash flows in the year 2002, although there can be no assurances that interest rates will not significantly change. A 10% change in the interest rate payable by the company on its variable rate debt would have increased or decreased the six month interest expense by approximately \$70,000 assuming that the company's borrowing level is unchanged. The company did not use derivative instruments to adjust the company's interest rate risk profile during the six months ended June 30, 2002.

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### PART II. OTHER INFORMATION

#### ITEM 1. LEGAL PROCEEDINGS

##### Health Services Organization Lawsuits

On or about May 22, 2002, the parties in Fogg, Maxwell & Lanier, M.D., Inc., et al. v. PrimeVision Health, Inc. and OptiCare Health Systems, Inc., et al., agreed to a full and final settlement of all issues.

With regard to the remaining HSO lawsuits, on June 19, 2002, the Judicial Panel on Multidistrict Litigation granted the company's motion to consolidate the HSO matters for all pre-trial proceedings to the United States District Court for the Western District of Kentucky.

##### Optometric Eye Care Center, P.A. Claim

On August 12, 2002, the company and Optometric Eye Care Centers, P.A. consummated a transaction for the sale of the assets and certain liabilities of the Company's North Carolina retail optometry operations that resolved the dispute between the parties.

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##### Regulatory Proceedings

On August 2, 2002, the North Carolina Board of Optometry approved the sale of the company's North Carolina retail optometry operations to Optometric Eye Care Centers, P.A., however, regulatory proceedings convened by the North Carolina Board of Optometry in exercise of its continuing authority to oversee implementation of a consent order entered in December 1999 remain pending.

#### ITEM 2. CHANGES IN SECURITIES AND USE OF PROCEEDS.

Described below is information regarding all securities that have been sold by the company during the first quarter ended June 30, 2002 that were not registered under the Securities Act.

On May 21, 2002, the company granted options to purchase 1,210,000 shares at an exercise price of \$0.20 per share and on June 27, 2002 granted options to purchase 600,000 shares of common stock at \$0.26 per share, 200,000 shares at \$1.00 and 200,000 shares at \$2.00. These options were granted under the 2002 Stock Incentive Plan.

The above transactions were private transactions not involving a public offering and were exempt from the registration provisions of the Securities Act pursuant to Section 4(2) thereof. No underwriter was engaged in connection with the foregoing sales of securities. The company has reason to believe that (i) all of the foregoing purchasers were familiar with or had access to information concerning the operations and financial conditions of the company, (ii) all of those individuals purchasing securities represented that they acquired the shares for investment and not with a view to the distribution thereof, and (iii) other than with respect to the options, that the foregoing purchasers are accredited investors within the meaning of Regulation D promulgated under the Securities Act. At the time of issuance, all of the foregoing securities were deemed to be restricted securities for purposes of the Securities Act and the

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certificates representing such securities bore or will bear legends to that effect.

### ITEM 4. SUBMISSIONS OF MATTERS TO A VOTE OF SECURITY HOLDERS.

The Annual Meeting of Stockholders of OptiCare Health Systems, Inc. was held on May 21, 2002. There were represented, in person or by proxy, 8,793,201 shares of common stock entitled to vote at the meeting, constituting a quorum. The following matters were voted upon and approved by the company's stockholders at the meeting:

(i) At the meeting, the directors nominated were elected by the following votes:

	NUMBER OF SHARES VOTED FOR:	NUMBER OF SHARES VOTED AGAINST:	NUMBER OF SHARES ABSTAINED:
	-----	-----	-----
Dean J. Yimoyines, M.D.	7,781,269	1,011,932	718,768
Eric J. Bertrand	8,500,037	293,164	-
David B. Cornstein	8,498,937	294,264	1,100
Norman S. Drubner	7,837,683	955,518	662,354
Mark S. Hoffman	8,498,937	294,264	1,100
Clark A. Johnson	8,500,037	293,164	-
Melvin Meskin	8,498,937	294,264	1,100
Mark S. Newman	8,498,937	294,264	1,100

(ii) the election of Deloitte & Touche LLP as independent auditors of the company, for the year ending December 31, 2002, was ratified by a vote of 4,162,378 in favor, 245,175 votes against and 910,538 abstentions.

(iii) the company's amended and restated 2002 stock incentive plan was also approved at the meeting by a vote of 7,834,147 in favor, 11,656 votes against and 947,398 abstentions.

