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SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

☒

Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 For the quarterly period ended October 28, 2000, or

☐

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

Commission file number 33-66342

**COLE NATIONAL GROUP, INC.**  
(Exact name of registrant as specified in its charter)

Delaware  
(State or other jurisdiction of  
incorporation or organization)

34-1744334  
(I.R.S. employer  
identification no.)

5915 Landerbrook Drive  
Mayfield Heights, Ohio  
(Address of principal executive offices)

44124  
(Zip code)

(440) 449-4100  
(Registrant's telephone number, including area code)

The registrant meets the conditions set forth in General Instruction H(1)(a) and (b) of Form 10-Q and is therefore filing this form in the reduced disclosure format.

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

All of the outstanding capital stock of the registrant is held by Cole National Corporation.

As of November 20, 2000 1,100 shares of the registrant's common stock, \$.01 par value, were outstanding.

**COLE NATIONAL GROUP, INC. AND SUBSIDIARIES**  
**FORM 10-Q**  
**QUARTER ENDED OCTOBER 28, 2000**  
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## PART I — FINANCIAL INFORMATION

### Item 1. Financial Statements

#### COLE NATIONAL GROUP, INC. AND SUBSIDIARIES CONSOLIDATED BALANCE SHEETS (Dollars in thousands) (Unaudited)

|  | October 28,<br>2000 | January 29,<br>2000 |
|--|---------------------|---------------------|
| Assets   |                     |                     |
| Current assets:  |                     |                     |
| Cash and temporary cash investments  | 9,324               | \$ 28,953           |
| Accounts receivable, less allowance for doubtful accounts of \$5,473 and \$7,557, respectively                               | 39,847              | 41,650              |
| Current portion of notes receivable  | 4,965               | 4,917               |
| Inventories  | 147,059             | 116,514             |
| Refundable income taxes  | 836                 | 836                 |
| Prepaid expenses and other   | 7,265               | 6,942               |
| Deferred income tax benefits   | 5,391               | 3,758               |
| Total current assets   | 214,687             | 203,570             |
| Property and equipment, at cost  | 263,586             | 252,625             |
| Less — accumulated depreciation and amortization   | (146,575)           | (140,791)           |
| Total property and equipment, net  | 117,011             | 111,834             |
| Notes receivable, excluding current portion and less reserves for uncollectible amounts of \$4,822 and \$4,196, respectively | 6,752               | 10,550              |
| Deferred income taxes and other assets   | 57,802              | 60,175              |
| Intangible assets, net   | 153,118             | 157,399             |
| Total assets   | <u>\$ 549,370</u>   | <u>\$ 543,528</u>   |
| Liabilities and Stockholder's Equity   |                     |                     |
| Current liabilities:   |                     |                     |
| Short-term borrowing   | 8,500               | —                   |
| Current portion of long-term debt  | 332                 | 585                 |
| Accounts payable   | 58,965              | 58,514              |
| Payable to affiliates, net   | 59,298              | 63,589              |
| Accrued interest   | 7,096               | 6,090               |
| Accrued liabilities  | 76,725              | 70,802              |
| Accrued income taxes   | —                   | 178                 |
| Total current liabilities  | 210,916             | 199,758             |
| Long-term debt, net of discount and current portion  | 274,247             | 274,210             |
| Other long-term liabilities  | 13,166              | 16,611              |
| Stockholder's equity   | 51,041              | 52,949              |
| Total liabilities and stockholder's equity   | <u>\$ 549,370</u>   | <u>\$ 543,528</u>   |

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

**COLE NATIONAL GROUP, INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENT OF OPERATIONS**  
(Dollars in thousands)  
(Unaudited)

