

HEARUSA INC
Form 10-Q
November 12, 2003

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 September 27, 2003

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 0-16453

HearUSA, Inc.

(Exact Name of Registrant as Specified in Its Charter)

Delaware

22-2748248

(State of Other Jurisdiction of
Incorporation or Organization)

(I.R.S. Employer
Identification No.)

1250 Northpoint Parkway, West Palm Beach, Florida

33407

(Address of Principal Executive Offices)

(Zip Code)

Registrant's Telephone Number, Including Area Code (561) 478-8770

Former Name, Former Address and Former Fiscal Year,
if Changed Since Last Report

Indicate by check 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

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

On October 31, 2003, 30,423,636 shares of the Registrant's Common Stock were outstanding, including 1,876,370 exchangeable shares of HEARx Canada, Inc.

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Part I Financial Information

Item 1. Financial Statements

HearUSA, Inc.
consolidated Balance Sheets
ASSETS

	September 27, 2003	December 28, 2002
	(unaudited)	(audited)
Current assets:		
Cash and cash equivalents	\$ 3,615,305	\$ 2,410,023
Investment securities	435,000	435,000
Accounts and notes receivable, less allowance for doubtful accounts of \$550,706 and \$587,322	7,249,226	5,963,677
Inventories	1,075,620	945,743
Prepaid expenses and other	416,361	889,197
Assets of discontinued operations (Note 1)		1,472,849
Total current assets	12,791,512	12,116,489
Property and equipment net	5,428,462	6,910,966
Intangibles, net (Note 4)	43,846,428	44,211,588
Deposits and other	400,456	482,982
Other assets of discontinued operations (Note 1)		1,143,783
	\$ 62,466,858	\$ 64,865,808
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	\$ 9,184,765	\$ 9,675,004
Accrued expenses	2,716,787	4,665,547
Accrued salaries and other compensation	1,105,998	1,868,772
Current maturities of long term debt	4,245,124	4,017,007
Dividends payable	1,315,339	1,215,167
Liabilities of discontinued operations (Note 1)		906,364
Total current liabilities	18,568,013	22,347,861
Long term debt, less current maturities	23,526,265	21,971,499
Long term debt, less current maturities of discontinued operations		110,890
Commitments and contingencies (Note 6)		
Mandatorily redeemable convertible preferred stock (Note 2)	4,563,000	
Stockholders equity:		
Preferred stock (Note 2):		
(Aggregate liquidation preference \$2,330,000 and \$8,108,167) \$1 par, 5,000,000 shares authorized		
Series J (233 shares outstanding)	233	233
Series H Junior Participating (0 shares outstanding)		
1998 Convertible (0 and 4,563 shares outstanding)		4,563
Total preferred stock	233	4,796
Common stock: \$.10 par; 50,000,000 shares authorized 28,891,355 and 24,457,055 shares issued	2,889,135	2,445,705

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Stock subscription	(412,500)	(412,500)
Additional paid-in capital	112,199,322	117,314,681
Accumulated deficit	(96,463,495)	(96,765,446)
Accumulated other comprehensive income – currency translation adjustment (Note 1)	82,026	331,763
Treasury stock, at cost: 523,662 & 518,660 common shares	(2,485,141)	(2,483,441)
	<u>15,809,580</u>	<u>20,435,558</u>
	<u>\$ 62,466,858</u>	<u>\$ 64,865,808</u>

See accompanying notes to the consolidated financial statements

HearUSA, Inc.
Consolidated Statements of Operations
Nine Months Ended September 27, 2003 and September 28, 2002

	September 27, 2003	September 28, 2002
	(unaudited)	(unaudited)
Net Revenues	\$53,664,664	\$40,553,650
Operating costs and expenses:		
Cost of products sold	15,202,201	11,791,342
Center operating expenses	26,062,405	22,933,432
General and administrative expenses	7,529,998	7,969,563
Depreciation and amortization	2,334,585	1,777,168
Total operating costs and expenses	51,129,189	44,471,505
Income (loss) from operations	2,535,475	(3,917,855)
Non-operating income (expense):		
Interest income	16,701	107,125
Interest expense	(1,608,717)	(1,196,025)
Other income		5,671
Income (loss) before equity in loss of affiliated company	943,459	(5,001,084)
Equity in loss of affiliated company		(630,801)
Income (loss) from continuing operations	943,459	(5,631,885)
Discontinued operations		
Loss from discontinued operations (including loss on disposal of \$105,296 and \$0)	(201,536)	(226,206)
Net income (loss) before dividends on preferred stock	741,923	(5,858,091)
Dividends on preferred stock	(439,972)	(547,052)
Net income (loss) applicable to common stockholders	\$ 301,951	\$ (6,405,143)
Net income (loss) per common share basic	\$ 0.01	\$ (0.32)
Net income (loss) per common share diluted	\$ 0.01	\$ (0.32)
Weighted average number of shares of Common stock outstanding:		
Basic	30,424,466	19,862,681
Diluted	48,191,168	19,862,681

