OPTICARE HEALTH SYSTEMS INC
Form 10-K
March 30, 2004

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

FORM 10-K

(MARK ONE)

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

FOR THE FISCAL YEAR ENDED DECEMBER 31, 2003
OR

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

COMMISSION FILE NUMBER 001-15223

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

DELAWARE	76-0453392
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)

87 GRANDVIEW AVENUE, WATERBURY, CONNECTICUT	06708
(Address of Principal Executive Offices)	(Zip Code)

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

Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class	Name of Each Exchange on Which Registered
Common Stock, $.001 par value	American Stock Exchange

Securities registered pursuant to Section 12(g) of the Act: None.

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. [X]Yes [ ]No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. [ ]

Indicate by check mark whether the registrant is an accelerated filer (as defined in Exchange Act Rule 12b-2). [ ]Yes [X]No

The aggregate market value of the registrant's Common Stock held by non-affiliates of the registrant (without admitting that any person whose shares are not included in such calculation is an affiliate) computed by reference to the closing market price as reported on the American Stock Exchange on June 30, 2003, the last business day of the registrant's most recently completed second fiscal quarter, was $4,920,389.

The number of shares outstanding of the registrant's Common Stock, par value $.001 per share, as of March 1, 2004, was 30,386,061 shares.

DOCUMENTS INCORPORATED BY REFERENCE

Certain information required in Part III of this Annual Report on Form 10-K is incorporated herein by reference to the registrant's Proxy Statement for the 2004 Annual Meeting of Stockholders.

OPTICARE HEALTH SYSTEMS, INC.

FORM 10-K

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PART I

ITEM 1. BUSINESS

THE FOLLOWING BUSINESS SECTION CONTAINS FORWARD-LOOKING STATEMENTS, WHICH INVOLVE RISKS AND UNCERTAINTIES. ACTUAL RESULTS COULD DIFFER MATERIALLY FROM THOSE ANTICIPATED IN THESE FORWARD-LOOKING STATEMENTS AS A RESULT OF CERTAIN FACTORS. (SEE "MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS--RISK FACTORS").

GENERAL

OptiCare Health Systems, Inc. is an integrated eye care services company focused on providing managed vision and professional eye care products and services. We operate in three distinct segments of the eye care market which, together, cover virtually every major sector of that market:

- Our Managed Vision Division contracts with insurers, employer groups, managed care plans, HMOs and other third-party payers to manage claims payment administration of eye health benefits for contracting parties in eight states and to provide insurance coverage relating to certain eye care products and services.

- Our Consumer Vision Division sells retail optical products to consumers and owns and/or operates integrated eye health centers, professional optometric practices and surgical facilities in Connecticut where comprehensive eye care services are provided to patients. We also own a manufacturing laboratory in Connecticut, in which prescription eyeglasses are fabricated and supplied to all of our Connecticut locations.

- Our Distribution & Technology Division serves the professional eye care market through (i) Wise Optical, a distributor of contact and ophthalmic lenses and other eye care accessories and supplies; (ii) a Buying Group program, which provides group purchasing arrangements for optical and ophthalmic goods and supplies to ophthalmologists, optometrists and opticians, and (iii) CC Systems, which provides systems and software solutions, including production, management and inventory systems, for eye care professionals and for eyeglass manufacturing laboratories.

Our principal executive offices are located at 87 Grandview Avenue, Waterbury, Connecticut, 06708. Our telephone number is (203) 596-2236 and our web site address is www.opticare.com. We include our web site address in this Annual Report on Form 10-K only as an inactive textual reference and do not intend it to be an active link to our web site.

We make available free of charge through the Investor Relations section of our web site our Corporate Code of Conduct and Ethics and our Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K and all amendments to those reports as soon as reasonably practicable after such material is electronically filed with, or furnished to, the Securities and Exchange Commission (the SEC). The public may read and copy any materials we file with the SEC at the SEC's Public Reference Room, 450 Fifth Street, NW, Washington, D.C. 20549. The public may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. Because we file reports and other information with the SEC electronically, the public may obtain

access to those documents at the SEC's Internet web site: http://www.sec.gov.

THE EYE CARE INDUSTRY

Overview

The eye care market includes both eye care services (including the systems and equipment for delivering such services) and optical products.

In the eye care services sector, eye health professionals, including ophthalmologists and optometrists, provide diagnostic eye examinations and treatment interventions to address complex eye and vision conditions, including disease and/or lack of functionality of the eyes. The most common conditions addressed by eye care professionals are nearsightedness, farsightedness and astigmatism. These eye and vision conditions are treated with surgical intervention (notably, laser surgery), prescription glasses, contact lenses or some combination of these treatments.

The optical products sector of the eye care market consists of the manufacture, distribution and sale of corrective lenses, eyeglasses, frames, contact lenses and other related optical products.

In the U.S., ophthalmologists and optometrists have traditionally delivered eye care services. Optical products are typically dispensed by opticians. Ophthalmologists are specifically trained physicians who have completed four years of medical school, obtained a medical degree and have received specialty training in ophthalmology. Ophthalmologists are licensed to conduct diagnostic examinations and to perform ophthalmic surgery. Optometrists complete four years of optometry school and are generally licensed to perform routine eye examinations and prescribe corrective optical devices (principally eyeglasses and contact lenses). Optometrists do not perform surgery, but often provide pre- and post-operative care. Opticians measure, fabricate, fit and adjust glasses as requested by patients and as prescribed by doctors. They also perform routine repairs and dispense eyeglasses and contact lenses. There are approximately 20,000 practicing ophthalmologists and 31,000 practicing optometrists in the U.S.

The U.S. market for eye care services and optical products is large and growing. Approximately 61% of the U.S. population--169 million people--require some form of vision correction; and over 100 million--or some 60% of those consumers--purchase eye wear each year. Annual market growth rates of 2% to 5% are expected to continue for the next several years. The single most compelling explanation for such growth is demographics, and, specifically the aging baby boom segment of the population. The need for corrective lenses is highly correlated with age. While 63% of 25-44 year-olds need such lenses, 95% of 45-64 year-olds require them. As the median age of the population increases (the portion of the U.S. population age 45 and over is projected to grow 21% from 2001 to 2010), the number of Americans requiring vision correction is expected to grow. Further, the rise of third-party plan providers continues to fuel growth in the industry. Since 1989, the portion of the eye care population covered by third-party plan providers has grown from 40% to 54%.

Eye care in the U.S. is a $45 billion market. Of that, approximately $29 billion is spent annually on health care services related to eye care. In addition, consumers spend approximately $16 billion annually on retail optical products, of which approximately 84%--or $14 billion--is spent on lenses and frames, while approximately 12%--or $2 billion--is spent on contact lenses (with the balance, approximately 4% or $0.6 million, being spent on sunglasses).

We do business in both sectors of this market (i.e., by providing eye care services and selling optical products). We also do business across both sectors of this market (i.e., by providing managed vision services with respect to both eye care services and optical products).

Eye Care Services and Products

We expect the demand for optical products and eye care services to show steady growth. We believe that the aging of the population, including the "baby boom" generation, will increase the demand for optical products and eye care services such as the medical and surgical treatment of such common disorders as glaucoma, macular degeneration, diabetic retinopathy and cataracts. For instance, Glaucoma affects approximately 3 million people in the U.S. and is projected by industry sources to double by 2030. 2.7 million cataract surgeries were performed in 2002, and that number is expected to increase to approximately 3.2 million by 2007. Since patients over the age of 65 are most affected by these eye disorders, the Medicare program is the primary payer for treatment, including surgical treatment, of these disorders.

Managed Vision Services

According to InterStudy, a health care research firm, as of January 2002, total U.S. enrollment in health maintenance organizations was 76.1 million. Additionally, approximately 80 million Americans are enrolled in

preferred provider organizations. Almost all health care insurance plans cover medical/surgical treatment of eye disorders and many also provide vision care benefits, including routine eye exams and optical products.

We believe that enrollment in health care insurance plans, which provide coverage of eye care services will continue to grow. We expect this trend will be supported by managed care plans offering enhanced vision and eye care benefits in order to more aggressively compete for potential membership.

Further, vision care coverage is the fastest growing employee benefit. Vision is a low-cost, high perceived value benefit, rated by employees as one of the three most important benefits. The percentage of employers offering vision benefits rose from 34% in 1996 to 56% in 2000, the latest year for which such statistics are available.

DESCRIPTION OF BUSINESS DIVISIONS

Our business operations are managed through three divisions which, together, cover virtually every major sector of the eye care market: Managed Vision; Consumer Vision; and Distribution & Technology.

Managed Vision Division

Description

Our Managed Vision Division contracts with insurers, insurance fronting companies, employer groups, managed care plans, HMOs and other third-party payers to manage claims payment and administration of eye health benefits for those contracting parties in Connecticut, Colorado, Georgia, Missouri, New York, North Carolina, Tennessee and Texas. The typical range of benefits administered includes well eye exams, prescription optical products and medical and surgical services related to eye care.

We have leveraged our leadership position in key markets to build a strong provider base of eye care professionals: ophthalmologists, optometrists and opticians. We verify and approve the credentials of these providers, ensuring they meet plan and regulatory standards. We educate these providers concerning the plan benefits which we administer and then streamline the authorization and claims payment process.

We believe that our managed care services provide significant value to third-party payers by delivering high quality managed eye care benefits to plan members and comprehensive, cost-effective administrative services to the third-party payers. We believe that we are well positioned to compete for all types of eye care contracts because of our managed care expertise, sophisticated information systems, third party provider relationships and operating history.

Strategy

Recognizing the significant growth potential of this market segment, we are:

- Expanding our sales and marketing capabilities to organically grow in certain South-East and North-East markets;

- Positioning ourselves to contract for business directly with employer groups and other associations, thereby reaching another sector of the third-party payer market and broadening the base of our revenue stream;

- Increasing our market density, which will enable us to offer cost advantages by directing volume to targeted manufacturers, thereby increasing the value of our services to the practitioners who contract with us; and

- Offering non-insurance related products, including Administrative Services Only (ASO) and IRC Section 125 plans, with benefits that include the administration of well eye examinations and/or prescription optical products.

Market Position

As of December 31, 2003, we administered eye care benefit programs, delivered through networks of eye care professionals nationwide, for approximately 2 million benefit enrollees under capitation (i.e., payment by an insurer to a managed care entity or network of a fixed amount per member or per enrollee each month, quarter or year) and/or fee-for-service arrangements.

Customers

Our Managed Care Vision Benefits' customers include insurers, managed care plans, HMOs and other third-party payers. With the advent of our Direct-to-Employer suite of products, our customer base is being enlarged to include, among others, employers, employer groups, unions, trade organizations and municipalities. We have six managed vision contracts with two insurers, CIGNA and United St. Louis, which account for 14 % of the our consolidated revenue in 2003. CIGNA experienced a decline in membership in January 2004, which translates into a $2.0 million decline in our annual revenue, however, a new contract with a different payor became effective March 1, 2004, which will offset this decrease in revenue.

Most of our contracts have terms of one to three years and contain an

automatic renewal provision for additional one-year periods and grant either party the right to terminate the contract upon 90-180 days' notice.

Products & Services

OptiCare is distinguished in the eye care insurance industry because it offers a number of different risk-bearing contractual relationships for its clients. In addition to traditional "Managed Care Vision Benefits," described in the first point below, we began offering a new suite of products in February of 2003, which we refer to as our "Direct-to-Employer" products, described in the second, third and fourth points below.