There were no broker non-votes on any of the above proposals.

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### ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K.

#### a. Exhibits

The following Exhibits are filed as part of this Quarterly Report on Form 10-Q:

EXHIBIT	DESCRIPTION
3.1	Certificate of Incorporation of Registrant, incorporated herein by reference to Exhibit 3.1 to the Registrant's Annual Report on Form 10-KSB filed February 3, 1995.
3.2	Certificate of Amendment of the Certificate of Incorporation, dated as of August 13, 1999, as filed with the Delaware Secretary of State on August 13, 1999, incorporated herein by reference to Exhibit 3.1 to

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- Registrant's Current Report on Form 8-K filed on August 30, 1999.
- 3.3 Amended and Restated By-laws of Registrant adopted March 27, 2000, incorporated herein by reference to Exhibit 3.3 to Registrant's Annual Report on Form 10-K filed on March 30, 2000.
- 3.4 Certificate of Designation with respect to the Registrant's Series A Convertible Preferred Stock, as filed with the Delaware Secretary of State on August 13, 1999, incorporated herein by reference to Exhibit 3.2 to Registrant's Current Report on Form 8-K filed on August 30, 1999.
- 3.5 Warrant agreement dated as of August 13, 1999, between the Registrant and Bank Austria Creditanstalt Corporate Finance, Inc., incorporated herein by reference to Exhibit 3.3 to the Registrant's Current Report on Form 8-K filed on August 30, 1999.
- 3.6 Warrant Agreement dated as of October 10, 2000, by and between OptiCare Health Systems, Inc. and Medici Investment Corp., incorporated herein by reference to the Registrant's Quarterly Report on Form 10-Q for the quarter ended 9/30/00, Exhibit 10.14.
- 3.7 Certificate of Amendment of the Certificate of Incorporation, dated as of January 21, 2002, increasing the authorized common stock of the Company from 50,000,000 to 75,000,000 shares, incorporated herein by reference to the Registrant's Current Report on Form 8-K dated January 25, 2002, Exhibit 3.1.
- 3.8 Certificate of Designation, Rights and Preferences of the Series B 12.5% Voting Cumulative Convertible Participating Preferred Stock of the Company, as filed with the Delaware Secretary of State on January 23, 2002, incorporated herein by reference to the Registrant's Current Report on Form 8-K dated January 25, 2002, Exhibit 3.2.
- 3.9 Amendment No. 1 to the Amended and Restated Bylaws of OptiCare Health Systems, Inc., incorporated herein by reference to the Registrant's Current Report on Form 8-K dated January 25, 2002, Exhibit 3.3.
- 4.1 Performance Stock Program, incorporated herein by reference to Exhibit 4.1 to the Registrant's Registration Statement on Form S-4, registration no. 333-78501, first filed on May 14, 1999, as amended (the "Registration Statement 333-78501"). +
- 4.2 Amended and Restated 1999 Employee Stock Purchase Plan, incorporated herein by reference to Exhibit 4.2 to Registrant's Annual Report on Form 10-K filed on March 30, 2000.+
- 4.3 2000 Professional Employee Stock Purchase Plan incorporated herein by reference to Exhibit 4.3 to Registrant's Annual Report on Form 10-K filed on March 30, 2000.+
- 4.4 Amended and Restated 2002 Stock Incentive Plan.+\*
- 10.7 Settlement agreement dated as of April 9, 1999, among

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PrimeVision Health, Inc., Dr. Allan L.M. Barker, Dr. D. Blair Harrold, Optometric Eye Care Center, P.A., Steven B. Waite, Bank Austria AG, and Bank Austria Corporate Finance, Inc., incorporated herein by reference to Exhibit 10.8 to the Registration Statement 333-78501.