|  | <b>Thirteen Weeks Ended</b> |                             | <b>Thirty-nine Weeks Ended</b> |                             |
|--|-----------------------------|-----------------------------|--------------------------------|-----------------------------|
|  | <b>October 28,<br/>2000</b> | <b>October 30,<br/>1999</b> | <b>October 28,<br/>2000</b>    | <b>October 30,<br/>1999</b> |
| Net revenue                              | \$255,901                   | \$250,408                   | \$777,656                      | \$770,429                   |
| Costs and expenses:                      |                             |                             |                                |                             |
| Cost of goods sold                       | 83,450                      | 87,012                      | 257,759                        | 266,012                     |
| Operating expenses                       | 158,519                     | 149,268                     | 476,345                        | 447,994                     |
| Depreciation and amortization            | 9,278                       | 9,363                       | 27,874                         | 26,632                      |
| Total costs and expenses                 | <u>251,247</u>              | <u>245,643</u>              | <u>761,978</u>                 | <u>740,638</u>              |
| Operating income                         | 4,654                       | 4,765                       | 15,678                         | 29,791                      |
| Interest and other<br>(income) expense:  |                             |                             |                                |                             |
| Interest expense                         | 7,035                       | 6,855                       | 20,776                         | 20,441                      |
| Interest and other income                | <u>(18)</u>                 | <u>(153)</u>                | <u>(254)</u>                   | <u>(550)</u>                |
| Total interest and other expense,<br>net | <u>7,017</u>                | <u>6,702</u>                | <u>20,522</u>                  | <u>19,891</u>               |
| Income (loss) before income taxes        | (2,363)                     | (1,937)                     | (4,844)                        | 9,900                       |
| Income tax provision (benefit)           | <u>(1,927)</u>              | <u>(794)</u>                | <u>(3,391)</u>                 | <u>4,059</u>                |
| Net income (loss)                        | <u>\$ (436)</u>             | <u>\$ (1,143)</u>           | <u>\$ (1,453)</u>              | <u>\$ 5,841</u>             |

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

**COLE NATIONAL GROUP, INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
(Dollars in thousands)  
(Unaudited)

|  | <b>Thirty-Nine Weeks Ended</b> |                             |
|--|--------------------------------|-----------------------------|
|  | <b>October 28,<br/>2000</b>    | <b>October 30,<br/>1999</b> |
| Cash flows from operating activities:  |                                |                             |
| Net income (loss)  | \$ (1,453)                     | \$ 5,841                    |
| Adjustments to reconcile net income (loss) to net cash provided by operating activities: |                                |                             |
| Depreciation and amortization  | 27,874                         | 26,632                      |
| Non-cash interest, net   | 837                            | 799                         |
| Increases (decreases) in cash resulting from changes in assets and liabilities:          |                                |                             |
| Accounts and notes receivable, prepaid expenses and other assets                         | 5,020                          | 400                         |
| Inventories  | (30,545)                       | (13,968)                    |
| Accounts payable, accrued liabilities and other liabilities                              | (1,663)                        | (22,378)                    |
| Accrued interest   | 1,006                          | 874                         |
| Accrued, refundable and deferred income taxes  | 4,112                          | 3,513                       |
| Net cash provided by operating activities  | <u>5,188</u>                   | <u>1,713</u>                |
| Cash flows from investing activities:  |                                |                             |
| Purchases of property and equipment, net   | (23,087)                       | (21,036)                    |
| Systems development costs  | (5,567)                        | (10,980)                    |
| Acquisitions of businesses, net  | —                              | (2,281)                     |
| Other, net   | 53                             | (582)                       |
| Net cash used by investing activities  | <u>(28,601)</u>                | <u>(34,879)</u>             |
| Cash flows from financing activities:  |                                |                             |
| Proceeds from working capital borrowings   | 8,500                          | —                           |
| Repayment of long-term debt  | (281)                          | (303)                       |
| Advances to affiliates, net  | (3,623)                        | 5,338                       |
| Payment of deferred financing fees   | (377)                          | (281)                       |
| Other, net   | (435)                          | 148                         |
| Net cash provided by financing activities  | <u>3,784</u>                   | <u>4,902</u>                |
| Cash and temporary cash investments:   |                                |                             |
| Net decrease during the period   | (19,629)                       | (28,264)                    |
| Balance, beginning of the period   | 28,953                         | 51,057                      |
| Balance, end of the period   | <u>\$ 9,324</u>                | <u>\$ 22,793</u>            |

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

COLE NATIONAL GROUP, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements  
(Unaudited)

(1) Basis of Presentation and Accounting Policies

Cole National Group, Inc. is a wholly owned subsidiary of Cole National Corporation. The consolidated financial statements include the accounts of Cole National Group and its wholly owned subsidiaries (collectively, the “Company”). All significant intercompany transactions have been eliminated in consolidation.

The accompanying consolidated financial statements have been prepared without audit and certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted, although management believes that the disclosures herein are adequate to make the information not misleading. Results for interim periods are not necessarily indicative of the results to be expected for the full year. These statements should be read in conjunction with the Company’s consolidated financial statements and notes thereto included in its annual report on Form 10-K for the fiscal year ended January 29, 2000.

In the opinion of management, the accompanying financial statements contain all adjustments (consisting only of normal recurring accruals) necessary to present fairly the Company’s financial position as of October 28, 2000 and the results of operations and cash flows for the 39 weeks ended October 28, 2000 and October 30, 1999.