- Managed Care Vision Benefits - We administer vision benefits for health plans to over 2 million benefit lives under capitation and fee-for-service arrangements. Benefits administered under these programs are for well vision, preventive exams and optical hardware in addition to medical and surgical eye care benefits. We assume partial or full financial risk with respect to nearly all of the lives for which we administer vision benefits. We have been administering benefits of this nature for more than ten years.

- Insured Vision Plan - We provide insurance coverage for well vision, preventive examinations and optical hardware through Fidelity Security Life Insurance Company and through our captive insurance company, OptiCare Vision Insurance Company, Inc.

- Section 125 Vision Plan - This vision benefit allows qualified groups and individuals to participate in vision programs for well vision, preventive examinations and optical hardware on a pretax basis.

- ASO Vision Plan - We administer benefits on a fee basis for well vision, preventive examinations and optical hardware for qualified groups which are self-funded.

Operations

The following are the principal components of our Managed Vision operations:

- Provider Contracting - Upon obtaining a managed care contract, we typically define and/or develop a network of ophthalmologists, optometrists and opticians to provide the eye care services required under the contract. Generally, we attempt to contract first with eye care professionals with whom we have an existing contractual relationship. Additionally, we seek to enter into contracts with independent eye care professionals as well as to work in conjunction with our partners to build networks that meet set access standards.

- Provider Credentialing - Under most contracts, we "credential" eye care professionals (i.e., establish to both our, and the third-party payer's, satisfaction the credentials of such professionals) who provide the eye care services specified under the contract to the third-party payer's members. In addition to our network enrollment process, we credential when requested by the health plan or as required by state law consistent with the standards established by those plans or applicable law. In those instances, we undertake a review process on each prospective eye care professional, which includes obtaining a copy of the state license and Drug Enforcement Agency number, verifying hospital privileges, liability insurance and

board certification and reviewing work history.

In conducting our credentialing reviews, we apply the national standards--set by the National Committee for Quality Assurance--by which health plans are measured for compliance with quality assurance initiatives. OptiCare was re-awarded accreditation in 2003 as a Credentialing Verification Organization by the National Committee for Quality Assurance for 11 out of 11 elements. Eye care professionals, who are credentialed for our panels, are currently re-credentialed every three years.

- Claims Payment - For most contracted payers, we pay claims to our network providers for services rendered in the fulfillment of vision benefits for members. We also have Internet capabilities for authorizations (if needed), direct claim submission and claim tracking. Additionally, we accept claims via electronic data interchange, allowing providers to send claims through their own practice management software. We believe these enhancements have continued to help lower our cost of operations, improve service, and speed the payment cycle to our providers.

  To enhance our claims payment administration, we utilize proprietary systems, which allow us to strictly follow Center for Medicare and Medicaid Services' rules for payment of eye care claims. In addition, we have posted on-line our clinical criteria for treatment of every eye care condition for which we provide covered services. Our providers can use our secure web server to check these criteria and to inform themselves of new or modified criteria as changes occur.

- Utilization Management - Our Utilization Management staff ensures that established clinical criteria are followed in provision of services and benefits to members. Using proprietary clinical criteria for eye care procedures that are based on Center for Medicare and Medicaid Services' local carrier policy and the American Academy of Ophthalmology's guidelines, we work with eye care professionals to determine appropriate eye care treatments. While these practices are intended to reduce unnecessary procedures--and therefore costs--there can be no assurance that costs may not become excessive.

- Plan Member Relations - Service representatives answer plan members' questions relating to their benefits and the status of their claims and help resolve complaints relating to their eye care treatment. We believe that our issue-resolution structure is unique to the industry and increases plan members' satisfaction with their eye care benefits.

- Provider Relations - We continuously educate providers concerning the various plan benefits being administered. In addition, with the assistance of our staff, providers may obtain required authorizations prior to performing certain eye care procedures.

- Quality Management - Our Quality Management Department tracks complaints and concerns and conducts surveys for members, providers and payers to ensure that all parties are satisfied with the services and the service levels provided. Department personnel also recommend, or take, steps to address conditions from which valid complaints have arisen. In addition, we perform prospective-outcome studies and other quality assessment studies on the care rendered by our network of providers.

- Claim Data Analysis - Our financial analysts review claim and other data to provide feedback to management and to the insurance companies and other payers with which we have claims payment contracts

concerning our performance, enabling management to maintain profitability while providing excellent service.

Legal & Compliance

Our Managed Vision Division is subject to the following legal requirements and regulations:

Licensing Requirements. Most states impose strict licensure requirements on health insurance companies, HMOs and other companies that engage in the business of insurance, pre-paid health care or defined managed care activities. In some states, these laws do not apply to the discounted fee-for-service or capitation programs between insurers and provider networks contracting with those insurers.

Certain states, however, such as Texas, where we work strictly on a capitated basis, require that the risk-bearing entity (e.g., the managed care company) be licensed for capitated arrangements unless that entity qualifies under certain exceptions (such as that it be a professional corporation which is owned by eye care providers). We do not qualify for such an exception. As a risk-bearing entity, we are currently licensed only in Texas and operate our capitated arrangements through a wholly-owned, single-service HMO subsidiary, AECC Total Vision Health Plan of Texas, Inc. (See "--Regulation of Our HMO Subsidiary")

If we are required to become licensed under the laws of states other than Texas for our Managed Care Vision Benefits products, the licensure process can be lengthy and time consuming. In states where we already are conducting such business, unless the regulatory authority permits us to continue to operate while the licensure process is progressing, we could suffer losses of revenue that would result in material adverse changes in our business while the licensing process is pending. In addition, licensing requirements may mandate strict financial and other requirements we may not immediately be able to meet and which, if waivers or other exemptions are not available, might cause us to withdraw from those states or otherwise cause a material adverse change to our business, operations or financial position. (The same risks may not apply to the same degree for our Direct-to-Employer suite of products due to our relationship with Fidelity Security Life Insurance Company, which is licensed to write life and health insurance in all 50 states (New York, reinsurance only).) Once licensed, we would be subject to regulatory compliance and required to report to the licensing authority.

We also hold a license as a third-party administrator in North Carolina, South Carolina and Texas and are a licensed utilization review agent in South Carolina, Texas, Tennessee and New York. In addition, we have applied for a preferred provider network license in Connecticut.

In New Jersey we have applications on file to become a Certified Organized Delivery System and a third-party administrator.

These same requirements, it should be noted, can also serve as a barrier to entry to competition in states where such licensure is required.

Regulation of Our Capitve Insurance Subsidiary. Our Captive Insurance Company subsidiary, Opticare Vision Insurance Company (OVIC) is a licensed Captive Insurance Company domiciled in South Carolina. It is subject to regulation and supervision by the South Carolina Department of Insurance who requires us to maintain $500,000 of unencumbered capital and surplus.

Regulation of Our HMO Subsidiary. Our Texas HMO subsidiary, AECC Total

Vision Health Plan of Texas, Inc. is a licensed single service HMO. It is subject to regulation and supervision by the Texas Department of Insurance, which has broad administrative powers relating to standards of solvency, minimum capital and surplus requirements, maintenance of required reserves, payment of dividends, statutory accounting and reporting practices and other financial and operational matters. The Texas Department of Insurance requires that stipulated amounts of paid-in-capital and surplus be maintained at all times. Our Texas HMO subsidiary is required by terms of an Order of the Commissioner of Insurance, dated August 12, 1999, as modified in November 2003, to maintain a minimum net worth of $500,000. Dividends payable to us by our Texas HMO subsidiary are generally limited to the lesser of 10% of statutory-basis capital and surplus or net income of the preceding year excluding realized capital gains.

Third Party Administration Licensing. Some states require licensing for companies providing administrative

services in connection with managed care business. We currently hold third party administrator licenses in North Carolina and Texas. We may seek licenses in the states where they are required for eye care networks, if needed. In the event such licensure is required and we are unable to obtain a license, we may be forced to withdraw from that state, which could have a material adverse effect on our business.

Direct-to-Employer Insurance Products. Fidelity Security Life Insurance Company, a carrier licensed to write life and health insurance in all 50 states (New York, reinsurance only), underwrites our insured product. Fidelity has been rated A- (Excellent), based on an analysis of financial position and operating performance by A.M. Best Company, an independent analyst of the insurance industry. Our insured product, offered through Fidelity, is reinsured through OptiCare Vision Insurance Company, Inc., our wholly-owned subsidiary, which is domiciled in South Carolina and has received approval to operate as a captive insurance company from the South Carolina Department of Insurance.

Preferred Provider Networks. We previously registered as a preferred provider network (PPN) with the Connecticut Office of Health Care Access. In 2003 this regulatory function was transferred to the Department of Insurance and the definition of a PPN was revised to focus on entities assuming financial risk. We have an application pending with the Department of Insurance for a PPN in Connecticut. Many states have provider network licensure registration requirements and many of these mandate that an organization have specified financial reserves or insolvency protections and provide financial reporting and disclosures to state officials. Our activities over time in Connecticut and/or in various other states may subject us to regulation under such arrangements, and our ability to comply with these requirements or to secure the necessary regulatory approval, cannot be assured.

"Any Willing Provider" Laws. Some states have adopted, and others are considering, legislation that requires managed care networks to include any qualified and licensed provider who is willing to abide by the terms of the network's contracts. These laws could limit our ability to develop effective managed care networks in such states. We believe that the medical management and eye care claim data analysis services we offer would provide greater value to our clients if such legislation were adopted in states where we do business. There are currently no states in which we operate our managed care business that have "any willing provider" requirements, although Texas does impose certain anti-discrimination requirements for ophthalmologists and optometrists . Further, with the introduction of our Direct-to-Employer suite of products, we have added business lines which would not be directly affected by adoption of "any willing provider" requirements in the states in which we do such business.

Health Insurance Portability and Accountability Act - Administrative Simplification. The Health Insurance Portability and Accountability Act (referred to as HIPAA), passed in 1996 by Congress, requires the Department of Health and Human Services (referred to as HHS) to enact standards for information sharing, security and the use, disclosure and confidentiality of patients' protected health information. The HHS, in its administrative simplification provisions, has published three sets of final regulations implementing healthcare transactions and privacy standards under HIPAA. These regulations apply to what are termed "covered entities" (i.e., health plan, health care clearinghouse, healthcare provider) and, under terms of the regulations, in certain instances we may be a covered entity and in other instances we may be classified as a business associate of an independent covered entity. In addition, state laws may place additional limitations on the use or disclosure of patients' information.

The first set of final regulations requires covered entities to use uniform standards, including data reporting, formatting and coding, for common healthcare transactions. The Standards for Electronic Transactions Final Rule was published August 2000 and became effective October 2000 with a compliance date of October 2002. The effective date was later delayed to October 2003. We implemented the appropriate compliance initiatives, including systems enhancements, to implement the electronic transaction and code set requirements and we believe we are in compliance with this regulation.

The second set of final regulations imposes new standards relating to the privacy of individually identifiable health information. The Standards for Privacy and Individually Identifiable Health Information Final Rule was published December 2000 and became effective April 2001 with a compliance date of April 2003. These standards require covered entities to comply with rules governing the use and disclosure of protected health information. The standards also require covered entities to enter into certain contractual provisions with any business associate to whom individually identifiable information is disclosed. We implemented appropriate

compliance initiatives, including systems enhancements, training and administrative efforts, required to be compliant with the HIPPA Privacy Regulations and we believe we are in compliance with this regulation.

A third set of regulations under HIPAA, the Final Rule for Security Standards, was published in February 2003 with a compliance date of April 2005. The Final Rule establishes minimum security requirements for covered entities to protect health information in electronic form. In some cases, we will also have to comply with applicable state regulations regarding privacy and medical information. We have has created a security plan that includes administrative, technical and physical security safeguards to ensure appropriate compliance by the effective date.

