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SOLA INTERNATIONAL INC  
Form 10-Q  
February 14, 2001

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UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, DC 20549  
FORM 10-Q

(X) QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE  
SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended December 31, 2000  
or

( ) TRANSITION REPORT PURSUANT TO SECTION 12 OR 15(d)  
OF THE SECURITIES EXCHANGE ACT OF 1934

Commission File Number 1-13606

SOLA INTERNATIONAL INC.

(Exact name of registrant as specified in its charter)

DELAWARE 94-3189941  
(State or other jurisdiction of (I.R.S. employer identification no.)  
incorporation or organization)

1290 OAKMEAD PARKWAY, SUITE 230, SUNNYVALE, CA 94085  
(Address of principal executive offices)  
(zip code)

(408) 735-1982  
(Registrant's telephone number, including area code)

Indicate by check mark whether the Registrant (1) has filed all reports  
required to be filed by Section 13 or 15(d) of the Securities Exchange Act of  
1934 during the preceding 12 months (or for such shorter period that the  
Registrant was required to file such reports), and (2) has been subject to  
such filing requirements for the past 90 days. Yes X No \_\_\_\_\_  
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As of February 2, 2001, 23,693,416 shares of the registrant's common stock,  
par value \$0.01 per share, which is the only class of common stock of the  
registrant, were outstanding.

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SOLA INTERNATIONAL INC.

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### PART I FINANCIAL INFORMATION

#### Item 1. Financial Statements

SOLA INTERNATIONAL INC.

Consolidated Condensed Balance Sheets  
(in thousands, except per share data)

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	December 31, 2000 (unaudited)
	-----
ASSETS	
Current assets:	
Cash and cash equivalents.....	\$ 17,397
Trade accounts receivable, less allowance for doubtful accounts of \$7,169 and \$8,873 at December 31, 2000 and March 31, 2000, respectively.....	121,295
Inventories.....	138,676
Other current assets.....	24,035
	-----
Total current assets.....	301,403
Property, plant and equipment, at cost, less accumulated depreciation and amortization.....	130,866
Goodwill and other intangibles, net.....	178,162
Other long-term assets.....	53,379
	-----
Total assets.....	\$663,810 =====
LIABILITIES AND SHAREHOLDERS' EQUITY	
Current liabilities:	
Notes payable to banks.....	\$ 5,953
Current portion of long-term debt.....	8,323
Accounts payable.....	57,834
Accrued liabilities.....	44,919
Accrued payroll and related compensation.....	30,128
Bank debt.....	141,600
Other current liabilities.....	1,390
	-----
Total current liabilities.....	290,147
Long-term debt, less current portion.....	1,253
Bank debt, less current portion.....	--
Senior notes.....	94,721
Other long-term liabilities.....	23,644
	-----
Total liabilities.....	409,765 -----
Commitments and Contingencies	
Shareholders' equity:	
Preferred stock, \$0.01 par value; 5,000 shares authorized; no shares issued.....	--
Common stock, \$0.01 par value; 50,000 shares authorized; 24,937 shares issued.....	249
Additional paid-in capital.....	281,491
Equity participation loans.....	--
Retained earnings.....	7,221
Cumulative other comprehensive loss.....	(26,750)
Common stock in treasury, at cost - 1,245 shares at December 31, 2000.....	(8,166)
	-----
Total shareholders' equity.....	254,045 -----
Total liabilities and shareholders' equity.....	\$663,810 =====

The accompanying notes are an integral part of these consolidated condensed

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financial statements

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SOLA INTERNATIONAL INC.

Unaudited Consolidated Condensed Statements of Income  
(in thousands, except per share data)

	Three Months Ended December 31,	
	2000	1999
	----	----
Net sales.....	\$ 126,144	\$127,238
Cost of sales.....	76,753	71,983
	-----	-----
Gross profit.....	49,391	55,255
	-----	-----
Research and development expenses.....	3,373	4,861
Selling and marketing expenses.....	25,732	25,752
General and administrative expenses.....	14,286	16,529
Special charges.....	100,637	(657)
	-----	-----
Operating expenses.....	144,028	46,485
	-----	-----
Operating income/(loss).....	(94,637)	8,770
Interest expense, net.....	5,600	4,963
	-----	-----
Income/(loss) before provision for income taxes, minority interest and extraordinary item.....	(100,237)	3,807
Benefit/(provision) for income taxes.....	32,490	(1,218)
Minority interest.....	62	86
	-----	-----
Income/(loss) before extraordinary item	(67,685)	2,675
Extraordinary item, net of tax.....	--	--
	-----	-----
Net income/(loss).....	(\$67,685)	\$ 2,675
	=====	=====
Earnings/(loss) per share - basic		
Earnings/(loss) per share before extraordinary item.....	(\$2.86)	\$ 0.11
Extraordinary item.....	--	--
	-----	-----
Earnings/(loss) per share - basic.....	(\$2.86)	\$ 0.11
	=====	=====
Weighted average common shares outstanding.....	23,693	24,875
	=====	=====
Earnings/(loss) per share - diluted:		
Earnings/(loss) per share before extraordinary item.....	(\$2.86)	\$ 0.11
Extraordinary item.....	--	--
	-----	-----
Earnings/(loss) per share - diluted.....	(\$2.86)	\$ 0.11
	=====	=====

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Weighted average common and dilutive securities outstanding.....	23,693 =====	25,075 =====
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The accompanying notes are an integral part of these consolidated condensed financial statements

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SOLA INTERNATIONAL INC.