See accompanying notes to the consolidated financial statements

HearUSA, Inc.
Consolidated Statements of Operations
Three Months Ended September 27, 2003 and September 28, 2002

	September 27, 2003	September 28, 2002
	(unaudited)	(unaudited)
Net Revenues	\$ 17,276,558	\$ 15,882,602
Operating costs and expenses:		
Cost of products sold	4,745,705	5,100,773
Center operating expenses	8,927,598	9,389,563
General and administrative expenses	2,657,870	3,104,708
Depreciation and amortization	700,011	736,433
Total operating costs and expenses	17,031,184	18,331,477
Income (loss) from operations	245,374	(2,448,875)
Non-operating income (expense):		
Interest income	4,740	14,373
Interest expense	(493,179)	(572,400)
Other income		5,671
Loss from continuing operations	(243,065)	(3,001,231)
Discontinued operations		
Loss from discontinued operations	(3,830)	(226,206)
Loss before dividends on preferred stock	(246,895)	(3,227,437)
Dividends on preferred stock	(142,547)	(236,347)
Net loss applicable to common stockholders	\$ (389,442)	\$ (3,463,784)
Net loss per common share basic	\$ (0.01)	\$ (0.12)
Net loss per common share diluted	\$ (0.01)	\$ (0.12)
Weighted average number of shares of Common stock outstanding:		
Basic	30,423,652	29,990,582
Diluted	30,423,652	29,990,582

See accompanying notes to the consolidated financial statements

HearUSA, Inc.
Consolidated Statements of Cash Flows
Nine Months Ended September 27, 2003 and September 28, 2002

	September 27, 2003	September 28, 2002
	(unaudited)	(unaudited)
Cash flows from operating activities:		
Net income(loss)	\$ 741,923	\$ (5,858,091)
Loss from discontinued operations	201,536	
Net income (loss) from continuing operations	943,459	(5,858,091)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and amortization	2,335,085	1,816,923
Provision for doubtful accounts	591,663	121,276
Loss on disposition of equipment	1,563	153,137
Equity loss in affiliated company		630,801
Compensation expense from the issuance of capital stock		40,250
Changes in assets and liabilities:		
(Increase) decrease in:		
Accounts and notes receivable	(1,261,040)	228,084
Inventories	(135,218)	108,141
Prepaid expenses and other	526,216	375,816
Increase (decrease) in:		
Accounts payable	(546,318)	1,517,504
Accrued salaries and other	(1,699,867)	521,385
Net cash provided/(used) by continuing operations	755,543	(344,774)
Net cash used by discontinued operations	(372,098)	
Net cash provided/(used) by operating activities	383,445	(344,774)
Cash flow from investing activities:		
Purchase of property and equipment	(215,079)	(428,053)
Proceeds from the sale of discontinued operations	1,164,667	
Capital expenditure from discontinued operations	(8,196)	
Purchase of investment securities		(5,257,524)
Proceeds from the sale of mature investments		5,257,524
Issuance of note receivable in affiliated company		(8,384,122)
Purchase of pre-combination investment in Helix		(2,000,000)
Cost of business combination		(1,568,742)
Net cash provided/(used) in investing activities	941,392	(12,380,917)
Cash flows from financing activities:		
Proceeds from issuance of:		
Long-term debt	3,500,000	13,123,095
Principal payments of debt of discontinued operations	(29,822)	
Principal payments: Long-term debt	(3,152,046)	(3,020,656)
Purchase of treasury stock	(1,700)	
Redemption of preferred stock, net of costs	(153,757)	(351,093)
Proceeds from issuance of employee stock options	15	
Proceeds from issuance of capital stock	40,250	1,500,000
Dividends on preferred stock	(339,800)	(715,334)

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Net cash (used)/provided by financing activities	(136,860)	10,536,012
Effects of exchange rate changes on cash	17,305	
Net increase (decrease) in cash and cash equivalents	1,205,282	(2,189,679)
Cash and cash equivalents at beginning of period	2,410,023	5,561,608
Cash and cash equivalents at end of period	\$ 3,615,305	\$ 3,371,929
Supplemental disclosure of non-cash investing and financing activities:		
Purchase of investment in affiliated company by exchanging notes receivable from affiliated company	\$	\$ 2,700,000

See accompanying notes to the consolidated financial statements

HearUSA, Inc
Notes to Consolidated Financial Statements
(unaudited)

The accompanying unaudited consolidated financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments, consisting of normal recurring accruals, considered necessary for a fair presentation, have been included. Operating results for the nine month period ended September 27, 2003 are not necessarily indicative of the results that may be expected for the year ending December 27, 2003. For further information, refer to the audited consolidated financial statements and footnotes thereto included in the Company's annual report on Form 10-K for the year ended December 28, 2002.