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- 10.8 Vision care capitation agreement between OptiCare Eye Health Centers, Inc. and Blue Cross & Blue Shield of Connecticut, Inc. (and its affiliates) dated October 23, 1999, incorporated herein by reference to Exhibit 10.9 to the Registration Statement 333-78501.
- 10.9 Eye care services agreement between OptiCare Eye Health Centers, Inc. and Anthem Health Plans, Inc. (d/b/a Anthem Blue Cross and Blue Shield of Connecticut), effective November 1, 1998, incorporated herein by reference to Exhibit 10.10 to the Registration Statement 333-78501.
- 10.10 Contracting provider services agreement dated April 26, 1996, and amendment thereto dated as of January 1, 1999, between Blue Cross and Blue Shield of Connecticut, Inc., and OptiCare Eye Health Centers, Inc., incorporated herein by reference to Exhibit 10.11 to the Registration Statement 333-78501.
- 10.11 Form of employment agreement between the Registrant and Dean J. Yimoyines, M.D., effective August 13, 1999, incorporated herein by reference to Exhibit 10.12 to the Registration Statement 333-78501.+
- 10.12 Form of employment agreement between the Registrant and Steven L. Ditman, effective August 13, 1999, incorporated herein by reference to Exhibit 10.13 to the Registration Statement 333-78501.+
- 10.13 Form of employment agreement between the Registrant and Dr. Allan L.M. Barker, effective August 13, 1999, incorporated herein by reference to Exhibit 10.14 to the Registration Statement 333-78501.+
- 10.14 Form of employment agreement between the Registrant and Dr. D. Blair Harrold, effective August 13, 1999, incorporated herein by reference to Exhibit 10.15 to the Registration Statement 333-78501.+
- 10.16 Lease dated September 22, 1987 and lease extension agreement dated December 12, 1997 by and between Cross Street Medical Building partnership, as landlord, and Ophthalmic Physicians and Surgeons, P.C., as tenant, for premises located at 40 Cross Street, Norwalk, Connecticut incorporated herein by reference to Exhibit 10.16 to the Registration Statement 333-78501.
- 10.17 Lease agreement dated September 1, 1995 by and between French's Mill Associates, as landlord, and OptiCare Eye



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Health Centers, Inc. as tenant, for premises located at 87 Grandview Avenue, Waterbury, Connecticut incorporated herein by reference to Exhibit 10.17 to the Registration Statement 333-78501.

- 10.18 Lease agreement dated September 30, 1997 by and between French's Mill Associates II, LLP, as landlord, and OptiCare Eye Health Center, P.C., as tenant, for premises located at 160 Robbins Street, Waterbury, Connecticut (upper level), incorporated herein by reference to Exhibit 10.18 to the Registration Statement 333-78501.
- 10.19 Lease agreement dated September 1, 1995 and amendment to lease dated September 30, 1997 by and between French's Mill Associates II, LLP, as landlord, and OptiCare Eye Health Center, P.C., as tenant, for premises located at 160 Robbins Street, Waterbury, Connecticut (lower level), incorporated herein by reference to Exhibit 10.19 to the Registration Statement 333-78501.
- 10.20 Lease agreement dated September 1, 1995 between O.C. Realty Associates Limited Partnership, as landlord, and OptiCare Eye Health Centers, Inc., as tenant, for premises located at 54 Park Lane, New Milford, Connecticut, incorporated herein by reference to Exhibit 10.20 to the Registration Statement 333-78501.
- 10.21 Lease dated March 1, 1997 by and between D. Blair Harrold & Allan L.M. Barker d/b/a Harrold Barker Investment Co. ("HBIC"), as landlord, and Consolidated Eye Care, Inc. ("CEC"), as tenant, for premises located at 112-B Zebulon Court, Rocky Mount, North Carolina, incorporated herein by reference to Exhibit 10.12 to the Registrant's Quarterly Report on Form 10-Q filed on November 15, 1999.
- 10.22 Lease dated March 1, 1997 by and between HBIC, as landlord, and CEC, a wholly-owned subsidiary of PrimeVision Health, Inc., as tenant, for premises located  
  
at 110 Zebulon Court, Rocky Mount, North Carolina, incorporated herein by reference to Exhibit 10.13 to the Registrant's Quarterly Report on Form 10-Q filed on November 15, 1999.
- 10.23 Lease dated March 1, 1997 by and between HBIC, as landlord, and CEC, as tenant, for premises located at 112-A Zebulon Court, Rocky Mount, North Carolina, incorporated herein by reference to Exhibit 10.14 to the Registrant's Quarterly Report on Form 10-Q filed on November 15, 1999.
- 10.24 Form of health services organization agreement between PrimeVision Health, Inc. and eye care providers, incorporated herein by reference to Exhibit 10.21 to the Registration Statement 333-78501.