Unaudited Consolidated Condensed Statements of Cash Flows  
(in thousands)

	Nine Months Ended December 31, 2000	Nine Months End December 31, 19
	-----	-----
Net cash provided by operating activities.....	\$ 4,772	\$ 9,793
Cash flows from investing activities:		
Purchase of business.....	(2,480)	(3,673)
Investments in trade investments and joint ventures.....	(1,337)	(5,219)
Capital expenditures.....	(15,654)	(13,869)
Other investing activities.....	14	1,045
Net cash used in investing activities.....	(19,457)	(21,716)
Cash flows from financing activities:		
Payments on equity participation loans/exercise of stock options.....	34	607
Net receipts/(payments) under notes payable to banks.....	(8,813)	2,373
Borrowings on long-term debt.....	2,524	1,996
Payments on long-term debt.....	(3,217)	(4,443)
Proceeds under bank debt.....	36,400	14,500
Purchase of treasury stock.....	(8,166)	--
Repurchase of senior notes.....	(4,984)	--
Net cash provided by financing activities.....	13,778	15,033
Effect of exchange rate changes on cash and cash equivalents.....	(548)	(311)
Net increase/(decrease) in cash and cash equivalents.....	(1,455)	2,799
Cash and cash equivalents at beginning of period.....	18,852	21,578
Cash and cash equivalents at end of period.....	\$ 17,397 =====	\$ 24,377 =====

The accompanying notes are an integral part of these consolidated condensed

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financial statements

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SOLA INTERNATIONAL INC.

Notes to Consolidated Condensed Financial Statements  
(unaudited)

## 1. Basis of Presentation

The accompanying consolidated condensed financial statements of the Company have been prepared without audit, pursuant to the rules and regulations of the Securities and Exchange Commission. Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to such rules and regulations. The consolidated condensed balance sheet as of March 31, 2000 was derived from audited financial statements. The accompanying consolidated condensed financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto included in the Company's annual report on Form 10-K for the fiscal year ended March 31, 2000.

The financial information included herein reflects all adjustments (consisting of normal recurring adjustments) which are, in the opinion of management, necessary for a fair presentation of the results for the interim period. The results of operations for the nine months ended December 31, 2000 are not necessarily indicative of the results to be expected for the full year.

In June 1998, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 133, "Accounting for Derivative Instruments and Hedging Activities". This statement establishes accounting and reporting standards for derivative instruments and requires recognition of all derivatives as assets or liabilities in the statement of financial position and measurement of those instruments at fair value. Subsequently, the FASB issued SFAS No. 137, which defers the effective date of SFAS No. 133 to fiscal years beginning after June 15, 2000. The Company is in the process of determining the impact that adoption and implementation will have on its consolidated financial statements.

In December 1999, the Securities and Exchange Commission issued Staff Accounting Bulletin No. 101 (SAB 101), "Revenue Recognition in Financial Statements." SAB 101 provides guidance for revenue recognition under certain circumstances. The accounting and disclosures prescribed by SAB 101 will be adopted effective for the Company's fourth quarter of 2001 retroactive to the first quarter of fiscal year 2001. The Company believes there will be no material impact resulting from the application of SAB 101.

## 2. Inventories

	December 31, 2000 (in thousands)	March 31, 2000 (in thousands)
	-----	-----
Raw Materials	\$ 20,769	\$ 15,427
Work In Progress	3,359	7,273
Finished Goods	89,379	105,274
Molds	25,169	44,914
	-----	-----

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\$138,676

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\$172,888

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Molds comprise mainly finished goods for use by manufacturing affiliates in the manufacture of spectacle lenses.

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### 3. Bank Credit Agreement

The Company's Multicurrency Credit Agreement ("Agreement") contains a number of covenants including compliance with certain financial tests and maintenance of certain financial ratios. At December 31, 2000, the Company did not meet the Leverage Ratio covenant of the Agreement. Subsequent to December 31, 2000, a one-time waiver was obtained for this covenant. Management has prepared projections that indicate that the Company may not be in compliance with this covenant as of March 31, 2001. As a result, the Company has classified the \$141.6 million outstanding under the Agreement as a current liability for the period ended December 31, 2000. The terms of the waiver require the Company to (i) include an amendment to the credit agreement which grants a security interest in certain personal property located in the United States of the Company and American Optical Lens Company ("AOLC"), a wholly owned subsidiary of the Company, (ii) require AOLC to provide a guaranty to support the obligations of the facility (iii) limit the facility to \$200 million from January 31, 2001 until March 31, 2001 and \$185 million from April 1, 2001 until May 7, 2001 (iv) pay certain fees. Management is currently in discussions with several financial institutions in order to explore financing alternatives, including bank credit facilities, long-term fixed-rate note offerings and subordinated debt offerings.

The Company continues to have significant liquidity requirements. In addition to working capital needs and capital expenditures, the Company has cash requirements for debt service. In the event that the Company is unable to arrange a further waiver or an extension of the termination date of the Agreement and the Company does not obtain refinancing by May 7, 2001 an event of default will have occurred. The company's Senior Notes contain a "cross default" provision which would be triggered if a default occurs under the Agreement and will result in an acceleration of both the Senior Notes and the debt. Management anticipates that if it is successful in obtaining a new credit it will have access to sufficient financial resources to ensure that the Company's current cash resources, together with other available sources of cash and cash generated from operations, will be able to fund the Company's operations, debt service and required capital expenditures through the end of fiscal 2002 and beyond. In the event such refinancing is not successfully obtained prior to May 7, 2001, to meet its additional remaining capital requirements and to service its debt obligations, the Company will be required to sell additional equity securities, sell existing assets and/or enter into new financing arrangements. There can be no assurance the Company will be able to obtain the additional financing necessary to satisfy its cash requirements, in which event the Company will be unable to fund its ongoing operations, which would have a materiel adverse effect on its business, results of operations and financial condition.

### 4. Contingencies

The Company is subject to environmental laws and regulations concerning emissions to the air, discharges to surface and subsurface waters and the generation, handling, storage, transportation, treatment and disposal of waste materials.

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The Company is currently participating in a remediation program of one of its manufacturing facilities under the Comprehensive Environmental Response, Compensation and Liability Act and the Superfund Amendments and Reauthorization Act of 1986. Since March 1997 the Company has curtailed clean-up activities, and continues to monitor contamination levels. During the quarter ended December 31, 1997 a report on contamination levels, and the impact of curtailed activities, was submitted to the EPA, which indicates no significant impact on the site from the curtailed activities, and the EPA has consented to continued curtailment of activities. The Company expects continued reduction of clean-up activities due to relatively low levels of contamination existing at the site. Reserves for these clean-up and monitoring activities are considered to be adequate by the Company and are immaterial to the Company's financial position.