*Inventories*

The accompanying interim consolidated financial statements have been prepared without physical inventories.

*Cash Flows*

Net cash flows from operating activities reflect cash payments for income taxes and interest of \$843,000 and \$18,934,000 respectively, for the 39 weeks ended October 28, 2000, and \$407,000 and \$18,767,000 respectively, for the 39 weeks ended October 30, 1999.

*Total Other Comprehensive Income (Loss)*

Total other comprehensive income (loss) for the 13 and 39 weeks ended October 28, 2000 and October 30, 1999 is as follows (000’s omitted):

|                                      | Thirteen Weeks |                  | Thirty-Nine Weeks |                |
|--------------------------------------|----------------|------------------|-------------------|----------------|
|                                      | 2000           | 1999             | 2000              | 1999           |
| Net income (loss)                    | \$(436)        | \$(1,143)        | \$(1,453)         | \$5,841        |
| Cumulative translatoin income (loss) | (271)          | (53)             | (455)             | 156            |
| Total comp rehensive income (loss)   | <u>\$(707)</u> | <u>\$(1,196)</u> | <u>\$(1,908)</u>  | <u>\$5,997</u> |

**COLE NATIONAL GROUP, INC. AND SUBSIDIARIES**  
**Notes to Consolidated Financial Statements**  
**(Unaudited)**

**(2) Credit Facility**

In June 2000, the credit facility was amended to provide availability under the working capital commitment ranging from \$50.0 million to 75.0 million based on the Company’s current debt leverage ratio described in the credit facility. As of October 28, 2000, total availability under the credit facility was \$50.0 million. The amendment also modified certain covenants, as well as the permitted levels on indebtedness, dividends, investments, and capital expenditures.

**(3) Segment Information**

Information on the Company’s reportable segments is as follows (000’s omitted):

|                                   | <b>Thirteen Weeks</b> |                   | <b>Thirty-Nine Weeks</b> |                  |
|-----------------------------------|-----------------------|-------------------|--------------------------|------------------|
|                                   | <b>2000</b>           | <b>1999</b>       | <b>2000</b>              | <b>1999</b>      |
| Net revenue:                      |                       |                   |                          |                  |
| Cole Vision                       | \$200,338             | \$197,219         | \$597,322                | \$599,971        |
| Things Remembered                 | <u>55,563</u>         | <u>53,189</u>     | <u>180,334</u>           | <u>170,458</u>   |
| Consolidated net revenue          | <u>\$255,901</u>      | <u>\$250,408</u>  | <u>\$777,656</u>         | <u>\$770,429</u> |
| Income:                           |                       |                   |                          |                  |
| Cole Vision                       | \$ 6,913              | \$ 6,622          | \$ 15,400                | \$ 25,040        |
| Things Remembered                 | <u>307</u>            | <u>270</u>        | <u>9,816</u>             | <u>9,408</u>     |
| Total segment profit              | <u>7,220</u>          | <u>6,892</u>      | <u>25,216</u>            | <u>34,448</u>    |
| Unallocated amounts:              |                       |                   |                          |                  |
| Corporate expenses                | <u>2,566</u>          | <u>2,127</u>      | <u>9,538</u>             | <u>4,657</u>     |
| Consolidated operating income     | <u>4,654</u>          | <u>4,765</u>      | <u>15,678</u>            | <u>29,791</u>    |
| Interest and other expense, net   | <u>7,017</u>          | <u>6,702</u>      | <u>20,522</u>            | <u>19,891</u>    |
| Income (loss) befor eincome taxes | <u>\$ (2,363)</u>     | <u>\$ (1,937)</u> | <u>\$ (4,844)</u>        | <u>\$ 9,900</u>  |

**(4) Reclassifications**

Certain fiscal 1999 amounts have been reclassified to conform with the fiscal 2000 presentation.



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

Certain information required by this item has been omitted pursuant to General Instruction H of Form 10-Q.

The following is a discussion of certain factors affecting Cole National Group’s results of operations for the 13 and 39 week periods ended October 28, 2000 and October 30, 1999 (the Company’s third quarter and first nine months, respectively). This discussion should be read in conjunction with the consolidated financial statements and notes thereto included elsewhere in this filing and the audited financial statements for the fiscal year ended January 29, 2000 included in the annual report on Form 10-K.

Fiscal years end on the Saturday closest to January 31 and are identified according to the calendar year in which they begin. For example, the fiscal year ended January 29, 2000 is referred to as “fiscal 1999.” The current fiscal year, which will end February 3, 2001, is referred to as “fiscal 2000.”