We are currently assessing the security standards to ensure that we have the required systems and procedures in place to comply with the new HIPPA regulations. While we will incur costs to become compliant with the HIPAA regulations, we believe this will not have a significant overall impact on our results of operations. We will continue to monitor new developments under HIPAA and the regulations and pronouncements issued thereunder to ensure compliance.

In addition to its administrative simplification provisions, HIPAA also imposes criminal penalties for fraud against any healthcare benefit program, for theft or embezzlement involving healthcare and for false statements in connection with the payment of any health benefits. These HIPAA fraud and abuse

provisions apply not only to federal programs, but also to private health benefit programs. HIPAA also broadened the authority of the Department of Health and Human Services Office of Inspector General, or OIG, to exclude participants from federal healthcare programs. Although we do not know of any current violations of the fraud and abuse provisions of HIPAA, if we were found to be in violation of these provisions, the government could seek penalties against us including exclusion from participation in government payer programs. Significant fines could cause liquidity problems and adversely affect our results of operations.

Interpretation and Implications. Many of the laws described may involve civil and criminal penalties and have been subject to limited judicial and regulatory interpretation. These laws often have been subject to limited judicial and regulatory interpretation. They are enforced by regulatory agencies that are vested with broad discretion in interpreting their meaning. Our agreements and activities have not been examined by federal or state authorities under these laws and regulations. There can be no assurance that review of our business arrangements will not result in determinations that adversely affect our operations or that certain material agreements between us and eye care providers or third-party payers will not be held invalid and unenforceable.

In addition, some of these laws and their interpretation vary from state to state. The regulatory framework of certain jurisdictions may limit our expansion into, or ability to continue operations within, such jurisdictions if we are unable to modify our operational structure to conform to such regulatory framework. Any limitation on our ability to continue operating in the manner in which we have operated in the past could have an adverse effect on our business, financial condition and results of operations.

Competition

Our Managed Vision Division competes with several regional and national eye health companies, which provide services to health plans, associations, employer groups and various other payers. Our largest competitor is Vision Service Plan of America. We also compete for managed care contracts with HMOs, PPOs and private insurers, many of which have larger provider networks and greater financial and other resources than we do. Managed care organizations compete on the basis of administrative strength, size, quality and geographic coverage of their provider networks, marketing abilities, information systems, operating efficiencies and price.

Consumer Vision Division

Description

The Consumer Vision Division provides eye care services and products to consumers through a total of 18

integrated eye health centers and professional optometric practices, a surgery center and a laser correction center we own and/or operate in Connecticut. (In the integrated eye health centers, comprehensive eye care services are provided by ophthalmologists and optometrists.) We also conduct all management, billing, systems and related procedures for the operation of all locations.

Strategy

We are seeking to improve the profitability of our Consumer Vision Division by generating higher volume through existing locations. To do so, we are trading

on our promise of "better doctors, better training, better care" and our wide selection of quality brand name and private label products which span a wide range of price points. Further, we are developing and executing test marketing programs to increase optical sales and implementing profit improvement plans throughout the Consumer Vision Division.

Market Position

We are the second largest optical retailer in Connecticut.

Customers

Our customers and patients are individuals who come to us for eye exams, corrective lenses, surgery and non-prescription eyewear, such as sunglasses. We are not dependent upon customers or patients of any particular age, gender, ethnic origin or from any particular community or economic strata.

Products & Services

Integrated Eye Health Centers. Through our nine integrated eye health centers, comprehensive eye care services are provided to individual patients. Such services include medical and surgical treatment of eye diseases and disorders by ophthalmologists, and vision measuring and non-surgical eye care correction and treatment services by optometrists.

Professional Optometric Practices. Our professional optometric practice locations provide vision correction services by optometrists, and/or sell eyeglasses and other optical products. These facilities are either free-standing or are located within our fully integrated eye health centers. Our professional optometric practices provide all customary optical goods and are supported by our billing, collection and information systems. We operate 18 retail optical locations in Connecticut (nine of those facilities also offer medical services and are referred to as the "integrated eye health centers" discussed above).

Surgical Centers. We own and operate two surgery centers in Connecticut, one of which is a laser correction center. In our ambulatory surgery center in Waterbury, Connecticut, ophthalmic surgeons perform a range of eye care surgical procedures, including cataract surgery, and surgical treatment of glaucoma, macular degeneration and diabetic retinopathy. In our laser center in Danbury, Connecticut, we use a VISX excimer laser for the correction of nearsightedness, farsightedness and astigmatism. In these centers, we bill patients (or their insurers, HMOs, Medicare, Medicaid or other responsible third-party payers) for use of the surgery facility. Our surgeons bill the patients separately for their services. For laser correction, patients are billed directly and, generally, we are not reimbursed by third-party payers. Our ambulatory facility in Waterbury is state licensed, approved for the payment of facility fees by most health plans and is Medicare approved.

Manufacturing Laboratory. We also have a complete manufacturing facility in Connecticut, with state of the art equipment, in which lenses are farbricated, surfaced and ground to specifications and supplied to all of our Connecticut locations. Additionally, our lab manufacturing services are integrated into some of our Managed Vision programs that are administered in Connecticut.

Operations

For our integrated eye health centers, professional optometric practices and surgical centers, we contract with a

professional corporation, OptiCare P.C., which employs ophthalmologists and optometrists, to provide surgical, medical, optometric and other professional services to patients. We provide management services to OptiCare P.C. under a renewable professional services and support agreement. We refer to OptiCare P.C. as our "professional affiliate."

We purchase most of our eyeglass frames, ophthalmic lenses, contact lenses and other optical goods and devices through our Buying Group and/or Wise Optical, our optical product distribution company (See "--Distribution & Technology Division").

Legal & Compliance

The federal and state governments extensively regulate the health care industry. Our business is subject to numerous federal and state laws and regulations, including the following:

Surgical Facility Regulations. Our licensed ophthalmic outpatient surgical facility in Waterbury, Connecticut is subject to the terms of Certificate of Need approvals from the Office of Health Care Access and licensure under the provisions of the Connecticut Public Health Code. The facility also is a participating provider under the federal Medicare and Connecticut Medicaid programs and has provider agreements with various commercial and governmental third-party payers. Violation of any of the terms and conditions of the Certificate of Need approvals and the Connecticut Public Health Code license governing the facility's operation could result in fines or other sanctions against the facility and its operators, including OptiCare being enjoined or precluded from further operation of the facility. Failure to adhere to the terms of participation for the Medicare or Medicaid programs or a violation of billing or other requirements for the public and private third-party payment programs governing the facility could result in civil or criminal sanctions against the facility and its operators, refund obligations or claims denials and/or termination or exclusion from participation in Medicare, Medicaid or other payer programs. The structure of relationships involving the facility and clinicians providing services in conjunction with the facility also is subject to the federal fraud and abuse statute (the anti-kickback statute) and related state and federal authorities.

Excimer Laser Regulation. Medical devices, including the excimer laser used in our Danbury, Connecticut laser surgery center, are subject to regulation by the U.S. Food and Drug Administration, referred to as the FDA. Failure to comply with applicable FDA requirements could subject us, our affiliated providers or laser manufacturers to enforcement action, product seizures, recalls, withdrawal of approvals and civil and criminal penalties. Further, failure to comply with regulatory requirements, or any adverse regulatory action--including a reversal of the FDA's current position that the use of excimer lasers by physicians outside FDA approved guidelines is a "practice of medicine" decision, which the FDA is not authorized to regulate--could result in a limitation on, or prohibition of, our use of excimer lasers.

Regulation of Laser Vision Marketing. The marketing and promotion of laser correction and other vision correction surgery procedures in the U.S. is subject to regulation by the FDA and the Federal Trade Commission, referred to as the FTC. The FDA and FTC have released a joint communique on the requirements for marketing these procedures in compliance with the laws administered by both agencies. The FTC staff also issued more detailed staff guidance on the marketing and promotion of these procedures. It has been monitoring marketing activities in this area through a non-public inquiry to identify activities that may require further FTC attention. The FDA has traditionally taken the position that the promotion and advertising of lasers by manufacturers and physicians should be limited to the uses approved by the FDA. Although the FDA does not prevent non-approved uses of excimer lasers, the FDA reserves the right to

regulate advertising and promotion of non-FDA-approved uses.

Corporate Practice of Ophthalmology and Optometry . The laws of a number of states prohibit corporations that are not owned entirely by eye care professionals from:

- Employing eye care professionals;
- Receiving for their own account reimbursements from third-party payers for health care services rendered by licensed professionals;

- Controlling clinical decision-making; or
- Engaging in other activities that constitute the practice of ophthalmology or optometry.

To comply with these requirements, we:

- Perform only non-professional services;
- Contract with our professional affiliate (which is owned by a licensed ophthalmologist), which in turn employs or contracts with licensed ophthalmologists or optometrists to provide professional services to patients;
- Do not represent to the public or customers that we provide professional eye care services (which is done by the professional affiliate); and
- Do not exercise influence or control over the professional practices or clinical judgements of eye care practitioners employed by the professional affiliate.
- Only dispense prescription ophthalmic products under the sole supervision of the employees of the professional affiliate.

Our agreement with our professional affiliate specifically provides that all decisions required by law to be made by licensed ophthalmologists or optometrists shall be made only by such licensed persons, and that we shall not engage in any services or activities which would constitute the practice of ophthalmology or optometry. If health care regulations and their interpretations change in the future, we may have to revise the terms of such agreement to comply with regulatory changes.

Prohibitions of Certain Referrals. The Omnibus Budget Reconciliation Act of 1993 includes a provision that significantly expands the scope of the Ethics in Patient Referral Act, also known as "Stark." The provisions of Stark originally prohibited a physician from referring a Medicare or Medicaid patient to any entity for the provision of clinical laboratory services if the physician or a family member of the physician had an ownership interest in or compensation relationship with the entity. The revisions to Stark prohibit a referral to an entity in which the physician or a family member has a prohibited ownership interest or compensation relationship if the referral is for any of a list of "designated health services", which includes "prosthetic devices." Under federal authority and the standards imposed by various state Medicaid programs, eyeglasses and contact lenses for patients who have undergone certain ophthalmic procedures would be considered prosthetic devices covered by Stark. The Stark regulations provide that the prohibition of referrals for these types of eyewear does not apply if the arrangement between the physician and the eyewear seller

conforms to the Anti-Kickback Law and other regulatory requirements. There can be no assurance that future interpretations of such laws and future regulations promulgated thereunder will not affect our existing relationship with our professional affiliate.

State Fee-Splitting and Anti-Kickback Law. Most states have laws which prohibit the paying or receiving of any remuneration, direct or indirect, that is intended to induce referrals for health care products or services and prohibit "fee-splitting" by health care professionals with any party except other health care professionals in the same professional corporation or practice association. In most cases, these laws apply to the paying of a fee to another person for referring a patient or otherwise generating business, and do not prohibit payment of reasonable compensation for facilities and services other than the generation of business, even if the payment is based on a percentage of the revenues of the professional practice. In addition, to the extent we are engaged in the direct delivery of vision care services in a jurisdiction we have to comply with those statutes. There is no express statute on this specific subject in Connecticut.