Under the terms of the sale agreement with Pilkington plc ("Pilkington"), for the purchase of the Sola business in December 1993 ("Acquisition"), Pilkington has indemnified the Company with regard to expenditures subsequent to the Acquisition for certain environmental matters relating to circumstances existing at the time of the Acquisition. Under the terms of the indemnification, the Company is responsible for the first \$1 million spent on such environmental matters, Pilkington and the Company share equally the cost of any further expenditures between \$1 million and \$5 million, and Pilkington retains full liability for any expenditures in excess of \$5 million.

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In the ordinary course of business, various legal actions and claims pending have been filed against the Company. While it is reasonably possible that such contingencies may result in a cost greater than that provided for in the financial statements, it is the opinion of management that the ultimate liability, if any, with respect to these matters, will not materially affect the consolidated operations or financial position of the Company.

### 5. Comprehensive Income

The components of comprehensive income, net of related tax, are as follows (in thousands):

	Three Months		Nine Months	
	Ended December 31, 2000	1999	Ended December 31, 2000	1999
	----	----	----	----
Net income/(loss)	\$(67,685)	\$ 2,675	\$(64,098)	\$15,834
Foreign currency translation adjustments	9,597	(3,531)	(1,527)	1,080
	-----	-----	-----	-----
Comprehensive income (loss)	\$(58,088)	\$ (856)	\$(65,625)	\$16,914
	=====	=====	=====	=====

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### 6. Earnings/(Loss) Per Share

The following table sets forth the computation of basic and diluted earnings/(loss) per share for the three and nine months ended December 31, 2000 and 1999 (in thousands except per share data):



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	Three Months Ended December 31, 2000 ----	Three Months Ended December 31, 1999 ----	Ni De
Numerator:			
Income/(loss) before extraordinary item.....	\$ (67,685)	\$ 2,675	\$
Extraordinary item, net of tax.....	--	--	-
	-----	-----	-
Net income/(loss).....	\$ (67,685)	\$ 2,675	\$
	=====	=====	=
Denominator:			
Denominator for basic earnings per share - Weighted average common shares outstanding.....	23,693	24,875	
Effect of dilutive securities:			
Employee stock options.....	--	200	
	-----	-----	
Denominator for diluted earnings per share - Weighted average common shares and dilutive securities outstanding.....	23,693	25,075	
	=====	=====	
Basic earnings/(loss) per share:			
Income/(loss) before extraordinary item.....	\$ (2.86)	\$ 0.11	\$
Extraordinary item, net of tax.....	--	--	-
	-----	-----	-
Net income/(loss).....	\$ (2.86)	\$ 0.11	\$
	=====	=====	=
Diluted earnings/(loss) per share:			
Income/(loss) before extraordinary item.....	\$ (2.86)	\$ 0.11	\$
Extraordinary item, net of tax.....	--	--	-
	-----	-----	-
Net income/(loss).....	\$ (2.86)	\$ 0.11	\$
	=====	=====	=

For the three and nine months ended December 31, 2000, approximately 3.4 million common stock options were not included in the calculation of diluted net loss per share because to do so would be anti-dilutive for those periods. For the three and nine months ended December 31, 1999, 2.2 million common stock options were excluded from the calculation of diluted earnings per share because the options exercise price was greater than the average market price of the common shares.

7. Special Charges and Transition Costs

During the three and nine months ended December 31, 2000 the Company recorded pretax special charges of \$100.6 million and \$114.6 million, respectively. The pre-tax special charges are comprised of the following:

(in thousands)

Three Months Ended  
December 31, 2000  
-----

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Charges associated with work-force reductions	\$ 4,163
Inventory write-off associated with product standardization	39,895
Charges associated with facility closures and product transfers	19,110
Goodwill write-off	17,025
Asset write-offs associated with discontinued product line	17,328
Charges associated with the devaluation of the Brazilian Real	3,116
	-----
Total	\$100,637
	=====

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Primarily as a result of the Company's restructuring plan, which commenced in the fourth quarter of fiscal 2000, the Company incurred \$100.6 million of pretax special charges during the three months ended December 31, 2000. The Company incurred \$4.2 million associated with workforce reductions mainly in North America (233 employees). During the three months ended December 31, 2000 the Company paid \$1.3 million related to workforce reductions implemented in the fourth quarter of fiscal 2000 and first nine months of fiscal 2001. The special charge includes \$39.9 million related to the write-off of inventories and molds which were discontinued as a result of the Company's efforts to globally standardize product specifications. The Company also continued the transfer of high-volume production to low-cost manufacturing locations and the consolidation of manufacturing expertise into fewer production facilities. As a result, charges of \$1.0 million were incurred related to production cost inefficiencies, \$18.1 million related to redundant equipment write-off and facility closure costs and \$17.0 million related to the write-off of goodwill associated with a prior acquisition of a lens manufacturing business. Additionally, in the third quarter of fiscal 2001 the Company discontinued the development and manufacture of polycarbonate Matrix products. As a result, the Company incurred \$17.3 million in asset write-offs including equipment (\$5.9 million), inventory (\$10.8 million) and related commitments (\$0.6 million). Lastly, the devaluation of the Brazilian Real (11% in the third fiscal quarter) and the related impact on asset valuation resulted in a special charge of \$3.1 million.