1. Summary of Significant Accounting Policies

Helix Transaction

On July 27, 2001, the Company and Helix Hearing Care of America Corp., a Canadian corporation (Helix), signed a definitive merger agreement, which was subsequently amended and restated as of November 6, 2001. Helix owned or managed, prior to the combination, 126 hearing healthcare clinics located in Massachusetts, New York, Ohio, Michigan, Wisconsin, Minnesota, Washington and Missouri as well as in the Provinces of Ontario and Quebec. The transaction was approved by the stockholders of both the Company and Helix on June 26, 2002 and by the Canadian courts on June 28, 2002. The transaction closed on July 11, 2002, and was effective June 30, 2002, the first day of the Company's third quarter of 2002, for financial reporting purposes.

As of September 27, 2003, 2,055,943 exchangeable shares of HEARx Canada, Inc., an indirect subsidiary of the Company, were issued or will be issued to certain former common shareholders of Helix in connection with the combination. Each exchangeable share of HEARx Canada, Inc. is exchangeable for one share of the Company's common stock. These exchangeable shares are traded on the Toronto Stock Exchange under the symbol HUX .

Discontinued Operations

On July 15, 2003, the Company sold 100% of the shares of the Company's three subsidiaries and selected assets associated with the management of the centers located in the Canadian Province of Quebec, to Forget & Sauve, Audioprothesistes, S.E.N.C. (Forget & Sauve) and 6068065 Canada Inc., private entities owned and controlled by Steve Forget, a former Helix officer and director. Mr. Forget served as an officer of HearUSA until October 2002 and as a director until May 2003. The sale agreement provided for total payments to the Company of approximately \$1.7 million, representing, in part, payment of pre-existing debt owed the Company by Forget & Sauve. The Company received an initial cash payment of \$700,000 at closing and will receive subsequent payments of approximately \$1 million through December 2003. At September 27, 2003, Forget and Sauve owed the Company approximately \$500,000. The payments are secured by the accounts receivable of Forget & Sauve and one of the three subsidiaries.

The three subsidiaries and selected assets have been presented as a discontinued operation and the consolidated financial statements have been reclassified to segregate the assets, liabilities and operating results of these subsidiaries for all periods presented. The assets of this operation are reported under the center segment. Assets and liabilities of discontinued operations were recorded at the lower of their carrying amount or fair value less the cost to sell. The sale resulted in a loss on disposal of approximately \$105,000. Net revenues of the discontinued operations for the three and six months ended June 28, 2003 were approximately \$1.4 million and \$2.6 million.

HearUSA, Inc
Notes to Consolidated Financial Statements
(unaudited)

Earnings Per Share

For purposes of computing net income per common share basic and diluted, for the nine months ended September 27, 2003, the weighted average number of shares of common stock outstanding includes the effect of the 2,055,943 exchangeable shares of HEARx Canada, Inc. described above, as if they were outstanding common stock of the Company on June 30, 2002, the effective date of the combination for financial reporting purposes. For computing net income per share diluted for the nine months ended September 27, 2003, 16,997,723 shares were included which represents the common stock equivalent for the outstanding convertible preferred stock of the Company.

Basis of Consolidation

The consolidated financial statements include the accounts of the Company and its wholly owned and majority controlled subsidiaries. Intercompany accounts and transactions have been eliminated in consolidation.

Investment in Affiliated Company

Prior to the closing of the combination with Helix, the Company owned approximately 10.5 percent of the common shares of Helix. The Company accounted for this investment using the equity method because the Company had the ability to exercise significant influence over the operational and financial policies of Helix as a result of the terms of the merger agreement with Helix and the use of certain proceeds of the Company's credit facility with Siemens Hearing Instruments, Inc. (Siemens) to repay certain debts of Helix. Under the equity method, the Company recorded its proportionate share of profits and losses of Helix based on the Company's percentage interest in Helix.

Comprehensive Income

Comprehensive income is defined to include all changes in equity except those resulting from investments by owners and distributions to owners. The Company's other comprehensive income represents a foreign currency translation adjustment.

Comprehensive income (loss) and the components of other comprehensive income are as follows:

	Nine Months Ended		Three Months Ended	
	September 27, 2003	September 28, 2002	September 27 2003	September 28, 2002
Comprehensive income (loss):				
Net income (loss) for period	\$ 741,923	\$(5,858,091)	\$(246,895)	\$(3,227,437)
Other comprehensive income:				
Foreign currency translation adjustments	(249,737)	485,999	(248,465)	456,264
Comprehensive income (loss) for the period	\$ 492,186	\$(5,372,092)	\$(495,360)	\$(2,771,173)

Reclassifications

Certain amounts in the 2002 consolidated financial statements have been reclassified in order to conform to the 2003 presentation.