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- 10.25 Professional Services and Support Agreement dated December 1, 1995 between OptiCare Eye Health Centers, Inc. and OptiCare P.C., a Connecticut professional corporation, incorporated herein by reference to Exhibit 10.22 to the Registration Statement 333-78501.
- 10.26 Voting Agreement, dated as of July 14, 1999, between Thomas Cooke and PrimeVision Health, Inc., incorporated herein by reference to Exhibit 10.23 to the Registration Statement 333-78501.
- 10.27 Amended and Restated Loan and Security Agreement, dated as of August 13, 1999, among Consolidated Eye Care, Inc., renamed OptiCare Eye Health Network, Inc, OptiCare Eye Health Centers, Inc., and PrimeVision Health, Inc. as borrowers, the Registrant as the Parent, the lenders named therein (the "Lenders"), Bank Austria, AG (the "LC Issuer"), and Bank Austria Creditanstalt Corporate Finance, Inc., as the agent (the "Agent") (excluding schedules and other attachments thereto), incorporated herein by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K filed on August 30, 1999.
- 10.28 Guaranty dated as of August 13, 1999, among the Registrant, OptiCare Eye Health Centers, Inc., PrimeVision Health, Inc., Consolidated Eye Care, Inc., renamed OptiCare Eye Health Network, Inc., and each of the other subsidiaries and affiliates of the Registrant listed on the signature pages thereto, in favor of the Lenders, the LC Issuer and the Agent, incorporated herein by reference to Exhibit 10.2 to the Registrant's Current Report on Form 8-K filed on August 30, 1999.
- 10.29 Security Agreement dated as of August 13, 1999, among the Registrant and the other parties listed on the signature page thereto in favor of the Agent for the benefit of the Lenders and the LC Issuer, incorporated herein by reference to Exhibit 10.3 to the Registrant's Current Report on Form 8-K filed on August 30, 1999.
- 10.30 Conditional Assignment and Trademark Security Agreement dated as of August 13, 1999, between the Registrant and the Agent for the benefit of the Lenders and the LC Issuer, incorporated herein by reference to Exhibit 10.4 to the Registrant's Current Report on Form 8-K filed on August 30, 1999.
- 10.31 Pledge and Security Agreement, dated as of August 13, 1999, among each of the Registrant, OptiCare Eye Health Centers, Inc., PrimeVision Health, Inc., Consolidated Eye Care, Inc., renamed OptiCare Eye Health Network, Inc., and each of the other subsidiaries and affiliates of the Registrant listed on the signature pages thereto, in favor of the Agent for the benefit of the Lenders and the LC Issuer, incorporated herein by reference to Exhibit 10.5 to the Registrant's Current Report on Form 8-K filed on August 30, 1999.
- 10.32 Assignment of Notes and Security Agreement, dated as of August 13, 1999, between PrimeVision Health, Inc. and the Agent, incorporated herein by reference to Exhibit 10.6 to the Registrant's Current Report on Form 8-K filed on August 30, 1999.

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- 10.33 Agreement and Plan of Merger, dated as of April 12, 1999, among the Registrant (then known as "Saratoga Resources, Inc."), OptiCare Shellco Merger Corporation, Prime Shellco Merger Corporation, OptiCare Eye Health Centers, Inc., a Connecticut corporation, and PrimeVision Health, Inc., incorporated herein by reference to Exhibit 2 to the Registration Statement 333-78501.
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- 10.36 Stock Purchase Agreement dated October 1, 1999, among the Registrant, Stephen Cohen, Robert Airola, Gerald Mandel and Reginald Westbrook (excluding schedules and other attachments thereto), incorporated herein by reference to Exhibit 10.10 to the Registrant's Quarterly Report on Form 10-Q filed on November 15, 1999.
- 10.38 Lease dated March 1, 1997, between the Registrant as tenant and Drs. D. Blair Harrold and Allan L.M. Barker as landlord, covering premises known as 579 Cross Creek Mall, Fayetteville, N.C., incorporated herein by reference to Exhibit 10.39 to the Registrant's Registration Statement on Form S-1, registration no. 333-93043, first filed on December 17, 1999, as amended ("Registration Statement 333-93043").
- 10.39 Lease dated March 1, 1997, between the Registrant as tenant and Optometric Eye Care Center, P.A., as landlord, covering premises at 315-A Western Boulevard, Jacksonville, N.C., incorporated herein by reference to Exhibit 10.40 to the Registration Statement 333-93043.
- 10.40 Employment agreement between the Registrant as employer and Gordon A. Bishop, dated August, 13, 1999, incorporated herein by reference to Exhibit 10.41 to the Registration Statement 333-93043. +
- 10.41 Lease dated September 1, 1999, between the Registrant as tenant and Harrold-Barker Realty, as landlord, covering premises located in Rocky Mount, N.C., incorporated herein by reference to Exhibit 10.42 to the Registration Statement 333-93043.
- 10.42 Professional Services and Support Agreement between the Registrant and Optometric Eye Care Center, P.A., incorporated herein by reference to Exhibit 10.43 to the Registration Statement 333-93043.
- 10.44 First Amendment to Amended and Restated Loan and Security Agreement, dated as of June 30, 2000, by and among Bank Austria Creditanstalt Corporate Finance, Inc., and the Registrant, incorporated herein by reference to Exhibit 10.9 to the Registrant's Form 10-Q filed on August 14, 2000.
- 10.45 Second Amendment to Amended and Restated Loan and Security Agreement, dated as of October 10, 2000, by and among the