During the nine months ended December 31, 2000 the Company recorded pretax special charges of \$114.6 million. The Company incurred \$11.4 million associated with workforce reductions in North America, Europe and Australia (543 employees). The special charge includes \$42.1 million related to the write-off of inventories and molds which were discontinued as a result of the Company's efforts to globally standardize product specifications. The Company commenced this identification of inventories in the fourth quarter of fiscal 2000. Also, the Company continued the transfer of high-volume production to low-cost manufacturing locations and the consolidation of manufacturing expertise into fewer production facilities that commenced in the fourth quarter of fiscal 2000. As a result, charges of \$2.7 million were incurred related to production cost inefficiencies, \$20.9 million related to redundant equipment write-off and facility closure costs and \$17.0 million related to the write-off of goodwill associated with a prior acquisition of a lens manufacturing business. Additionally, as a result of the discontinuation of the development of the polycarbonate Matrix product line, the Company incurred \$17.3 million in asset write-offs including equipment (\$5.9 million), inventory (\$10.8 million) and related commitments (\$0.6 million). Lastly, the devaluation of the Brazilian Real (11% in the third fiscal quarter) and the related impact on asset valuation resulted in a special charge of \$3.1 million.

Details of the special charges are as follows:

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	Workforce Reductions	Inventory Write-offs	Facility Closures and Product Transfers	Goodwill Write-offs	Asset Write offs Associated with Discontinue Product Lin
	-----	-----	-----	-----	-----
Restructuring Liability as of March 31, 2000	\$ 6,268	\$ -	\$ -	\$ -	\$ -
	-----	-----	-----	-----	-----
Fiscal 2001: Charges to Operations:					
First Quarter	6,088	-	744	-	-
Second Quarter	1,161	2,181	3,817	-	-
Third Quarter	4,163	39,895	19,110	17,025	17,328
	-----	-----	-----	-----	-----
Nine Months Ended December 31, 2000	11,412	42,076	23,671	17,025	17,328
Utilized:					
Non cash	-	(42,076)	(21,062)	(17,025)	(17,328)
Cash	(7,688)	-	(188)	-	-
	-----	-----	-----	-----	-----
Restructuring Liability as of December 31, 2000	\$ 9,992	\$ -	\$ 2,421	\$ -	\$ -
	=====	=====	=====	=====	=====

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The restructuring liability as of December 31, 2000 is included in accrued liabilities. The Company anticipates that substantially all of the accrued restructuring costs will be paid in fiscal 2002 and will be funded through future asset sales and cash provided by operations.

In connection with the restructuring plan, the Company anticipates recording additional pretax special charges of approximately \$11 million, before any related gain on asset sales, primarily in the fourth fiscal quarter. As a result of the restructuring, the Company is in the process of selling land and buildings made redundant by the restructuring plan which are expected to generate proceeds in excess of \$20 million and result in a net gain on sale.

The special charges during the nine months ended December 31, 1999 comprise costs associated with the consolidation of the Sola and American Optical manufacturing facilities in Mexico, work force reductions and the erosion of the Brazilian Real.

Additionally, during the third quarter of fiscal 2001, the Company incurred transition costs associated with executing its restructuring plan. Such costs amounted to \$8.8 million and were primarily related to interim workforce and out-of-pocket expenditures which are expected to be eliminated as the restructuring plan is fully executed. Of these costs, \$4.7 million are reflected in cost of sales, \$0.5 million in research and development expenses, \$2.0 million in selling and marketing expenses and \$1.6 million in general and

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administrative expenses. The Company anticipates the restructuring plan will be substantially implemented over the ensuing five quarters.

### 8. Extraordinary Item

During the nine months ended December 31, 2000 the Company purchased \$5.0 million of its 6 7/8% Senior Notes due 2008. As a result, the Company recorded an extraordinary gain of \$1.5 million, net of tax of \$0.9 million, resulting from the difference between the carrying value of the notes and the purchase price. The purchase was funded by the Company's credit facility and resulted in a decline in net borrowings.

### 9. Subsequent Event

In January 2001 the Company acquired the net assets of Oracle Lens Manufacturing Corporation ("Oracle"), a manufacturer and distributor of polycarbonate lenses located in Rhode Island. The Company acquired Oracle for cash consideration of approximately \$15.4 million and \$2.0 million payable in two years. The Oracle acquisition was funded through borrowings under the Company's Multicurrency Credit Agreement.

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

### Overview

The following discussion of the Company's financial condition and results of operations should be read in conjunction with the Company's consolidated condensed financial statements and notes thereto included elsewhere herein.

### Results of Operations

Three months ended December 31, 2000 compared to three months ended December 31, 1999

### Net Sales

Net sales totaled \$126.1 million in the three months ended December 31, 2000, reflecting a decrease of 0.9% over net sales of \$127.2 million for the same period in the prior year. The decrease in net sales is primarily attributable to the impact of the strong dollar on non-U.S. dollar sales. Using constant exchange rates, net sales increased by 6.3%. Higher priced products accounted for approximately 70% of net sales for the three months ended December 31, 2000 compared to 71% for the same period in the prior year. Progressive lens net sales for the three months ended December 31, 2000 decreased 6.0% from the same period in the prior year, due primarily to impact of the strong U.S. dollar. Using constant exchange rates the regional performances were as follows: North America decreased by 2.4%, Europe increased by 10.6% and Rest of World increased by 17.0%.

### Gross Profit and Gross Margin

Gross profit totaled \$49.4 million for the three months ended December 31, 2000, reflecting a decrease of 10.6% from gross profit of \$55.3 million for the same period in the prior year. Gross profit as a percentage of net sales

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("gross margin") decreased from 43.4% for the three months ended December 31, 1999 to 39.2% for the three months ended December 31, 2000. Included in gross profit for the current quarter was approximately \$4.7 million of costs relating to transition activities associated with the Company's restructuring plan (see note 7 of notes to financial statements). These transition costs include underabsorption of manufacturing overhead due to reduced production levels and the impact of product migration activities. If these costs were excluded, gross margin would have been 42.9% for the quarter ended December 31, 2000. Additionally, the Company experiences price competition, which can be severe in certain markets, especially for standard products.