Federal Anti-Kickback Law. Federal law prohibits the offer, payment, solicitation or receipt of any form of remuneration in return for the referral of "federal health care program" patients, or in return for the purchase, lease or order of any item or service that is covered by a "federal health care program." A "federal health care program" includes Medicare, Medicaid, TriCare/CHAMPUS, and certain other state programs funded by the federal

government, among others. Pursuant to this law, the federal government has pursued a policy of increased scrutiny of transactions among health care providers in an effort to reduce potential fraud and abuse relating to government health care costs. The Medicare and Medicaid anti-kickback statute (42 USC Section 1320a-7b), referred to as the Anti-Kickback Statute, provides criminal penalties for individuals or entities participating in federal health care programs who knowingly and willfully offer, pay, solicit or receive remuneration in order to induce referrals for items or services reimbursed under such programs. In addition to federal criminal penalties, the Social Security Act provides for civil monetary penalties and exclusion of violators from participation in federal health care programs. A violation of the Anti-Kickback Statute requires the existence of all of these elements: (i) the offer, payment, solicitation or receipt of remuneration; (ii) the intent to induce referrals; (iii) the ability of the parties to make or influence referrals of patients; (iv) the provision of services that are reimbursable under any federal health care programs; and (v) patient coverage under any federal health care program.

To our knowledge, there have been no case law decisions regarding service agreements similar to that which we have with our professional affiliate that would indicate that such agreements violate the Anti-Kickback Statute. Because of the breadth of the Anti-Kickback Statute and the government's active enforcement thereof, there can be no assurance, however, that future interpretations of such laws will not require modification of our existing relationship with our professional affiliate. If our services agreement is ever determined to be in violation of the Anti-Kickback Statute, it is likely that there would be a material adverse impact on our business, financial condition and results of operation.

Advertising Restrictions. Many states have laws which prohibit licensed eye care professionals from using advertising which includes any name other than their own, or from advertising in any manner that is likely to mislead a person to believe that a non-licensed professional is eligible to be engaged in the delivery of eye care services. Advertising is prohibited if it is undertaken in

a manner that is deemed inappropriate for a professional or likely to mislead and there are regulatory requirements in Connecticut delineating certain specific requirements in this regard to which we must comply. Our services agreement with our professional affiliate provides that all advertising shall conform to these requirements, but there can be no assurance that the interpretation of the applicable laws or our advertising will not inhibit us or result in legal violations that could have a material adverse effect on us.

Health Insurance Portability and Accountability Act - Administrative Simplification. This federal statute and its regulations, discussed above in "--Managed Vision Division" is applicable to the Consumer Vision Division as well.

Interpretation and Implications. The laws described above have civil and criminal penalties and have been subject to limited judicial and regulatory interpretation. They are enforced by regulatory agencies that are vested with broad discretion in interpreting their meaning. Our agreements and activities have not been examined by federal or state authorities under these laws and regulations. There can be no assurance that review of our business arrangements will not result in determinations that adversely affect our operations or that certain material agreements between us and eye care providers or third-party payers will not be held invalid and unenforceable. Any limitation on our ability to continue operating in the manner in which we have operated in the past could have an adverse effect on our business, financial condition and results of operations.

In addition, these types of laws and their interpretation vary from state to state. The regulatory framework of certain jurisdictions may limit our expansion into such jurisdictions if we are unable to modify our operational structure to conform to such regulatory framework.

Competition

The most direct competition for our Consumer Vision Division is with independent ophthalmologists and optometrists, as well as with regional operators of retail optical locations. On a national basis, companies that compete in this sector include retail optical chains, such as LensCrafters, Cole Vision, Pearle Vision, Wal-Mart, Eye Care Centers of America, Eyecare, Consolidated Vision Group, Costco Wholesale, U.S. Vision and D.O.C. Optics. Retail optical operators compete on price, service, product availability and location.

Several of our competitors have greater financial and other resources than we have or may charge less for certain

services than we do. However, we believe the integrated nature of our business model provides significant competitive advantages in the marketplace.

Distribution & Technology Division

Our Distribution & Technology Division serves the professional eye care practitioner market in the U.S. and Canada with optical products, collective buying arrangements and software systems and support. We continue to establish a sales function, which will be equipped to communicate, and deliver, to the professional eye care practitioner market the full range of our Distribution & Technology Division's products and services.

Description

We sell optical and ophthalmic goods and related medical supplies to professional eye care practitioners directly, through Wise Optical, one of the largest contact lens distributors in the U.S. and, indirectly, through a "Buying Group" program, which is a specialized group purchasing arrangement for ophthalmologists, optometrists and opticians. Under the trade name CC Systems, OptiCare also designs, develops and markets advanced practice management / point-of-sale computer systems for optometry and ophthalmology practices and for retail optical locations as well as management information systems for optical manufacturing laboratories.

Strategy

As a provider to the professional eye care practitioner of substantially all of the products, services and software needed to successfully operate an eye care practice, we intend to capitalize on the uniquely integrated nature of our business.

We intend to continue the expansion of our distribution of optical and ophthalmic goods and medical supplies through leveraging Wise Optical's field sales/customer service force of nearly 50 individuals nationwide.

We further intend to develop a unified selling strategy, which cross-sells products and services to customers within the Distribution & Technology Division and which makes such products and services available to our other divisions and their customers, as well. A common theme of that selling strategy is "operating efficiency." Through Wise Optical and our Buying Group, we can provide our professional eye care practitioner customers with one-stop-shopping--enabling them to compete more effectively. Through CC Systems, we can provide many of those same customers with the operating efficiencies which arise from utilization of a fully-integrated suite of practice management and eyeglass manufacturing software products.

We intend to expand our Buying Group and Wise Optical volume by directing, as appropriate, our Consumer Vision Division's purchasing requirements through the Buying Group or Wise Optical and by cross-selling such products and services to professional eye care practitioners who are members of our Managed Vision Division provider panels.

Market Position

We are one of the leading integrated providers in the U.S. of optical and ophthalmic goods and related medical supplies and of software systems designed for eye care practitioners and eyeglass manufacturing laboratories. Within the contact lens market, Wise Optical is one of the largest distributors (to eye care professionals) in the U.S. Wise Optical is also a distributor of ophthalmic lenses, and sales of such lenses are the fastest growing segment of Wise Optical's distribution business. Our Buying Group is also one of the largest of its kind in the U.S. wholesale optical goods market. CC Systems' market share for its practice management / point-of-sale and fabricating management operating and information systems places it among the top five vendors in North America of comparable products to the optical industry.

Customers

Our Wise Optical and Buying Group customers include independent ophthalmology and optometric practices and opticians as well as the integrated eye health centers and professional optometric practices of our Consumer Vision Division.

Wise Optical and our Buying Group each have approximately 2,700 and 1,800 active customers, respectively, most of whom are independent eye care practitioners.

Similarly, our software systems' customers are ophthalmology and optometry practices, optical product dispensaries and optical laboratories, based mainly in North America. As of March 1, 2004, we had approximately 70 retail, 100 lens manufacturing, and 20 combined customers using our eye care systems and software services throughout the U.S. and Canada. In addition, ophthalmology and optometry practices use our remote entry software to place orders with laboratories, which also use our software, for custom manufactured lenses for their patients. We are not dependent on any one, or on several, large customers. We believe that there will be increasing demand for management and information systems solutions for independent practitioners (who comprise the majority of practicing ophthalmologists and optometrists) as well as for group practices. We believe these doctors and opticians have the potential to benefit from our services in this area.

Products & Services

We sell optical and ophthalmic goods (e.g., contact lenses, ophthalmic lenses, eyeglass frames and accessories) and related medical supplies to professional eye care practitioners directly, through Wise Optical, and, indirectly, through a "Buying Group" program, which is a specialized group purchasing arrangement for ophthalmologists, optometrists and opticians. Wise Optical is an authorized distributor of contact and ophthalmic lenses manufactured by such major vendors as: Johnson & Johnson, Ciba Vision, Bausch & Lomb, CooperVision, Ocular Sciences and Essilor. Wise Optical also sells Gelflex contact lenses, manufactured by Gelflex Laboratories, and Extreme H(2)O, a contact lens designed to withstand dehydration. Wise Optical is also an authorized Hilco distributor, carrying its optical supplies, eyewear accessories, tools and consumer products.

We also sell practice management and point-of-sale software, including Internet-based remote order entry software, which captures and links patient data, provides such data to a remote manufacturing location for immediate custom processing of optical goods, such as eyeglasses and contact lenses, and generates invoices and other record-keeping data. This software supports such aspects of eye health practice management as: billing, collections, record-keeping, production control and inventory control. Our systems work on a stand-alone basis or can be integrated as "partners" with the proprietary products of other manufacturers. One of the advantages of these systems is that they involve a seamless interface from the point at which the patient orders glasses, to the computer-driven eyeglass manufacturing phase and to the billing phase--reducing expense and minimizing the possibility of error.

Operations

Wise Optical purchases and takes possession of inventory and offers it for sale via catalog and on its web site. Orders are taken by customer service representatives, who are our employees, or are submitted by customers on-line. To accommodate time-zone differences and to stay closer to its customers, Wise Optical has customer service offices through which orders may be placed in California, Oregon, Texas, Kansas and North Carolina. Orders are immediately processed, packed and shipped from the Wise Optical warehouse in Yonkers, New York, on the same day they are received. Most orders are delivered to customers the day after the orders were placed. Among our vendors, two, Vistakon and Ciba Vision, receive approximately 72% of the business of Wise Optical. Three others, Bausch & Lomb, Coopervision and Ocular Sciences, account for another 22% of such business. If one or more of these vendors should cease to sell products to Wise Optical, it could have a material adverse effect on our business.

Our Buying Group leverages the purchasing strength of its approximately

2,500 members, of which 1,800 are active, making it possible for them to purchase goods on a discounted basis from one or more suppliers chosen from our national panel of approximately 230 different vendors. We enter into a non-exclusive account relationship

with each of the ophthalmologists, optometrists and opticians who are members of the Buying Group. These members may then place orders directly with our contracted vendors. The vendors are required to furnish a discount to the purchasers, ship the product directly to the practice and bill us at the predetermined price. We, in turn, bill the participating practices and bear the credit risk. Earnings of the Buying Group are based on the spread between the merchandise cost to us and the prices paid for the merchandise by Buying Group members. Among our vendors, two, Marchon Eyewear, Inc., and Safilo USA, Inc., receive approximately 25% of the business of our Buying Group members. Five others, Silhouette Optical Ltd., Essilor of America, Inc., Ciba Vision, Coopervision, Inc. and Viva International Group, account for another 25% of such business. If one or more of these vendors should cease to allow our members to purchase products from them through our Buying Group, it could have a material adverse effect on our business.

CC Systems' sales are made on a direct basis and leads are developed through various sources. These include: customer word-of-mouth and software partner leads (Misys, IDX, Gerber Coburn, etc.) as well as trade show attendance. Products are delivered, installed and supported by our installation and support group and by our subcontractors. We also re-market computer and network hardware, adding value through our software installation and configuration.

Competition

There are 17 primary contact lens distributors in the U.S., with Wise Optical being, we believe, one of the largest distributors of soft contact lenses. These distributors compete on price and variety of products, which are based, in part, on allowances and authorizations from the contact lens manufacturers. Buying group organizations compete on the basis of price, size and purchasing power of their members, the strength of their credit, and the strength of their supplier agreements and relationships. We also compete with a range of systems and software vendors which cater to eye health professionals. We believe we are distinguished from our competition by our software products' sophisticated interfaces, scalability and ease of modification.

While some of our competitors have greater financial and other resources than we do, we believe that the comprehensive range of products, services and software, which we offer to the professional eye care practitioner, distinguishes us from many of those competitors.