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- Registrant and Bank Austria Creditanstalt Corporate Finance, Inc., incorporated herein by reference to the Registrant's Quarterly Report on Form 10-Q for the quarter ended September 30, 2000, Exhibit 10.11.
- 10.47 Secured promissory note dated as of October 10, 2000, made by the Registrant to Alexander Enterprise Holdings Corp., incorporated herein by reference to the Registrant's Quarterly Report on Form 10-Q for the quarter ended September 30, 2000, Exhibit 10.12
- 10.48 Security Agreement dated as of October 10, 2000, among the Registrant, OptiCare Eye Health Centers, Inc., PrimeVision Health, Inc., Consolidated Eye Care, Inc. and each of the other subsidiaries and affiliates of the Registrant listed on the signature pages thereto, in favor of Alexander Enterprise Holdings Corp., incorporated herein by reference to the Registrant's Quarterly Report on Form 10-Q for the quarter ended September 30, 2000, Exhibit 10.13.
- 10.49 Amended and Restated Secured Promissory Note issued as of October 10, 2000, by OptiCare Eye Health Centers, Inc., PrimeVision Health, Inc. and Consolidated Eye Care, Inc. to Alexander Enterprise Holdings Corp. ("Bridge Loan") , incorporated herein by reference to the Registrant's Annual Report on Form 10-K for the year ended December 31, 2000, Exhibit 10.49.
- 10.50 Employment Agreement between the Registrant and Jason M. Harrold, effective July 1, 2000, incorporated herein by reference to the Registrant's Quarterly Report on Form 10-Q for the quarter ended June 30, 2000, Exhibit 10.10. +
- 10.51 Pre-workout Agreement dated February 26, 2001, among Bank Austria Creditanstalt Corporate Finance, Inc. and OptiCare Eye Health Network, Inc., OptiCare Eye Health Centers, Inc., PrimeVision Health Inc., and the Registrant, incorporated herein by reference to the Registrant's Annual Report on Form 10-K for the year ended December 31, 2000, Exhibit 10.51.
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- 10.52 OptiCare Directors' and Officers' Trust Agreement dated November 7, 2001, between the Registrant and Norman S. Drubner, Esq., as Trustee, incorporated herein by reference to the Registrant's Annual Report on Form 10-K for the year ended December 31, 2000, Exhibit 10.52. +
- 10.53 Agreement for Consulting Services between Morris Anderson and Associates, Ltd. and OptiCare Health Systems, Inc. dated April 16, 2001, incorporated herein by reference to the Registrant's Annual Report on Form 10-K for the year ended December 31, 2000, Exhibit 10.53.
- 10.54 Form of Warrant to purchase 2,250,000 shares of common stock issued in connection with the Secured Promissory Note issued

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as of October 10, 2000, by OptiCare Eye Health Centers, Inc., PrimeVision Health, Inc. and OptiCare Eye Health Network, Inc. to Medici Investment Corp., incorporated herein by reference to the Registrant's Annual Report on Form 10-K for the year ended December 31, 2000, Exhibit 10.54.