### Operating Expenses

Operating expenses in the three months ended December 31, 2000 totaled \$144.0 million, an increase of \$97.5 million from the same period in the prior year. Included in operating expenses for the three months ended December 31, 2000 and 1999 were \$100.6 million of expense, and \$0.7 million of income, respectively, representing special charges. Also included in operating expenses for the current quarter were \$4.1 million of costs relating to transition activities associated with the Company's restructuring plan. If these special charges and transition costs were excluded from both periods, operating expenses would have been \$39.3 million and \$47.1 million, respectively, representing a decrease over the three months ended December 31, 1999 of 16.7%. Operating expenses, excluding the

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special charges and transition costs, for the three months ended December 31, 2000 and 1999 as a percentage of net sales were 31.1% and 37.1%, respectively. Research and development expenses for the three months ended December 31, 2000 decreased \$1.5 million to \$3.4 million, compared to \$4.9 million for the three months ended December 31, 1999, which represents 2.7% and 3.8% of net sales for the three months ended December 31, 2000 and 1999, respectively. The decrease in research and development expenses is due in part to the impact of the strong U.S. dollar against non-U.S. dollar expenses as well as headcount reductions associated with the restructuring plan. Selling and marketing expenses for the three months ended December 31, 2000 and 1999 were \$25.7 million, which represents 20.4% and 20.2% of net sales, respectively. General and administrative expenses for the three months ended December 31, 2000 were \$14.3 million compared to \$16.5 million for the same period in the prior year, a decrease of \$2.2 million. As a percentage of net sales general and administrative expenses decreased to 11.3% from 13.0% in the prior year.

Primarily as a result of the Company's restructuring plan, which commenced in the fourth quarter of fiscal 2000, the Company incurred \$100.6 million of pretax special charges during the three months ended December 31, 2000. The Company incurred \$4.2 million associated with workforce reductions mainly in North America (233 employees). During the three months ended December 31, 2000 the Company paid \$1.3 million related to workforce reductions implemented in the fourth quarter of fiscal 2000 and first nine months of fiscal 2001. The special charge includes \$39.9 million related to the write-off of inventories and molds which were discontinued as a result of the Company's efforts to globally standardize product specifications. The Company also continued the transfer of high-volume production to low-cost manufacturing locations and the consolidation of manufacturing expertise into fewer production facilities. As a result, charges of \$1.0 million were incurred related to production cost inefficiencies, \$18.1 million related to redundant equipment write-off and facility closure costs and \$17.0 million related to the write-off of goodwill associated with a prior acquisition of a lens manufacturing business. Additionally, in the third quarter of fiscal 2001 the Company discontinued the development and manufacture of polycarbonate Matrix products. As a result, the Company incurred \$17.3

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million in asset write-offs including equipment (\$5.9 million), inventory (\$10.8 million) and related commitments (\$0.6 million). Lastly, the devaluation of the Brazilian Real (11% in the third fiscal quarter) and the related impact on asset valuation resulted in a special charge of \$3.1 million.

Additionally, during the third fiscal quarter, the Company incurred transition costs associated with executing its restructuring plan. Such costs amounted to \$8.8 million and were primarily related to interim workforce and out-of-pocket expenditures which are expected to be eliminated as the restructuring plan is fully executed. Of these costs, \$4.7 million are reflected in cost of sales, \$0.5 million in research and development expenses, \$2.0 million in selling and marketing expenses and \$1.6 million in general and administrative expenses. The Company anticipates the restructuring plan will be substantially implemented over the ensuing five quarters.

### Operating Income/Loss

For the three months ended December 31, 2000 the Company's operating loss totaled \$94.6 compared to operating income of \$8.8 million for the same period in the prior year, a decrease of \$103.4 million. Operating income excluding special charges and transition costs in the three months ended December 31, 2000 and 1999 would have been \$14.8 million and \$8.1 million, respectively, an increase of \$6.7 million, or 90.0%.

### Net Interest Expense

Net interest expense totaled \$5.6 million for the three months ended December 31, 2000 compared to \$5.0 million for the three months ended December 31, 1999, an increase of \$0.6 million. The increase in interest expense is due to increased borrowing rates and increased borrowing levels.

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### Provision/Benefit for Income Taxes

The Company's combined state, federal and foreign tax rate represents an effective tax rate projected for the full fiscal 2001 year of 32%. For the three months ended December 31, 1999 the Company recorded an effective income tax rate of 32%, and for the full fiscal 2000 year the Company reported an effective tax rate of 83.9%. If the special charges reported in fiscal 2000 are excluded from income before provision for income taxes, and the tax benefit associated with the special charges is excluded from the provision for income taxes, the resulting effective combined state, federal and foreign tax rate for fiscal 2000 would have been 31.2%. As of December 31, 2000 the Company has on its balance sheet deferred tax assets amounting to approximately \$52.0 million and deferred tax liabilities of approximately \$11.5 million. The ultimate utilization of the deferred tax assets is dependent on the Company's ability to generate taxable income in the future.

### Net Income/Loss

Net loss for the three months ended December 31, 2000 totaled \$67.7 million compared to net income of \$2.7 million for the same period in the prior year. If the special charges, transition costs and the associated taxes were excluded from the three months ended December 31, 2000 and 1999, net income would have been \$6.9 million and \$2.2 million, respectively, an increase of \$4.7 million.

### Results of Operations

Nine months ended December 31, 2000 compared to nine months ended December 31,

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1999

### Net Sales

Net sales totaled \$400.7 million in the nine months ended December 31, 2000, compared to net sales of \$401.9 million for the same period in the prior year, a decrease of 0.3%. The decrease in net sales is primarily attributable to the impact of the strong dollar on non-U.S. dollar sales. Using constant exchange rates, net sales increased by 5.0%. Progressive lens net sales for the nine months ended December 31, 2000 decreased 7.6% from the same period in the prior year, due primarily to product mix change in the North American region and the impact of the strong U.S. dollar. Higher priced products accounted for approximately 71% of net sales for the nine months ended December 31, 2000 similar to the same period in the prior year. Net sales performances by region were as follows: Europe increased by 0.5%, Rest of World increased by 15.8%, and the North American region decreased by 7.2%. Using constant exchange rates, the regional performances were as follows: Europe increased by 13.4%, Rest of World increased by 19.5%, and North America decreased by 7.0%.