Results of Operations

The following table sets forth certain operating information for the third quarter and first nine months of fiscal 2000 and fiscal 1999 (dollars in millions):

|  | Third Quarter |         | Change | First Nine Months |         |
|--|---------------|---------|--------|-------------------|---------|
|  | 2000          | 1999    |        | 2000              | 1999    |
| Net reveunue:  |               |         |        |                   |         |
| Cole Vision  | \$200.3       | \$197.2 | 1.6%   | \$597.4           | \$599.9 |
| Things Remembered                                    | 55.6          | 53.2    | 4.5    | 180.3             | 170.5   |
| Total net revenue                                    | \$255.9       | \$250.4 | 2.2%   | \$777.7           | \$770.4 |
| Gross margin:  | \$172.5       | \$163.4 | 5.5%   | \$519.9           | \$504.4 |
| Operating expenses                                   | \$158.5       | \$149.2 | 6.2    | \$476.3           | 448.0   |
| Depreciation and amortization                        | \$ 9.3        | \$ 9.4  | (0.9)  | \$ 27.9           | 26.6    |
| Operating income                                     | \$ 4.7        | \$ 4.8  | (2.3)% | \$ 15.7           | \$ 29.8 |
| Percentage of net revenue:                           |               |         |        |                   |         |
| Gross margin   | 67.4%         | 65.3%   | 2.1    | 66.9%             | 65.5    |
| Operating expenses                                   | 62.0          | 59.7    | 2.3    | 61.3              | 58.1    |
| Depreciation and amortization                        | 3.6           | 3.7     | (0.1)  | 3.6               | 3.5     |
| Operating income                                     | 1.8%          | 1.9%    | (0.1)  | 2.0%              | 3.9     |
| Number of retail locations at the end of the period: |               |         |        |                   |         |
| Cole Licensed Brands                                 | 1,161         | 1,199   |        |                   |         |
| Pearle company-owned                                 | 444           | 455     |        |                   |         |
| Pearle franchised                                    | 423           | 412     |        |                   |         |
| Total Cole Vision                                    | 2,028         | 2,066   |        |                   |         |
| Things Remembered                                    | 794           | 811     |        |                   |         |
| Total Cole National                                  | 2,822         | 2,877   |        |                   |         |

The increase in net revenue for the third quarter and first nine months of fiscal 2000 was primarily attributable to increases in consolidated comparable store sales and revenue associated with the MetLife vision care business acquired in October 1999. These increases were partially offset by a reduction in the number of locations, including the closing of all optical departments at Montgomery Ward in December 1999, and by \$1.4 million of revenue in fiscal 1999 from the sale of rights under various franchise and other agreements for 13 franchise stores. Changes in comparable store sales by business were:

|                              | Third Quarter | First Nine Months |
|------------------------------|---------------|-------------------|
| Cole Licensed Brands         | 2.2%          | 4.2%              |
| Pearle U.S. company-owned    | 6.4%          | 0.7%              |
| Total Cole Vision            | 3.4%          | 2.8%              |
| Things Remembered            | 4.0%          | 6.3%              |
| Total Cole National          | 3.5%          | 3.6%              |
| Pearle U.S. franchise stores | 5.0%          | 3.2%              |
| Pearle U.S. chain-wide       | 5.6%          | 2.0%              |

At Cole Licensed Brands, an increase in the average selling price for the third quarter and first nine months was nearly offset by a decrease in number of units sold, primarily from closing the Montgomery Ward departments. At Pearle company-owned stores, third quarter sales benefited from an increase in both average transaction amount and number of transactions compared to the same period last year. Both measures reflected improvement from first half results. For the first nine months, the average transaction increase at Pearle was offset by a decrease in the number of transactions. At Things Remembered, the comparable store sales increases for the third quarter and first nine months reflected an increase in sales of new merchandise at higher average unit retails, partially offset by a third quarter decrease in the number of transactions.

The gross margin dollar increase for the third quarter was attributable to the revenue increase at Pearle and Things Remembered, the additional revenue associated with the MetLife vision care business and an improvement in gross margin as a percentage of net revenue. The improvement in gross margin rate was a result of higher average selling prices in the optical businesses, the additional MetLife vision care revenue and productivity gains at Things Remembered. At Cole Vision, gross margin rate improved 2.7 and 1.7 percentage points in fiscal 2000 compared to the third quarter and first nine months of last year, respectively. At Things Remembered, gross margin rate increased 0.4 percentage points to last year in the third quarter. Gross margin rate at Things Remembered decreased 0.5 percentage points to last year in the first nine months reflecting the impact of an aggressive merchandise clearance promotion in the first quarter of this year.