TRADEMARKS, DOMAIN NAMES AND ASSUMED NAMES

We own the following U.S. trademark registrations: OPTICARE and the miscellaneous curve design, which is the OptiCare Health Systems, Inc. logo; EYE CARE FOR A LIFETIME; EYEWEAR AND EYE CARE FOR A LIFETIME; CONNECTICUT VISION CORRECTION; LOSE THE GLASSES, KEEP THE VISION; THE DIFFERENCE IS CLEAR; and KEEPING YOU AHEAD OF THE CURVE. Other trademarks for which applications for U.S. registration are pending are: THE VISION OF HEALTH and DOCTOR'S EXPRESS. We also maintain a common law trademark in CLAIM IT.

We own the following domain names: opticare.com; opticareeye.com; opticare.net; opticare-ehn.com; opticarenas.net; opticareonline.com;

optical-online.com, wiseoptical.com, wisecontactus.com, yourlens.com, wisevisiongroup.com, and wiseopticalonline.com.

We operate under the following assumed names: Wise Optical; Wise Optical Vision Group; Wise/Corniche (California); Wise/Gulf Coast (Florida); Wise/North Central (Minnesota); Wise/Contact US (New York); Wise/North West (Oregon); Wise/South West (Texas); Wise/South East (North Carolina); Wise/Mid West (Kansas).

We consider these trademarks, domain names and assumed names important to our business. However, our business is not dependent on any individual trademark or trade name.

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EMPLOYEES

We and our professional affiliate have approximately 482 employees, including 78 ophthalmologists, optometrists and opticians and 39 ophthalmic assistants. These numbers include an aggregate of approximately 58 part-time personnel who work fewer than 30 hours per week. We believe that our relations with our employees are good. We are not a party to any collective bargaining agreement.

ITEM 2. PROPERTIES

We have executive offices in Waterbury, Connecticut, Yonkers, New York, and Rocky Mount, North Carolina.

The Waterbury facility, which contains corporate offices and an integrated eye health center, is leased under three separate leases with remaining terms of six, eight, and eight years, respectively. These leases have renewal options of 20, 20, and 10 years, respectively. The combined base rent is $807,364 per year for a total of 43,592 square feet.

The facilities in Rocky Mount which contain offices for our Managed Vision Division and Buying Group, are leased under one lease which began on August 1, 2002 and which has a remaining term of four years. The base rent for this facility is $184,000 per year for 19,355 square feet.

The Yonkers facility, which contains offices for our Distribution & Technology Division and a sales, service and fulfillment center for our Wise Optical business, is leased under one lease which began in August 2000 and which has a remaining term of seven years. The base rent for this facility is $415,875 per year for 27,575 square feet.

Our Distribution & Technology Division's CC Systems business is primarily conducted from offices in Largo, Florida, which are leased under one lease which began on October 1, 1999 expires in September 2004. The base rent for this facility is $27,000 per year for 2,520 square feet.

The facilities in Waterbury, Connecticut and Largo, Florida, described above, are each leased from parties that are affiliated or associated with one of our executive officers.

We lease 22 additional offices in the states of Connecticut, California, New York, North Carolina, Kansas and Texas, principally for our Consumer Vision and Distribution & Technology Division operations. These leases have remaining terms of up to ten years. Many of these leases are also subject to renewal

options. We believe our properties are adequate and suitable for our business as presently conducted.

ITEM 3. LEGAL PROCEEDINGS

HEALTH SERVICE ORGANIZATION LAWSUITS

In September and October 2001, the following actions were commenced: Charles Retina Institute, P.C. and Steven T. Charles, M.D. v. OptiCare Health Systems, Inc., filed in Chancery Court of Tennessee for the Thirtieth Judicial District at Memphis; Eye Associates of Southern Indiana, P.C. and Bradley C. Black, M.D. v. PrimeVision Health, Inc., filed in United States District Court, Southern District of Indiana; and Huntington & Distler, P.S.C., John A. Distler, M.D. and Anne C. Huntington, M.D. v. PrimeVision Health, Inc., filed in United States District Court, Western District of Kentucky. Plaintiffs (ophthalmology or optometry practices) in each of these actions alleged that our subsidiary, PrimeVision Health, Inc. (referred to as PrimeVision) defaulted under agreements effective as of April 1, 1999 entitled Services Agreement (HSO Model) (referred to as Services Agreements) by failing to provide the services allegedly required under those agreements in exchange for annual fees (referred to as HSO Fees) to be paid to PrimeVision. Plaintiffs also alleged that PrimeVision repudiated any duty to perform meaningful services under the Services Agreements and never intended to provide meaningful

services. Plaintiffs seek declaratory relief that they are not required to make any payments of HSO Fees to PrimeVision under the Services Agreements for a variety of reasons, including that plaintiffs are discharged of any duty to make payments, there was no termination of the Services Agreements that would trigger an obligation by plaintiffs to pay PrimeVision the amounts designated in the agreements as being owed upon early termination (referred to as the Buy-out Price), the agreements contained an unenforceable penalty, there was lack of consideration, and there was a mutual and material misunderstanding. Plaintiffs also seek damages for non-performance and breach of duty of good faith and fair dealing, and seek to rescind the Services Agreements for fraud in the inducement, material misrepresentation, and mistake. Finally, plaintiffs seek punitive damages and attorneys' fees, interest and costs. PrimeVision also filed denials of all of the material allegations of the complaints in the Huntington & Distler and Eye Associates of Southern Indiana cases, and asserted counterclaims to recover HSO Fees and the Buy-out Price.

In November 2001, PrimeVision commenced the following action: PrimeVision Health, Inc. v. Charles Retina Institute and Steven T. Charles, M.D. filed in United States District Court for the Eastern District of North Carolina, Western District. In this action, PrimeVision sued in North Carolina, which is its principal place of business, one of the practices which had, in an action cited above, sued it in Tennessee. PrimeVision alleged that the Services Agreement and a Transition Agreement, also entered into by Defendant and PrimeVision in April 1999, were part of an integrated transaction in which many practices (referred to as the Practices) that had previously entered into a physician practice management (referred to as PPM) arrangement with PrimeVision converted to a health service organization (referred to as HSO) model. As part of that integrated transaction, the Practices (including Defendant) repurchased assets that they had sold to PrimeVision in or about 1996 and were able to terminate agreements entered into with PrimeVision in 1996 and the obligations thereunder. PrimeVision sought a declaratory judgment that the Services Agreement is enforceable and that Defendant must pay to PrimeVision the annual HSO Fees required under the Services Agreement or, alternatively, the Buy-out Price.

The Multidistrict Litigation. On March 18, 2002, PrimeVision filed a motion with the Judicial Panel on Multidistrict Litigation in Washington, D.C. (referred to as the Judicial Panel) to transfer the foregoing litigation to a single federal district court for consolidated or coordinated pretrial proceedings. Over the opposition of the plaintiffs, the Judicial Panel granted the motion and ordered that all of the cases be consolidated in the U.S. District Court for the Western District of Kentucky under the caption In re PrimeVision Health, Inc. Contract Litigation, MDL 1466 (MDL 1466).

In October and November 2002, PrimeVision commenced the following actions:

1. PrimeVision Health, Inc. v. The Brinkenhoff Medical Center, Inc., Michael Brinkenhoff, M.D., Tri-County Eye Institute, and Mark E. Schneider, M.D., filed in the United States District Court for the Central District of California;

2. PrimeVision Health, Inc. v. Robert M. Thomas, Jr., M.D., a medical corporation, Robert M. Thomas, Jr., M.D., Jeffrey P. Wasserstrom, M.D., a medical corporation, Jeffrey P. Wasserstrom, M.D., Lawrence S. Rice, a medical corporation and Lawrence S. Rice, M.D., filed in the United States District Court for the Southern District of California;

3. PrimeVision Health, Inc. v. The Milne Eye Medical Center, P.C. and Milton J. Milne, M.D., filed in the United States District Court for the District of Maryland;

4. PrimeVision Health, Inc. v. Eye Surgeons of Indiana, P.C., Michael G. Orr, M.D., Kevin L. Waltz, M.D. and Surgical Care, Inc., in the United States District Court for the Southern District of Indiana, Indianapolis Division;

5. PrimeVision Health, Inc. v. Downing-McPeak Vision Centers, P.S.C. and John E. Downing, M.D., in the United States District Court for the Western District of Kentucky, Bowling Green Division;

6. Prime Vision Health, Inc. v. HCS Eye Institute, P.C., Midwest Eye Institute of Kansas City, John C. Hagan, III, M.D. and Michael Somers, M.D., filed in the United States District Court for the Western District of Missouri; and

7. PrimeVision Health, Inc. v. Delaware Eye Care Center, P.A., a professional corporation; and Gary Markowitz, M.D., filed in the Superior Court of the State of Delaware, New Castle County.

PrimeVision requested the Judicial Panel to transfer all of the actions except No. 7 to Kentucky and consolidate them as part of MDL 1466. (Action 7 could not be transferred because it was filed in state court.) The Judicial Panel entered a conditional transfer order for such actions, and because there was no opposition to transfer and consolidation in Actions 4, 5 and 6, they are now part of MDL 1466. One practice defendant in Action 1, and the defendants in Actions 2 and 3 opposed transfer to MDL 1466. On April 11, 2003, the Judicial Panel denied those defendants' motions to vacate the Judicial Panel's order to conditionally transfer the actions to the Western District of Kentucky and ordered the remaining three actions transferred to the Western District of Kentucky for inclusion in the coordinated or consolidated pretrial proceedings occurring there.

The actions filed by PrimeVision contain similar allegations as the action PrimeVision filed against Charles Retina Institute in North Carolina District Court as described above. Instead of declaratory relief, however, PrimeVision

seeks money damages for payment of the contractual Buy-Out Price.

All of the defendants have denied the material allegations of the complaints, and the defendants in Actions 3, 4, 5, 6 and 7, above, have asserted counterclaims and seek relief similar to the claims asserted and relief sought by the practices in the Charles Retina, Eye Associates of Southern Indiana and Huntington & Distler cases. PrimeVision has denied all of the material allegations of the counterclaims.

The parties have exchanged written discovery and have begun taking depositions. PrimeVision also is willing to discuss a potential settlement with any or all of the Practices, although there is no indication that the Practices are prepared to discuss settlement on the same general basis or terms as PrimeVision. At this stage of the actions, we are unable to form an opinion as to the likely outcome or the amount or range of potential loss, if any.

During 2002 and 2003, we reached settlement with two HSO Practices with which we were in litigation and with 11 other practices with which we were not in litigation but where there was a mutual desire to disengage from the Services Agreements. While we continue to meet our contractual obligations by providing the requisite services under our Services Agreements, we are in the process of disengaging from a number of these arrangements.

OTHER LITIGATION

OptiVest, LLC v. OptiCare Health Systems, Inc., OptiCare Eye Health Centers, Inc. and Dean Yimoyines, filed in the Superior Court, Judicial District of Waterbury, Connecticut on January 14, 2002. Plaintiff is a Connecticut limited liability corporation that entered into an Asset Purchase Agreement for certain of our assets. We believe we properly cancelled the Asset Purchase Agreement pursuant to its terms. Plaintiff maintains that it incurred expenses in investigating a potential purchase of certain assets, that we misled it with respect to our financial condition, and, as a result, Plaintiff has suffered damages. Plaintiff seeks specific performance of the Asset Purchase Agreement and an injunction prohibiting us from interfering with concluding the transactions contemplated by the Asset Purchase Agreement. Further, Plaintiff alleges a breach of contract with regard to the Asset Purchase Agreement. Plaintiff further alleges we engaged in innocent misrepresentation, negligent misrepresentation, intentional and fraudulent misrepresentation, and unfair trade practices with respect to the Asset Purchase Agreement.