### Gross Profit and Gross Margin

Gross profit totaled \$164.1 million for the nine months ended December 31, 2000, reflecting a decrease of 7.9% from gross profit of \$178.2 million for the same period in the prior year. Gross profit as a percentage of net sales ("gross margin") decreased from 44.3% for the nine months ended December 31, 1999 to 40.9% for the nine months ended December 31, 2000. Included in gross profit in fiscal 2001 was approximately \$4.7 million of costs relating to transition activities associated with the Company's restructuring plan (see note 7 of notes to financial statements). These transition costs include underabsorption of manufacturing overhead due to reduced production levels and the impact of product migration activities. If these costs were excluded, gross margin would have been 42.1% for the nine months ended December 31, 2000. The Company experiences price competition, which can be severe in certain markets, particularly for standard products.

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### Operating Expenses

Operating expenses in the nine months ended December 31, 2000 totaled \$244.1 million compared to operating expenses of \$141.8 million for the same period in the prior year. Included in operating expenses for the nine months ended December 31, 2000 and 1999 were special charges of \$114.6 million and \$3.7 million respectively. Also included in operating expenses in fiscal 2001 were \$4.1 million of costs relating to transition activities associated with the Company's restructuring plan. If these special charges and transition costs were excluded from both periods, operating expenses would have been \$125.4 million for the nine months ended December 31, 2000 and \$138.1 million for the same period in the prior year, a decrease of \$12.8 million. Operating expenses, excluding the charges and transition costs, for the nine months ended December 31, 2000 and 1999 as a percentage of net sales were 31.3% and 34.4%, respectively. Research and development expenses for the nine months ended December 31, 2000 decreased \$3.9 million to \$11.3 million, from \$15.2 million for the nine months ended December 31, 1999, which represent 2.8% and 3.8% of net sales for the nine months ended December 31, 2000 and 1999, respectively. The decrease in research and development expenses is due in part to the impact of the strong U.S. dollar against non-U.S. dollar expenses as well as headcount reductions associated with the restructuring plan. Selling and marketing expenses for the nine months ended December 31, 2000 decreased \$1.6 million to \$75.2 million compared to \$76.8 million for the same period in the prior year.

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Selling and marketing expenses represent 18.8% and 19.1% of net sales for the nine months ended December 31, 2000 and 1999, respectively. General and administrative expenses were \$43.0 million for the nine months ended December 31, 2000 and \$46.1 million for the same period in the prior year, a decrease of \$3.1 million. As a percentage of net sales, general and administrative expenses decreased from 11.5% for the months ended December 31, 1999 to 10.7% for the nine months ended December 31, 2000.

During the nine months ended December 31, 2000 the Company recorded pretax special charges of \$114.6 million. The Company incurred \$11.4 million associated with workforce reductions in North America, Europe and Australia (543 employees). The special charge includes \$42.1 million related to the write-off of inventories and molds which were discontinued as a result of the Company's efforts to globally standardize product specifications. The Company commenced this identification of inventories in the fourth quarter of fiscal 2000. Also, the Company continued the transfer of high-volume production to low-cost manufacturing locations and the consolidation of manufacturing expertise into fewer production facilities that commenced in the fourth quarter of fiscal 2000. As a result, charges of \$2.7 million were incurred related to production cost inefficiencies, \$20.9 million related to redundant equipment write-off and facility closure costs and 17.0 million related to the write-off of goodwill associated with a prior acquisition of a lens manufacturing business. Additionally, as a result of the discontinuation of the development of the polycarbonate Matrix product line, the Company incurred \$17.3 million in asset write-offs including equipment (\$5.9 million), inventory (\$10.8 million) and related commitments (\$0.6 million). Lastly, the devaluation of the Brazilian Real (11% in the third fiscal quarter) and the related impact on asset valuation resulted in a special charge of \$3.1 million.

In connection with the restructuring plan, the Company anticipates recording additional pretax special charges of approximately \$11 million, before any related gain on asset sales, primarily in the fourth fiscal quarter. As a result of the restructuring, the Company is in the process of selling land and buildings made redundant by the restructuring plan which are expected to generate proceeds in excess of \$20 million and result in a net gain on sale. As a result of these restructuring efforts, the Company expects annualized savings of approximately \$24 million before tax primarily due to reduced costs and operational efficiencies.

The special charges during the nine months ended December 31, 1999 comprise costs associated with the consolidation of the Sola and American Optical manufacturing facilities in Mexico, work force reductions and the erosion of the Brazilian Real.

Additionally, during the third fiscal quarter of 2001, the Company incurred transition costs associated with executing its restructuring plan. Such costs amounted to \$8.8 million and were primarily related to interim workforce and out-of-pocket expenditures which are expected to be eliminated as the restructuring

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plan is fully executed. Of these costs, \$4.7 million are reflected in cost of sales, \$0.5 million in research and development expenses, \$2.0 million in selling and marketing expenses and \$1.6 million in general and administrative expenses. The Company anticipates the restructuring plan will be substantially implemented over the ensuing five quarters.

Operating Income/Loss



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Operating loss for the nine months ended December 31, 2000 totaled \$80.0 million, a decrease of \$116.4 million from operating income of \$36.4 million for the nine months ended December 31, 1999. Operating income excluding the special charges and transition costs in the nine months ended December 31, 2000 and 1999 would have been \$43.4 million and \$40.1 million, respectively, an increase of \$3.3 million, or 8.2%.

### Net Interest Expense

Net interest expense totaled \$17.0 million for the nine months ended December 31, 2000 compared to \$13.9 million for the nine months ended December 31, 1999, an increase of \$3.1 million. The increase in interest expense is due primarily to increased borrowing rates and increased borrowing levels.

### Extraordinary Item

During the nine months ended December 31, 2000 the Company purchased \$5.0 million of its 6 7/8% Senior Notes due 2008. As a result, the Company recorded an extraordinary gain of \$1.5 million, net of tax of \$0.9 million resulting from the difference between the carrying value of the notes and the purchase price. The purchase was funded by the Company's credit facility and resulted in a decline in net borrowings.