The operating expense increases for the third quarter and first nine months were due primarily to increases in staffing for improved service levels in the optical businesses, increases in expenses associated with the rapid expansion of Target Optical and increases in managed vision care costs (primarily associated with the MetLife vision care business). A decline in comparable store sales at Pearle company-owned stores during the first six months this year also impacted the nine-month leverage loss. The impact of a \$1.8 million first quarter 2000 charge for severance costs recorded in connection with a personnel reduction at Cole Vision was offset by a similar charge in third quarter 1999. Payroll costs as a percentage of net revenue increased 1.4 percentage points for the third quarter and 1.6 percentage points for the first nine months compared to the same periods a year ago. Managed vision care costs increased 0.6 percentage points for the third quarter and first nine months compared to those same periods last year.

The increase in depreciation and amortization for the first nine months of fiscal 2000 compared to the same period last year was primarily attributable to amortization of systems development costs related to the Pearle manufacturing and merchandise/inventory management system implemented in the third quarter last year.

Operating income was essentially flat to last year, an improvement from first and second quarter results, attributable in large part to the sales improvement at Pearle. The decrease in operating income for the first nine months compared to the same period last year was primarily the result of the increases in operating expenses and depreciation and amortization as noted above.

The increase in interest and other (income) expense for the third quarter and first nine months compared to the same periods a year ago reflected increased interest expense from seasonal borrowing and less income due to reduced short-term investments. Income tax provisions were recorded in the first nine months of fiscal 2000 and fiscal 1999 using the Company's estimated annual effective tax rates of 70% and 41%, respectively. At the end of third quarter, the Company reassessed its estimate of the annual effective tax rate for fiscal 2000 increasing the rate from the previous estimate of 59%.

The net loss for the third quarter decreased to \$0.4 million from \$1.1 million for the same period last year. For the first nine months of fiscal 2000, net income decreased to a loss of \$1.5 million from a profit of \$5.8 million for the first nine months of fiscal 1999.

### **Outlook and Foward - Looking Information**

The Company expects significant improvement in its earnings for the fourth quarter of fiscal 2000, compared to the same period a year ago, due to improved sales and gross margin performance this year at Cole Vision and elimination of extra advertising expenditures at Pearle that were not productive last year. Achieving such results is, of course, subject to the usual holiday season sales risk at Things Remembered and other factors outlined in the next paragraph.

Certain sections of this Form 10-Q, including this Management's Discussion and Analysis, contain forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Actual results may differ materially from those forecasted due to a variety of factors that can adversely affect the Company's operating results, liquidity and financial condition such as risks associated with the timing and achievement of the continuing restructuring and improvements in the operations of the optical business, the Company's ability to select, stock and price merchandise attractive to customers, success of systems integration, competition in the optical industry, integration of acquired businesses, economic and weather factors affecting consumer spending, operating factors affecting customer satisfaction, including manufacturing quality of optical and engraved goods, the Company's relationships with host stores and franchisees, the mix of goods sold, pricing and other competitive factors, and the seasonality of the Company's business. Forward-looking statements are made based upon management's expectations and beliefs concerning future events impacting the Company. Forward-looking statements involve risk and uncertainty.

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

The Company is exposed to market risk from changes in foreign currency exchange rates, which could impact its results of operations and financial condition. Foreign exchange risk arises from the Company's exposure to fluctuations in foreign currency exchange rates because the Company's reporting currency is the United States dollar. Management seeks to minimize the exposure to foreign currency fluctuations through natural internal offsets to the fullest extent possible.

## **PART II — OTHER INFORMATION**

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

(a) Exhibits. The following Exhibits are filed herewith and made a part hereof:

27 Financial Data Schedule

(b) Reports on Form 8-K

None.

**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.

COLE NATIONAL GROUP, INC.

By: /s/ William P. Lahiff, Jr.  
William P. Lahiff, Jr.  
Vice President and Controller  
(Duly Authorized Officer and Principal  
Accounting Officer)

Date: December 7, 2000

**COLE NATIONAL GROUP, INC.**  
**FORM 10-Q**  
**QUARTER ENDED OCTOBER 28, 2000**

**EXHIBIT INDEX**

| <u>Exhibit<br/>Number</u> | <u>Description</u>      |
|---------------------------|-------------------------|
| 27                        | Financial Data Schedule |