The parties agreed to non-binding mediation, which began in April 2003 and will continue at a later date to be agreed by the parties. At the mediation, OptiVest, LLC agreed to withdraw its lawsuit and continue to attempt to resolve this matter through non-binding mediation. Optivest LLC has withdrawn its lawsuit however non-binding mediation has not been successful and the parties will submit this matter to binding arbitration to be scheduled in the future.

THREATENED LITIGATION

As previously reported, in the fourth quarter of 2002, we received notice from an attorney representing a physician employed by our professional affiliate regarding a possible employment claim and expressing disagreement with the computation of physicians' salaries in the professional affiliate, alleged mismanagement of our company and/or the professional affiliate, possible conflicts of interests and unlawful practice and/or compensation issues. In April 2003 the parties proceeded with non-binding mediation and believed the matter had been resolved, however, since that time the parties have been in

discussion regarding the resolution reached at the mediation and no formal settlement agreement has been entered into at this time.

In the normal course of business, 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 December 31, 2003 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 effect in relation to the Company's consolidated financial position or results of operations.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

We did not submit any matters to a vote of security holders in the fourth quarter of 2003.

DIRECTORS AND EXECUTIVE OFFICERS OF THE COMPANY

The following table sets forth the name, age and position of each of our directors and executive officers as of March 1 2004. Each director will hold office until the next annual meeting of stockholders or until his or her successor has been elected and qualified. Our executive officers are appointed by and serve at the discretion of the Board of Directors.

NAME	AGE	POSITION
Dean J. Yimoyines, M.D.	56	Chairman of the Board of Directors and Chief Executive
Eric J. Bertrand	31	Director
Gordon A. Bishop	55	President of Consumer Vision Division and Distribution Distribution and Technology Division
William A. Blaskiewicz	41	Vice President and Chief Financial Officer
Norman S. Drubner, Esq.	64	Director
Jason M. Harrold	35	President of Managed Vision Division
Mark S. Hoffman	42	Director
Richard L. Huber	67	Director
Clark A. Johnson	72	Director
Melvin Meskin	59	Director
Mark S. Newman	54	Director
Christopher J. Walls, Esq.	40	Vice President and General Counsel
Lance A. Wilkes	37	President and Chief Operating Officer

Dr. Yimoyines has served as Chairman of the Board and Chief Executive Officer since August 13, 1999. Dr. Yimoyines also served as our President from August 13, 1999 to June 10, 2002. Dr. Yimoyines is a founder of OptiCare Eye Health Centers, Inc. and has served as the Chairman, President and Chief Executive Officer of OptiCare Eye Health Centers, Inc. since 1985. Dr. Yimoyines has been instrumental in the development and

implementation of OptiCare Eye Health Centers, Inc.'s business for nearly 20 years. He graduated with distinction from the George Washington School of Medicine. He completed his ophthalmology residency at the Massachusetts Eye and

Ear Infirmary, Harvard Medical School. Dr. Yimoyines completed fellowship training in vitreoretinal surgery at the Retina Associates in Boston. He is a graduate of the OPM (Owner / President Management) program at Harvard Business School and is a Fellow of the American Academy of Ophthalmology.

Mr. Bertrand has been a member of the Board of Directors since January 2002 and is a Director of Palisade Capital Management, LLC, an affiliate of Palisade Concentrated Equity Partnership, L.P., where he has held a series of positions of increasing responsibility since 1997. From 1996 to 1997, Mr. Bertrand held a position with Townsend Frew & Company, a healthcare-focused investment banking boutique. From 1994 to 1996, he held positions with Aetna, Inc.'s private equity group, focusing on middle market leveraged buy-outs and larger private equity investments. Mr. Bertrand is a Director of U.S. Vision, Control F-1 and Versura, Inc. He holds a Bachelor of Science in Business Administration from Bryant College and a Master of Business Administration in Finance and Entrepreneurship with a certificate in the Digital Economy from New York University.

Mr. Bishop has served as President of our Consumer Vision Division since May 2001 and in September 2003 he replaced Gregory Eastburn as President of the Distribution sector of the Distribution and Technology Division. From August 1999 to November 2002, he also was President of our Buying Group. From June 1998 to August 1999, Mr. Bishop directed the retail operations of OptiCare Eye Health Centers, Inc. Mr. Bishop has over 30 years' of experience in the optical industry, having served in a variety of capacities with companies in the U.S. and Canada. From August 1997 to April 1998, he served as Vice President of Operations for Public Optical. From July 1994 to April 1997, he served as Operations Manager for Vogue Optical. From June 1990 to July 1994, he held positions of increasing responsibility with Standard Optical Ltd., ultimately holding the position of Vice President of Operations for that company. Mr. Bishop received his Business Administration Diploma from Confederation College of Applied Arts and Technology and subsequently obtained an Ophthalmic Dispensing Diploma from Ryerson Polytechnic University. He holds a variety of eye care professional certifications, including certification by the American Board of Opticianry. He holds a Fellowship in the National Academy of Opticianry.

Mr. Blaskiewicz has served as Chief Financial Officer of OptiCare since September 2001. Prior to that, he was Director of Finance, Corporate Controller, Vice President of Finance and, most recently, Chief Accounting Officer for OptiCare from February 1998 to August 2001. Prior to joining OptiCare, Mr. Blaskiewicz held various positions, including Director of Budgeting, with Massachusetts Mutual Life Insurance Company (1993 to 1998), Manager with Ernst & Young (1989 to 1993) and Field Auditor with the Internal Revenue Service (1986 to 1989). He holds a Master of Business Administration from the University of Hartford and a Bachelor of Science in Accounting from Central Connecticut State University, and is a member of the American Institute of Certified Public Accountants (AICPA), the Connecticut Society of Certified Public Accountants (CSCPA) and the Institute of Management Accountants (IMA). Mr. Blaskiewicz is a certified public accountant in Connecticut and holds Certified Management Accountant (CMA) and Certified Financial Management (CFM) designations from the IMA.

Mr. Drubner has been a member of the Board of Directors since November 2001; is senior partner in the law firm of Drubner, Hartley & O'Connor, which he founded in 1971; and is the owner of Drubner Industrials, a commercial real estate brokerage firm. Mr. Drubner has been practicing law in Connecticut since 1963, specializing in real estate, zoning and commercial transactions. He is a member of the Connecticut Bar and the Waterbury, Connecticut Bar Association. Mr. Drubner has been admitted to practice before the U.S. District Court, District of Connecticut. He is a former trustee of Teikyo Post University and was a Director of American Bank of Connecticut from 1985 - 2001. Mr. Drubner holds a Bachelor of Arts degree from Boston University and received his Juris

Doctor degree from Columbia University in 1963.

Mr. Harrold has served as President of the Managed Vision Division since August 2000. Mr. Harrold served as Chief Operating Officer of the Managed Vision Division from January 2000 through July 2000, before being appointed its President. Mr. Harrold served as Vice President of Operations from July 1999 to December, 1999, and Vice President of Quality Management from July 1996 to June 1999 for the Managed Vision Division. From November 1993 to July 1996, Mr. Harrold was employed by Alcon Laboratories as a sales representative for its vision care division. Mr. Harrold graduated from the University of South Carolina in 1992 with a Bachelor of Science degree with dual majors in Business Administration for Management Science and Insurance and Economic

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Security. He earned a Masters degree in Business Administration from Appalachian State University in 1993.

Mr. Hoffman has been a member of the Board of Directors since January 2002 and is a Managing Director of Palisade Capital Management, LLC, an affiliate of Palisade Concentrated Equity Partnership, L.P., which he joined upon its formation in 1995. He is a Director of Refac and Neurologix, publicly-traded companies, as well as several privately held companies, including Berdy Medical Systems, C3I, Telelogue and Marco Group. Mr. Hoffman is a graduate of the Wharton School at the University of Pennsylvania.

Mr. Huber has been a member of the Board of Directors since July 2002 and is Chief Executive Officer of Norte Sur, a private equity firm targeting Latin America. Mr. Huber is former Chairman, President and Chief Executive Officer of Aetna, Inc., the Hartford, Connecticut-based insurance company, which he joined in 1995. At Aetna, Mr. Huber was responsible for a number of strategic acquisitions, such as NYLCare, PruCare and USHealthcare, making Aetna the largest healthcare insurer in the world. Prior to Aetna, Mr. Huber had a 35-year career in banking, including four years as Vice Chairman and Director of Continental Bank and senior management positions at Chase Manhattan and Citibank. Mr. Huber serves as Director of Danielson Holding Company and was a member of the Congressional International Financial Institutions Advisory Commission. He is a former Coast Guard officer and holds a Bachelor of Arts degree from Harvard College.

Mr. Johnson has been a member of the Board of Directors since May 2002 and is Chairman of PSS World Medical, Inc., a national distributor of medical equipment and supplies to physicians, hospitals, nursing homes, and diagnostic imaging facilities. He is a Director of MetroMedia International Group, Neurologix, Inc., World Factory, Inc. and Refac; is retired Chairman and Chief Executive Officer of Pier 1 Imports; and is former Executive Vice President and Director of the Wickes Companies, Inc. Mr. Johnson, who attended the University of Iowa, completed the Advanced Management Program at the Harvard Business School. He is former Chairman of the American Business Conference, former trustee of Texas Christian University and is a former Chief Executive Officer Participant in the National Conference on Ethics in America.

Mr. Meskin has been a member of the Board of Directors since January 2002 and is Chairman of Refac, a publicly held company on the American Stock Exchange. Mr Meskin retired as Vice President-Finance-National Operations of Verizon, the combined Bell Atlantic/GTE telecommunications company. Mr. Meskin joined New York Telephone in 1970 and held a variety of line and staff assignments with the company over a 31-year career. In 1994, he was named Vice President-Finance and Treasurer for NYNEX Telecommunications. When Bell Atlantic and NYNEX merged, he was appointed Vice President-Finance and Comptroller of Bell Atlantic. Mr. Meskin is a member of the Board of Trustees of the Post

Graduate Center for Mental Health.

Mr. Newman has been a member of the Board of Directors since May 2002 and is Chairman of the Board, President and Chief Executive Officer of DRS Technologies, Inc., a leading supplier of defense electronics systems to government and commercial customers worldwide. Mr. Newman joined DRS Technologies in 1973, served many years as its Chief Financial Officer, was named a Director in 1988, became President and Chief Executive Officer in 1994, and was elected Chairman of the Board. Mr. Newman serves as Chairman of the American Electronics Association, and as a Director of the New Jersey Technology Council, SSG Precision Optronics and the Congoleum Corporation where he chairs the Audit Committee. He is a member of the Board of Governors of the Aerospace Industries Association of America, and also serves as a member of the Navy League of the United States, the National Defense Industrial Association, the Association of the U.S. Army, and the American Institute of Certified Public Accountants, among other professional affiliations. Mr. Newman holds a Bachelor of Arts degree in Economics from the State University of New York at Binghamton and a Master of Business Administration from Pace University. He is also a C.P.A.

Mr. Walls has served as Vice President, General Counsel and Corporate Secretary of OptiCare since February 2002. Prior to joining OptiCare, from December 2000 to February 2002, Mr. Walls was Vice President, Corporate Counsel and Corporate Secretary for Cyberian Outpost, Inc. a technology company in Connecticut. Prior to that, from October 1999 to December 2000, he was Corporate Counsel, Vice President of Business Affairs and Assistant Corporate Secretary with Real Media Inc., an international technology start-up. From December 1995 to October 1999, Mr. Walls served as an in-house litigator with St. Paul Fire and Marine Insurance Company. His professional career also included private practice concentrating on litigation that included medical malpractice defense and

complex insurance administrative proceedings. Mr. Walls received his Bachelor of Arts degree from the University of Dayton and his Juris Doctor degree from Widener University School of Law.