### Net Income/Loss

Net loss for the nine months ended December 31, 2000 totaled \$64.1 million compared to net income of \$15.8 million for the same period in the prior year. If the special charges, transition costs, extraordinary item and associated taxes were excluded from the nine months ended December 31, 2000 and 1999, net income would have been \$18.6 million and \$18.4 million, respectively, an increase of \$0.2 million.

### Liquidity and Capital Resources

Net cash provided by operating activities for the nine months ended December 31, 2000 amounted to \$4.8 million, a decrease of \$5.0 million from the funds provided by operating activities of \$9.8 million for the nine months ended December 31, 1999. The change from prior year is due primarily to the reduction in net income offset in part by a decrease in working capital.

Cash flows from investing activities in the nine months ended December 31, 2000 amounted to an outflow of \$19.5 million. Of this amount, \$15.7 million represented capital expenditures, \$2.5 million was for investment in acquisitions and \$1.3 million related to trade investments. The \$2.5 million spent on acquisitions represents the purchase of the remaining 65% ownership interest in a laboratory group located in Australia and New Zealand. Cash flows from investing activities in the nine months ended December 31, 1999 amounted to an outflow of \$21.7 million, reflecting capital expenditures of \$13.9 million, trade investments of \$5.2 million and acquisition of a laboratory in Portugal for \$3.7 million.

Management anticipates capital expenditures of approximately \$20 million annually over the next several years, of which approximately \$5 million annually

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is viewed as discretionary.

Net cash provided by financing activities in the nine months ended December 31, 2000 amounted to \$13.8 million, primarily related to borrowings under the Company's bank credit agreement. Cash outflows included \$8.2 million related to stock buy back under the Company's stock repurchase program. Additionally, during the nine months ended December 31, 2000 the Company purchased \$5.0 million of its 6 7/8% Senior Notes due 2008. The purchase was funded by the Company's credit facility and resulted in a decline in net borrowings. Net cash provided by financing activities in the nine months ended December 31, 1999 amounted to \$15.0 million, mostly due to the increase in bank borrowings and long term debt used to fund investment activities in excess of funds derived from operations.

The Company's Multicurrency Credit Agreement ("Agreement") contains a number of covenants including compliance with certain financial tests and maintenance of certain financial ratios. At December 31, 2000, the Company did not meet the Leverage Ratio covenant of the Agreement. Subsequent to December 31, 2000, a one-time waiver was obtained for this covenant. Management has prepared projections that indicate that the Company may not be in compliance with this covenant as of March 31, 2001. As a result, the Company has classified the \$141.6 million outstanding under the Agreement as a current liability for the period ended December 31, 2000. The terms of the waiver require the Company to (i) include an amendment to the credit agreement which grants a security interest in certain personal property located in the United States of the Company and American Optical Lens Company ("AOLC"), a wholly owned subsidiary of the Company, (ii) require AOLC to provide a guaranty to support the obligations of the facility (iii) limit the facility to \$200 million from January 31, 2001 until March 31, 2001 and \$185 million from April 1, 2001 until May 7, 2001 (iv) pay certain fees. Management is currently in discussions with several financial institutions in order to explore financing alternatives, including bank credit facilities, long-term fixed-rate note offerings and subordinated debt offerings.

In addition to the Company's borrowings under its multicurrency Bank Credit Agreement (\$141.6 million borrowed as of December 31, 2000 under a \$200 million facility) and the Company's outstanding 6 7/8% Senior Notes, its foreign subsidiaries maintain local credit facilities to provide credit for overdraft, working capital and some fixed asset investment purposes. As of December 31, 2000 the total borrowing capacity available to the Company's foreign subsidiaries under such local facilities was approximately \$20.0 million, of which \$6.0 million had been utilized.

The Company continues to have significant liquidity requirements. In addition to working capital needs and capital expenditures, the Company has cash requirements for debt service. In the event that the Company is unable to arrange a further waiver or an extension of the termination date of the Agreement and the Company does not obtain refinancing by May 7, 2001 an event of default will have occurred. The company's Senior Notes contain a "cross default" provision which would be triggered if a default occurs under the Agreement and will result in an acceleration of both the Senior Notes and the debt. Management anticipates that if it is successful in obtaining a new credit it will have access to sufficient financial resources to ensure that the Company's current cash resources, together with other available sources of cash and cash generated from operations, will be able to fund the Company's operations, debt service and required capital expenditures through the end of fiscal 2002 and beyond. In the event such refinancing is not successfully obtained prior to May 7, 2001, to meet its additional remaining capital requirements and to service its debt obligations, the Company will be required to sell additional equity securities, sell existing assets and/or enter into new financing arrangements. There can be no assurance the Company will be able to

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obtain the additional financing necessary to satisfy its cash requirements, in which event the Company will be unable to fund its ongoing operations, which would have a material adverse effect on its business, results of operations and financial condition.

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### Subsequent Event

In January 2001 the Company acquired the net assets of Oracle Lens Manufacturing Corporation ("Oracle"), a manufacturer and distributor of polycarbonate lenses located in Rhode Island. The Company acquired Oracle for cash consideration of approximately \$15.4 million and \$2.0 million payable in two years. The Oracle acquisition was funded through borrowings under the Company's Multicurrency Credit Agreement and is expected to be accretive to earnings.

### Impact of Recently Issued Accounting Standards

In June 1998, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 133, "Accounting for Derivative Instruments and Hedging Activities". This statement establishes accounting and reporting standards for derivative instruments and requires recognition of all derivatives as assets or liabilities in the statement of financial position and measurement of those instruments at fair value. Subsequently, the FASB issued SFAS No. 137, which defers the effective date of SFAS No. 133 to fiscal years beginning after June 15, 2000. The Company is in the process of determining the impact that adoption and implementation will have on its consolidated financial statements.