- 10.55 Form of Warrant to purchase 300,000 shares and 2,000,000 shares of common stock issued in connection with the Amended and Restated Secured Promissory Note issued as of October 10, 2000, by OptiCare Eye Health Centers, Inc., PrimeVision Health, Inc. and OptiCare Eye Health Network, Inc. to Medici Investment Corp., incorporated herein by reference to the Registrant's Annual Report on Form 10-K for the year ended December 31, 2000, Exhibit 10.55.
- 10.56 Form of Warrant to purchase 50,000 shares of common stock issued in connection with the Amended and Restated Secured Promissory Note issued as of October 10, 2000, by OptiCare Eye Health Centers, Inc., PrimeVision Health, Inc. and OptiCare Eye Health Network, Inc. to Dean J. Yimoyines, M.D., incorporated herein by reference to the Registrant's Annual Report on Form 10-K for the year ended December 31, 2000, Exhibit 10.56.
- 10.57 Form of Warrant to purchase 400,000 shares of common stock issued in connection with the Amended and Restated Secured Promissory Note issued as of October 10, 2000, by OptiCare Eye Health Centers, Inc., PrimeVision Health, Inc. and OptiCare Eye Health Network, Inc. to Palisade Concentrated Equity Partnership, L.P., incorporated herein by reference to the Registrant's Annual Report on Form 10-K for the year ended December 31, 2000, Exhibit 10.57.
- 10.58 Third Amendment to Amended and Restated Loan and Security Agreement, dated as of January 5, 2001, by and among Bank Austria Creditanstalt Corporate Finance, Inc. and OptiCare Eye Health Network, Inc., OptiCare Eye Health Centers, Inc., PrimeVision Health Inc., and the Registrant, incorporated herein by reference to the Registrant's Annual Report on Form 10-K for the year ended December 31, 2000, Exhibit 10.58.
- 10.59 Amendment to Security Agreement dated as of January 5, 2001, among the Registrant, OptiCare Eye Health Centers, Inc., PrimeVision Health, Inc., Consolidated Eye Care, Inc. and each of the other subsidiaries and affiliates of the Registrant listed on the signature pages thereto, in favor of Alexander Enterprise Holdings Corp., incorporated herein by reference to the Registrant's Annual Report on Form 10-K for the year ended December 31, 2000, Exhibit 10.59.
- 10.60 Restructure Agreement dated December 17, 2001, among Palisade Concentrated Equity Partnership, L.P., Dean J. Yimoyines, M.D. and the Company, incorporated herein by reference to the Registrant's Current Report on Form 8-K dated January 25, 2002, Exhibit 10.1.
- 10.61 Amendment No. 1, dated January 5, 2002, to the Restructure Agreement dated December 17, 2001, among Palisade Concentrated Equity Partnership, L.P., Dean J. Yimoyines, M.D. and the Company, incorporated herein by reference to

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the Registrant's Current Report on Form 8-K dated January 25, 2002, Exhibit 10.2.

- 10.62 Amendment No. 2, dated January 22, 2002, to the Restructure Agreement dated December 17, 2001, among Palisade Concentrated Equity Partnership, L.P. Dean J. Yimoyines, M.D. and the Company, incorporated herein by reference to the

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Registrant's Current Report on Form 8-K dated January 25, 2002, Exhibit 10.3.

- 10.63 Senior Secured Subordinated Note dated January 25, 2002, in the principal sum of \$13,900,000, issued by the Company to Palisade Concentrated Equity Partnership, L.P., incorporated herein by reference to the Registrant's Current Report on Form 8-K dated January 25, 2002, Exhibit 10.4.
- 10.64 Senior Secured Subordinated Note dated January 25, 2002, in the principal sum of \$100,000, issued by the Company to Linda Yimoyines, incorporated herein by reference to the Registrant's Current Report on Form 8-K dated January 25, 2002, Exhibit 10.5.
- 10.65 Subordinated Pledge and Security Agreement dated as of January 25, 2002, by the Company (including certain of its subsidiaries) as grantor, and Palisade Concentrated Equity Partnership, L.P., as secured party and agent for the other secured party (Linda Yimoyines), securing the senior secured subordinated notes made by the Company to the secured parties dated January 25, 2002, incorporated herein by reference to the Registrant's Current Report on Form 8-K dated January 25, 2002, Exhibit 10.6.
- 10.66 Form of Warrant dated January 25, 2002, issued to Palisade Concentrated Equity Partnership, L.P., for the purchase of up to 17,375,000 shares of common stock., incorporated herein by reference to the Registrant's Current Report on Form 8-K dated January 25, 2002, Exhibit 3.4.
- 10.67 Form of Warrant dated January 25, 2002, issued to Linda Yimoyines, for the purchase of up to 125,000 shares of common stock, incorporated herein by reference to the Registrant's Current Report on Form 8-K dated January 25, 2002, Exhibit 3.5.
- 10.68 Form of Warrant dated January 25, 2002, issued to CapitalSource Finance, LLC, for the purchase of up to 250,000 shares of common stock, incorporated herein by reference to the Registrant's Current Report on Form 8-K dated January 25, 2002, Exhibit 3.6.
- 10.69 Registration Rights Agreement dated January 25, 2002, covering common stock held by Palisade, common stock issuable on conversion of the Series B Preferred Stock and exercise of the warrants issued to Palisade, Linda Yimoyines