Mr. Wilkes has served as President and Chief Operating Officer of OptiCare since June 10, 2002. From 2001 to June 2002, Mr. Wilkes served as Senior Vice President of Business Development for CIGNA Health Services, a unit of CIGNA Corp. During his tenure with CIGNA, Mr. Wilkes was responsible for the development of new specialty healthcare businesses, including the founding of CIGNA Vision Care. From 1999 to 2001, Mr. Wilkes was head of strategy and mergers & acquisitions for Aetna USHealthcare, a unit of Aetna Inc. From 1989 to 1999, Mr. Wilkes held a variety of other executive positions at Aetna in finance, marketing and business development. A graduate of Brown University, Mr. Wilkes holds a Masters degree in Economics and Corporate Finance from Trinity College.

PART II

ITEM 5. MARKET FOR THE COMPANY'S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

Trading in OptiCare Common Stock

Our common stock is traded on the American Stock Exchange under the symbol "OPT". The high and low closing prices for the periods presented are based on trades effected on the American Stock Exchange.

2003	HIGH	LOW
4th Quarter	$0.99	$ 0.55
3rd Quarter	0.74	0.53
2nd Quarter	0.90	0.52
1st Quarter	0.90	0.29

2002	HIGH	LOW
4th Quarter	$0.44	$ 0.23
3rd Quarter	0.31	0.20
2nd Quarter	0.45	0.15
1st Quarter	0.45	0.13

On March 1, 2004, the last reported sale price of our common stock on the American Stock Exchange was $0.71 per share. As of March 1, 2004, there were approximately 200 stockholders of record of our common stock. The number of record holders was determined from the records of our transfer agent, Mellon Investor Services, LLC, and does not include beneficial owners of our common stock whose shares are held in the names of various securities brokers, dealers and registered clearing agencies. We believe the number of beneficial holders of our common stock is approximately 1,500.

We have never paid any cash dividends on our common stock and do not intend to pay any cash dividends on our common stock for the foreseeable future. It is our present policy that any retained earnings will be used for repayment of indebtedness, working capital, capital expenditures and general corporate purposes. Furthermore, we are precluded from declaring or paying any cash dividends on our common stock, or making a distribution to our stockholders under the covenants of our loan agreement with our senior lender, until the termination of such agreement and the repayment of all amounts due to such lender.

RECENT SALES OF UNREGISTERED SECURITIES.

None.

ITEM 6. SELECTED FINANCIAL DATA

The following selected historical consolidated financial data has been derived from audited historical financial statements and should be read in conjunction with our consolidated financial statements and the notes thereto and Management's Discussion and Analysis of Financial Condition and Results of Operations.

OptiCare in its present form is the result of mergers completed on August 13, 1999 among Saratoga Resources, Inc., PrimeVision Health, Inc. and OptiCare Eye Health Centers, Inc. For accounting purposes, PrimeVision was treated as the accounting acquirer and, therefore, the predecessor business for historical financial statement reporting purposes. During 2002, we sold the net assets of our retail optometry operations in North Carolina and accounted for the sale as a discontinued operation. Accordingly, historical amounts presented below have been restated to reflect discontinued operations treatment.

(in thousands, except per share data)	FOR THE YEARS ENDED DECEMBER 31			
	2003 (1)	2002	2001	2000
STATEMENT OF OPERATIONS DATA:				
Total net revenues	$125,702	$91,531	$94,082	$109,346
Income (loss) from continuing operations available to common stockholders (3)(5)	(12,971)	$4,335	$2,687	$(14,686)
Weighted average shares outstanding (4):				
Basic	30,067	12,552	12,795	12,354
Diluted	30,067	51,172	13,214	12,354
Income (loss) from continuing operations per share available to common stockholders:				
Basic	$(0.43)	$0.35	$0.21	$(1.19)
Diluted	$(0.43)	$0.10	$0.21	$(1.19)
BALANCE SHEET DATA:				
Net assets of discontinued operations	-	$ -	$9,494	$10,051
Total current assets	17,654	12,904	20,583	14,913
Goodwill and other intangibles, net	20,374	21,869	22,050	23,161
Total assets	45,855	45,105	59,742	55,513
Total current liabilities	13,827	10,668	17,128	49,454
Total debt (including current portion)	12,603	19,486	34,393	34,058
Redeemable preferred stock	5,635	5,018	-	-
Total stockholders' equity	14,412	$10,652	$6,982	$3,877

(1) We acquired Wise Optical on February 7, 2003, which was accounted for as a purchase. Accordingly, the results of operations of Wise Optical are included in the historical results of operations since February 1, 2003, the deemed effective date of the acquisition for accounting purposes.

(2) We acquired OptiCare Eye Health Centers, Inc. on August 13, 1999 and Cohen Systems, Inc. (now doing business as "CC Systems") on October 1, 1999, which were accounted for as purchases. Accordingly, the results of operations of OptiCare Eye Health Centers, Inc. and Cohen Systems, Inc. are included in the historical results of operations since September 1, 1999 and October 1, 1999, respectively, the deemed effective dates of the acquisitions for accounting purposes.

(3) Includes the effect of goodwill amortization of $943, $943 and $605 in 2001, 2000 and 1999, respectively. The amortization of goodwill was discontinued in 2002 pursuant to Statement of Financial Accounting Standards (SFAS) No. 142. Also includes preferred stock dividends of $618, $531, and $600 in 2003, 2002 and 1999, respectively.

(4) The weighted averages of common shares outstanding in 1999 have been adjusted to reflect the conversion associated with the reverse merger with Saratoga in August 1999.

(5) As a result of the Company's adoption of SFAS No. 145, the Company reclassified its previously reported gain from extinguishment of debt of approximately $8.8 million and related income tax expense of approximately $3.5 million in 2002 from an extraordinary item to continuing operations.

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion and analysis should be read in conjunction with our consolidated financial statements and notes thereto which are included elsewhere in this Annual Report on Form 10-K. (See "Index to Financial Statements" beginning at page F-1.)

Overview. We are an integrated eye care services company focused on vision benefits management (managed vision), retail optical sales and eye care services to patients and the distribution of products and software services to eye care professionals.

On February 7, 2003, we acquired substantially all of the assets and certain liabilities of the contact lens distribution business of Wise Optical Vision Group, Inc. (Wise Optical), a New York corporation. The results of operations of Wise Optical are included in the consolidated financial statements from February 1, 2003, the deemed effective date of the acquisition for accounting purposes. We have experienced substantial losses at Wise Optical in 2003. These losses were largely attributable to significant expenses incurred by Wise Optical, including integration costs (primarily severance and stay bonuses, legal and professional fees), weakness in gross margins and an operating structure built to support a higher sales volume. In September 2003, we began implementing strategies and operational changes designed to improve the operations of Wise Optical. These efforts include developing our sales force, improving customer service, enhancing productivity, eliminating positions and streamlining our warehouse and distribution processes. In addition, effective September 3, 2003, Gordon Bishop, President of our Consumer Vision division, replaced the former President of the Distribution division. Mr. Bishop brings industry expertise and a strong optical background to Wise, along with a focus on operating expenses. We believe these changes will lead to increased sales, improved gross margins and reduced operating costs in 2004, however if the losses at Wise Optical continue it could have a material adverse effect on our profitability and/or liquidity.

On May 12, 2003, Palisade Concentrated Equity Partnership, L.P., our majority shareholder, and Linda Yimoyines, wife of Dean J. Yimoyines, M.D., our Chairman of the Board and Chief Executive Officer, each exchanged the entire amount of principal and interest due to them under our senior subordinated secured notes payable, totaling an aggregate of $16.2 million, for a total of 406,158 shares of Series C Preferred Stock.

In the third and fourth quarters of 2003 we failed to comply with the minimum fixed charge ratio covenant under our revolving credit facility with CapitalSource Finance, LLC, for which we received a waiver.

Due to our covenant failure in the third quarter of 2003 and anticipated cash constraints in December 2003 through February 2004, both of which are mainly due to operating losses at Wise Optical and seasonality in our business, on November 14, 2003, we amended our term loan and revolving credit facility. As part of the amendment, we received (i) an additional $0.3 million term loan, (ii) an extension of the maturity dates of our term loan and revolving credit facility to January 25, 2006, (iii) a waiver for non-compliance with the minimum fixed charge ratio covenant through March 31, 2004 and (iv) a $0.7 million temporary over-advance on our revolving credit facility, which was fully repaid by March 1, 2004. Management believes it will comply with its future financial covenants beyond the date of the current waiver, however, if operating losses continue and we fail to comply with financial covenants in the future or otherwise default on our debt, our creditors could foreclose on our assets.

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Our business is comprised of three reportable operating segments: (1)

Managed Vision, (2) Consumer Vision, and (3) Distribution & Technology. Our Managed Vision Division contracts with insurers, managed care plans and other third-party payers to manage claims payment administration of eye health benefits for contracting parties. Our Consumer Vision Division sells retail optical products to consumers and operates integrated eye health centers and surgical facilities in Connecticut where comprehensive eye care services are provided to patients. Our Distribution & Technology Division provides products and services to eye care professionals (ophthalmologists, optometrists and opticians) through (i) Wise Optical, a distributor of contact and ophthalmic lenses and other eye care accessories and supplies; (ii) a Buying Group program, which provides group purchasing arrangements for optical and ophthalmic goods and supplies and (iii) CC Systems, which provides systems and software solutions to eye care professionals.

In addition to these segments, we receive income from other non-core operations and transactions, including our health service organization (HSO) operation which receives fee income for providing certain support services to individual ophthalmology and optometry practices. While we continue to provide the required services to these practices, we are in the process of generally disengaging from a number of these operations. (See "Legal Proceedings --Health Services Organization Lawsuits")

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

The discussion and analysis of our financial condition and results of operations are based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the U.S. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amount of assets and liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities at the date of our financial statements. Estimates are adjusted as new information becomes available. Actual results may differ from these estimates under different assumptions or conditions.

For a detailed discussion on the application of these and other accounting policies, see Note 2 to the consolidated financial statements." We believe the following critical accounting policies affect our more significant judgments and estimates used in the preparation of our consolidated financial statements.

Services Revenue

Through our affiliated professional corporation, OptiCare P.C., our Consumer Vision Division provides to consumers comprehensive eye care services, including medical and surgical treatment of eye diseases and disorders by ophthalmologists, and vision measuring and non-surgical treatments and correction services by optometrists. We charge a fee for providing the use of our ambulatory surgery center to professionals for surgical procedures. Our ophthalmic, optometric and ambulatory surgery center services are recorded at established rates, reduced by an estimate for contractual allowances and doubtful accounts. Contractual allowances arise due to the terms of certain reimbursement contracts with third-party payers that provide for payments to us at amounts different from our established rates. The contractual allowance represents the difference between the charges at established rates and estimated recoverable amounts and is recognized in the period the services are rendered. The contractual allowance recorded is estimated based on an analysis of historical collection experience in relation to amounts billed and other relevant information. Any differences between estimated contractual adjustments and actual final settlements under reimbursement contracts are recognized as adjustments to revenue in the period of final settlements. Historically, we have not had significant adjustments to this estimate.

Medical Claims Expense

Claims expense is recorded as provider services are rendered and includes an estimate for claims incurred but not reported. Reserves for estimated insurance losses are determined on a case by case basis for reported claims, and on estimates based on our experience for loss adjustment expenses and incurred but not reported claims. These liabilities give effect to trends in claims severity and other factors which may vary as the losses are ultimately settled. We believe that our estimates of the reserves for losses and loss adjustment expenses are reasonable; however, there is considerable variability inherent in the reserve estimates. These estimates are continually reviewed and, as adjustments to these liabilities become necessary, such adjustments are reflected in current

operations in the period of the adjustment. Historically, we have not had significant adjustments to this estimate.