In December 1999, the Securities and Exchange Commission issued Staff Accounting Bulletin No. 101 (SAB 101), "Revenue Recognition in Financial Statements." SAB 101 provides guidance for revenue recognition under certain circumstances. The accounting and disclosures prescribed by SAB 101 will be adopted effective for the Company's fourth quarter 2001 retroactive to the first quarter of fiscal year 2001. The Company believes there will be no material impact resulting from the application of SAB 101.

### Currency Exchange Rates

As a result of the Company's worldwide operations, currency exchange rate fluctuations tend to affect the Company's results of operations and financial position. The two principal effects of currency exchange rates on the Company's results of operations and financial position are (i) translation adjustments for subsidiaries where the local currency is the functional currency and (ii) translation adjustments for subsidiaries in hyper-inflationary countries. Translation adjustments for functional local currencies have been made to shareholders' equity. For the nine months ended December 31, 2000 and 1999 such translation adjustments were approximately (\$1.6) million and \$1.1 million, respectively.

For translation adjustments of the Company's subsidiaries operating in hyper-inflationary countries the functional currency is determined to be the U.S. dollar, and therefore all translation adjustments are reflected in the Company's Statements of Operations. In hyper-inflationary environments, the Company generally protects margins by methods which include increasing prices monthly at

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a rate appropriate to cover anticipated inflation, compounding interest charges on sales invoices daily and holding cash balances in U.S. dollar denominated accounts where possible.

Because a majority of the Company's debt is U.S. dollar denominated, the Company may hedge against certain currency fluctuations by entering into currency swaps (however certain currencies, such as the Brazilian Real, cannot be hedged economically), although no such swaps had been entered into as of December 31, 2000. As of December 31, 2000 certain of the Company's foreign subsidiaries had entered into forward contracts for intercompany purchase commitments in amounts other than their home currency. The carrying amount of the forward contracts approximates fair value, which has been estimated based on current exchange rates.

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### Seasonality

The Company's business is somewhat seasonal, with fiscal third quarter results generally weaker than the other three quarters as a result of lower sales during the holiday season, and fiscal fourth quarter results generally the strongest.

### Inflation

Inflation continues to affect the cost of the goods and services used by the Company. The competitive environment in many markets limits the Company's ability to recover higher costs through increased selling prices, and the Company is subject to price erosion in many of its standard product lines. The Company seeks to mitigate the adverse effects of inflation through cost containment and productivity and manufacturing process improvements. For a description of the effects of inflation on the Company's reported revenues and profits and the measures taken by the Company in response to inflationary conditions, see--"Currency Exchange Rates" above.

### European Union Conversion to the "Euro"

The Company has instituted a "Euro" conversion team and begun preliminary preparation for the conversion by eleven member states of the European Union to a common currency, the "Euro". Conversion to the Euro by these member states of the union is taking place on a "no compulsion, no prohibition" basis between January 1, 1999 and January 1, 2002. By January 1, 2002 all companies operating in the eleven member states will be required to be fully operational using the new currency. The Sola conversion team has primarily addressed the accounting and information systems changes that are necessary to facilitate trading in the Euro, the possible market place implications of a common currency and the currency exchange rate risks, with the initial emphasis placed on the system modifications. The Company has not completed the evaluation of the possible effect of the changes to the Euro on intercompany foreign currency loans, or the impact if any, on the market place implications of a common currency. Preliminary assessments indicate that the financial impact of conversion to a Euro-based currency will not be material to the Company's consolidated financial position, results of operations or cash flows.

### Information Relating to Forward-Looking Statements

This quarterly report includes forward-looking statements within the meaning

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of Section 21E of the Securities Exchange Act of 1934, including statements regarding among other items, (i) the impact of inflation, (ii) future income tax rates and capital expenditures, (iii) future special charges, (iv) refinancing efforts, and (v) the costs and other consequences related to conversion to the Euro. These forward-looking statements reflect the Company's current views with respect to future events and financial performance. The words "believe", "expect", "anticipate" and similar expressions identify forward-looking statements. Readers are cautioned not to place undue reliance on these forward-looking statements, which speak only as of their dates. The Company undertakes no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise. Actual results could differ materially from the forward-looking statements as a result of "Factors Affecting Future Operating Results" included in Exhibit 99.1 of the Company's Form 10-K for the fiscal year ended March 31, 2000, and the factors described in "Business-Environmental Matters", also included in the Company's Form 10-K for the fiscal year ended March 31, 2000.

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

There has been no material change in the Company's assessment of its sensitivity to market risk since its presentation set forth in Item 7A, "Quantitative and Qualitative Disclosures About Market Risk", in its Annual Report on Form 10-K for the fiscal year ended March 31, 2000.

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## PART II OTHER INFORMATION

### Item 1. Legal Proceedings

Not applicable

### Item 2. Changes in Securities and Use of Proceeds

Not applicable

### Item 3. Defaults upon Senior Securities

Not applicable

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

Not applicable

### Item 5. Other Information

Not applicable

### Item 6. Exhibits and Reports on Form 8-K

#### (a) Exhibits

Exhibit Number	Description
10.26	Amendment No. 4 to the Multicurrency Credit Agreement, dated as of June 14, 1996, among Sola International Inc., and the other Borrowers as the Borrowers, the Subsidiary Guarantors, The Bank of America National Trust and Savings Association, as Agent and Letter of Credit Issuing Bank, The First National Bank of Boston and The Bank of Nova

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Scotia, as Co-Agents, and the Other Financial Institutions Party Thereto

27 Financial Data Schedule

(b) Reports on Form 8-K

No Reports on Form 8-K were filed during the fiscal quarter ended December 31, 2000.

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SIGNATURE

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

Sola International Inc.  
(Registrant)

Dated: February 14, 2001  
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By: /s/ Steven M. Neil  
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Steven M. Neil  
Executive Vice President, Chief Financial Officer, Secretary and Treasurer (Duly Authorized Officer and Principal officer)

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Exhibit Index  
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27 Financial Data Schedule