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and CapitalSource Finance, L.L.C., incorporated herein by reference to the Registrant's Current Report on Form 8-K dated January 25, 2002, Exhibit 10.7.

- 10.70 Subordination Agreement dated January 25, 2002, among Palisade Concentrated Equity Partnership, L.P., Linda Yimoyines, CapitalSource Finance, L.L.C. and the Company, incorporated herein by reference to the Registrant's Current Report on Form 8-K dated January 25, 2002, Exhibit 10.8.
- 10.71 Amended and Restated Revolving Credit, Term Loan and Security Agreement dated as of January 25, 2002, between CapitalSource Finance, L.L.C. and the Company, including Annex I, Financial Covenants, and Appendix I, Definitions, incorporated herein by reference to the Registrant's Current Report on Form 8-K dated January 25, 2002, Exhibit 10.9.
- 10.72 Reassignment of Rights to Payments under Services Agreements, Physician Notes and Physician Security Agreements, between Bank Austria Creditanstalt Corporate Finance, Inc., and the Company, dated January 25, 2002, incorporated herein by reference to the Registrant's Current Report on Form 8-K dated January 25, 2002, Exhibit 10.10.
- 10.73 Assignment and Assumption Agreement dated January 25, 2002, between Bank Austria Creditanstalt Corporate Finance, Inc., and CapitalSource Finance, L.L.C., incorporated herein by reference to the Registrant's Current Report on Form 8-K dated January 25, 2002, Exhibit 10.11.
- 10.74 OptiCare Directors' & Officers' Tail Policy Trust dated January 10, 2002, between the Registrant and Norman S. Drubner, Esq., as trustee. +
- 10.75 Employment Agreement dated as of September 1, 2001, between the Registrant and William Blaskiewicz, incorporated herein by reference to Exhibit 10.21 of the

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Registrant's Quarterly Report on Form 10-Q for the Quarter ended March 31, 2001.+

- 10.76 Form of Employment Letter Agreement between the company and Christopher J. Walls dated February 18, 2002.+
- 10.77 Form of Employment Letter Agreement between the company and Lance A. Wilkes dated May 21, 2002.+\*

\* Filed herewith.

+ Management or compensatory plan.

b. Reports filed on Form 8-K filed in the period covered by this report:

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NONE

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SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be filed on its behalf by the undersigned, hereunto duly authorized.

Date: August 14, 2002

OPTICARE HEALTH SYSTEMS, INC.

By: /s/ William A. Blaskiewicz

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William A. Blaskiewicz  
Vice President and  
Chief Financial Officer  
(Principal Financial and Accounting  
Officer and duly authorized officer)

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CERTIFICATION

Each of the undersigned hereby certifies in his capacity as an officer of OptiCare Health Systems, Inc. ("the Company") that the Quarterly Report of the Company on Form 10-Q for the period ended June 30, 2002 fully complies with the requirements of Section 13(a) of the Securities Exchange Act of 1934 and that the information contained in such report fairly presents, in all material respects, the financial condition of the Company at the end of such period and the results of operations of the Company for such period.

Date: August 14, 2002



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/s/ Dean J. Yimoyines  
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Dean J. Yimoyines, M.D.  
Chairman and Chief Executive Officer

/s/ William A. Blaskiewicz  
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William A. Blaskiewicz  
Vice President and Chief Financial Officer