Goodwill

Goodwill, which arises from the purchase price exceeding the assigned value of net assets of acquired businesses, represents the value attributable to unidentifiable intangible elements being acquired. Of the total goodwill included on our consolidated balance sheet, approximately 61% is recorded in our Managed Vision segment, 25% in our Consumer Vision segment and 14% in our Distribution & Technology segment.

On an annual basis, or as circumstances dictate, management reviews goodwill and evaluates events or other developments that may indicate impairment in the carrying value. The evaluation methodology for potential impairment is inherently complex, and involves significant management judgment in the use of estimates and assumptions. We use multiples of revenue and earnings before interest, taxes, depreciation and amortization of comparable entities to value the reporting unit being evaluated for goodwill impairment.

We evaluate impairment using a two-step process. First, we compare the aggregate fair value of the reporting unit to its carrying amount, including goodwill. If the fair value exceeds the carrying amount, no impairment exists. If the carrying amount of the reporting unit exceeds the fair value, then we compare the implied fair value of the reporting unit's goodwill with its carrying amount. The implied fair value is determined by allocating the fair value of the reporting unit to all the assets and liabilities of that unit, as if the unit had been acquired in a business combination and the fair value of the unit was the purchase price. If the carrying amount of the goodwill exceeds the implied fair value, then goodwill impairment is recognized by writing the goodwill down to the implied fair value. In the third and fourth quarters of 2003, we recorded an impairment charge to goodwill as a result of a loss of a major customer in our Buying Group and poor operating performance in our Wise Optical reporting unit. Adverse changes in our business climate, revenues or profitability could require further reductions to the carrying value of our goodwill in future periods.

Events that may indicate goodwill impairment include significant or adverse changes in business or economic climate, an adverse action or assessment by a regulator, unanticipated competition, loss of key personnel, and the sale or expected sale/disposal of a reporting unit. Due to uncertain market conditions it is possible that that the financial information used to support our goodwill may change in the future, which could result in non-cash charges that would adversely affect our results of operations and financial condition. See note 10 to consolidated financial statements.

Income Taxes

We account for income taxes in accordance with Statement of Financial Accounting Standards (SFAS) No. 109, "Accounting for Income Taxes" which requires an asset and liability method of accounting for deferred income taxes. Under the asset and liability method, deferred tax assets and liabilities are recognized for the estimated future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax basis using enacted tax rates expected to apply to taxable income in the years the temporary differences are expected to reverse. Our determination of the likelihood that deferred tax assets can be realized is based on our examination of available evidence, which involves estimates and assumptions. We consider future market growth, forecasted earnings, future taxable income and known future events in determining the need for a valuation allowance. In the event we were to determine that we would not be able to realize all or part of our net deferred tax assets in the future, an adjustment to the deferred tax assets would be charged to earnings in the period such determination is made. In the third quarter of 2003, we recorded a valuation reserve against our entire deferred tax assets due to historical operating losses. As we experience future profitability, we expect to reduce or eliminate the valuation reserve. See note 19 to consolidated financial statements.

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RESULTS OF OPERATIONS

Year Ended December 31, 2003 Compared to Year Ended December 31, 2002

Managed Vision revenue. Managed Vision revenue represents fees received under our managed care contracts. Managed Vision revenue decreased to approximately $28.1 million for the year ended December 31, 2003, from approximately $29.4 million for the year ended December 31, 2002, a decrease of approximately $1.3 million or 4.5%. During the second quarter of 2003 the Texas state legislature made changes to its Medicaid program and as a result HMO Blue, with whom we maintained a Medicaid contract, withdrew from Texas' Medicaid program effective September 1, 2003. Therefore, our contract with HMO Blue terminated on September 1, 2003. This contract generated revenue of approximately $1.7 million in 2003 compared to approximately $2.5 million in 2002. In addition and also effective September 1, 2003, the Texas state legislature decided to no longer fund a vision benefit in its Children's Health Insurance Program or provide vision hardware benefits to those over the age of 21. We maintained a number of contracts through this program that reduced benefits and/or terminated on September 1, 2003 and these contracts generated revenues of approximately $2.0 million in 2003 and approximately $2.2 million in 2002. While this could become a trend in other states, we do not expect it to have a material impact on future revenue since we do not have a significant number of similar contracts in other states. Other decreased revenue of approximately $2.0 million was primarily from contracts not renewed in 2003, and was partially offset by increased revenue of approximately $1.5 million from new contracts and growth in existing contracts. CIGNA experienced a decline in membership in January 2004, which translates into an approximate $2.0 million decline in our annual revenue, however, a new contract with a different payor became effective March 1, 2004, which will offset this decrease in revenue. We expect future revenue to increase due to new contracts related to our to direct-to-employer initiative.

Product sales revenue. Product sales primarily include the sale of optical products through Wise Optical, our Buying Group and our Consumer Vision segment. Product sales revenue increased to approximately $72.8 million for the year ended December 31, 2003, from approximately $39.4 million for the year ended

December 31, 2002, an increase of approximately $33.4 million or 84.8%. This increase is primarily due to our acquisition of Wise Optical on February 7, 2003, which generated product sales revenue of approximately $41.9 million and an approximate $0.5 million increase in consumer vision product sales, primarily from an increase in purchasing volume as a result of sales incentives. This increase in revenue is partially offset by an approximate $9.0 million decrease in Buying Group revenue, due to a decrease in sales volume. The decrease in Buying Group sales volume is primarily due to the loss of the business of Optometric Eye Care Centers, P.A. and its franchise affiliates and, to a lesser extent, consolidation in the eye care industry whereby smaller independent eye care businesses are being replaced by larger eye care chains that purchase directly from vendors. We expect consolidation in this market to continue and potentially further reduce the Buying Group's market share revenue, however, we do not expect this trend to have a material impact on our overall profitability due to the low margins inherent in this business. We expect Wise Optical revenue to increase based on an increase in sales volume as a result of initiatives we began in September 2003.

Other services revenue. Other services revenue includes revenue earned from providing eye care services in our Consumer Vision segment, software services in our Distribution & Technology segment and HSO services. Services revenue increased to approximately $22.0 million for the year ended December 31, 2003, from approximately $20.4 million for the year ended December 31, 2002, an increase of approximately $1.6 million or 8.3%. This increase includes an approximate $1.5 million increase in Consumer Vision services revenue due to increased services volume in the optometry and surgical areas due to increased doctor coverage and an approximate $0.9 million increase in software services revenue due to an increase in sales volume due to improved management focus. These increases were offset by an approximate $0.8 million decrease in fees collected under our HSO agreements primarily due to disputes with certain physician practices, which are parties to these agreements, and due to HSO settlements which cancelled these agreements for the future. We continue to be in litigation with several of these practices and intend to continue to pursue settlement of these matters in the future. While we expect future HSO revenue to decline, we believe this will be more than off set by growth in Consumer Vision.

Other income. Other income represents non-recurring settlements on health service organization contracts. Other income increased to approximately $2.7 million for the year ended December 31, 2003 from approximately $2.3 million for the year ended December 31, 2002.

Medical claims expense. Medical claims expense decreased to $22.0 million for the year ended December 31, 2003, from approximately $22.3 million for the year ended December 31, 2002, a decrease of approximately $0.3 million. The medical claims expense loss ratio (MLR) representing medical claims expense as a percentage of Managed Vision revenue increased to 78.3% in 2003 from 75.9% in 2002. The MLR was lower in 2002 primarily due to a favorable adjustment to the reserve of approximately $0.6 million in 2002 from a contract settlement. Excluding this adjustment, MLR for 2002 would have been 77.9% compared to 78.3% in 2003. In addition, the MLR in 2003 was negatively impacted by the recent change in the Texas state legislature, which no longer funds a vision benefit in its Children's Health Insurance Program and vision hardware to Medicaid recipients over the age of 21. As a result, we experienced an increase in claims as utilization increased prior to the elimination of the benefit.

Cost of product sales. Cost of product sales increased to approximately $56.3 million for the year ended December 31, 2003, from approximately $31.1 million for the year ended December 31, 2003, an increase of approximately $25.2 million or 81.1%. This increase is primarily due to a $34.0 million increase in

product costs related to the increase in sales from the acquisition of Wise Optical in February 2003. The increase in product costs is partially offset by an approximate $8.5 million decrease in product costs associated with our Buying Group due to a decrease in sales volume and an approximate $0.3 million decrease in product costs in our Consumer Vision business primarily as a result of a shift in product mix to higher margin products as a result of sales incentives, a shift that we expect will continue into the future.

Cost of services. Cost of services increased to approximately $9.0 million for the year ended December 31, 2002, compared to approximately $8.2 million for the year ended December 31, 2002, an increase of approximately $0.8 million or 10.7%. Of this increase approximately $0.5 million is due to the increase in software sales volume and $0.3 million is due to the increase in Consumer Vision services.

Selling, general and administrative expenses. Selling, general and administrative expenses increased to approximately $38.2 million for the year ended December 31, 2003, from approximately $26.3 million for the year ended December 31, 2002, an increase of approximately $11.9 million. Of this increase, approximately $10.9 million represents operating expenses of Wise Optical and includes approximately $1.0 million of Wise Optical integration related costs consisting primarily of severance, stay bonuses, legal, consulting and other professional fees. The remaining increase is primarily attributed to costs we incurred as part of our direct-to-employer initiative in the Managed Vision segment, including legal, consulting, compensation costs for a new sales force and other professional fees. While we expect most of these cost to continue into the future, they will be offset by direct-to-employer sales revenue.

Goodwill impairment charge. For the year ended December 31, 2003, we recorded a non-cash goodwill impairment loss of approximately $1.6 million in our Distribution and Technology segment, due to decreases in Buying Group sales and significant operating losses at Wise Optical.

Interest expense. Interest expense decreased to approximately $2.1 million for the year ended December 31, 2003 from approximately $3.0 million for the year ended December 31, 2002, a decrease of $0.9 million. This decrease in interest expense is primarily due to the decrease in the average outstanding debt balance, primarily due to the conversion of debt to preferred stock in May 2003.

Gain (loss) from early extinguishment of debt. The approximate $1.9 million loss from early extinguishment of debt for the year ended December 31, 2003, primarily represents the write-off of deferred debt issuance costs and debt discount associated with the exchange of approximately $16.2 million of debt for Series C Preferred Stock, which occurred on May 12, 2003 and the amendment of our term loan with CapitalSource on November 13, 2003. The approximate $8.8 million gain on extinguishment of debt for the year ended December 31, 2002 was the result of our capital restructuring in January 2002. The 2002 gain is comprised of approximately $10.0 million of forgiveness of principal and interest by Bank Austria, our 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.

Income tax expense (benefit). For the year ended December 31, 2003, we recorded approximately $4.9 million of income tax expense, which includes approximately $7.6 million of tax expense to establish a full valuation allowance

against our deferred tax assets and is partially offset by an approximate $2.7

million income tax benefit on our loss from continuing operations. The valuation allowance was established based on the weight of historic available evidence, that it is more likely than not that the deferred tax assets will not be realized. The tax expense for the year ended December 31, 2002 of approximately $2.5 million was primarily due to approximately $3.5 million of tax expense associated with the approximate $8.8 million gain on extinguishment of debt, partially offset by an approximate $1.0 million of tax benefit on other operating losses.

Discontinued operations. In May 2002, our Board of Directors approved our plan to dispose of the net assets used in the retail optical and optometry practice locations we operated in North Carolina. On A