HearUSA, Inc
Notes to Consolidated Financial Statements
(unaudited)

Segments

Since the closing of the Helix transaction, the Company operates in three business segments: the operation and management of centers; the establishment, maintenance and support of an affiliated network; and the operation of an e-commerce business . The Company s business units are located in the United States and Canada.

	<u>Centers</u>	<u>E-commerce</u>	<u>Network</u>	<u>Corporate</u>	<u>Total</u>
Net Revenues					
9 months ended 9/27/03	\$52,826,000	\$ 53,000	\$ 786,000	\$	\$53,665,000
9 months ended 9/28/02	40,216,000	16,000	322,000		40,554,000
Income (Loss) from Operations					
9 months ended 9/27/03	10,693,000	(38,000)	390,000	(8,509,000)	2,536,000
9 months ended 9/28/02	6,248,000	(13,000)	95,000	(10,248,000)	(3,918,000)
9 months ended 9/27/03					
Depreciation and amortization	1,623,000		3,000	709,000	2,335,000
Identifiable assets	43,977,000		1,702,000	16,788,000	62,467,000
Capital Expenditures	239,000			178,000	417,000
9 months ended 9/28/02					
Depreciation and amortization	1,166,000		1,000	610,000	1,777,000
Identifiable assets	48,335,000		964,000	16,786,000	66,085,000
Capital Expenditures	221,000			207,000	428,000

Income (Loss) from Operations at the segment level are computed before general and administrative expenses.

Stock-based compensation

The Company has granted stock options to employees and directors under stock option plans. The Company accounts for those grants using the intrinsic value method under Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees . Stock-based employee compensation cost reflected in net income (loss) is not significant, as all options granted under those plans had an exercise price greater than or equal to the market value of the underlying common stock on the date of grant. The following table illustrates the effect on net income (loss) and income (loss) per share if the Company had applied the fair value recognition provisions of SFAS No. 123, (SFAS 123) Accounting for Stock-Based Compensation , to stock-based employee compensation:

HearUSA, Inc
Notes to Consolidated Financial Statements
(unaudited)

	Nine Months Ended		Three Months Ended	
	Sept. 27, 2003	Sept. 28, 2002	Sept. 27, 2003	Sept. 28, 2002
Net income (loss) applicable to common stockholders	\$ 301,951	\$ (6,405,143)	\$ (389,442)	\$ (3,463,784)
Deduct: Total stock based employee Compensation expense determined under fair value based method for all awards	(312,000)	(300,000)	(134,000)	(102,000)
Pro Forma	\$ (10,049)	\$ (6,705,143)	\$ (523,442)	\$ (3,565,784)
Income (loss) per share - basic				
As reported	\$ 0.01	\$ (0.32)	\$ (0.01)	\$ (0.12)
Pro forma	\$ 0.00	\$ (0.34)	\$ (0.02)	\$ (0.12)
Income (loss) per share - diluted				
As reported	\$ 0.01	\$ (0.32)	\$ (0.01)	\$ (0.12)
Pro forma	\$ 0.00	\$ (0.34)	\$ (0.02)	\$ (0.12)

For purposes of the above disclosure, the determination of the fair value of stock options granted in 2003 and 2002 was based on the following: (i) a risk free interest rate of 2.15%, and 3.42% respectively; (ii) expected option lives ranging from 5 to 10 years; (iii) expected volatility in the market price of the Company's common stock of 93%, and 98% respectively; and (iv) no dividends on the underlying common stock.

2. Stockholders Equity

Conversion of Preferred Stock into Shares of Common Stock

During the nine months ended September 28, 2002, 214 shares of the 1998 Convertible Preferred Stock plus accrued dividends of approximately \$70,000 and an 8% premium of approximately \$17,000 were redeemed for cash of approximately \$351,000.

Common Stock

During the nine months ended September 27, 2003 no warrants were exercised; employee stock options for 20 shares of common stock were exercised.

Private Placement

On March 29, 2002, the Company closed on a private placement of 1.5 million shares of common stock and 1.5 million common stock purchase warrants for an aggregate sales price of \$1.5 million. The offers and sales were made only to accredited investors as defined in Rule 501(a) of Regulation D and the Company relied on Regulation D and Section 4(2) of the Securities Act of 1933 to issue the securities without registration. The warrants may be exercised at any time until March 29, 2005 to purchase shares of common stock for an exercise price of \$1.15 per share. The Company has undertaken to register the common stock for resale.

All members of the board of directors of the Company, as of March 29, 2002, participated in the private placement, purchasing 805,000 of the 1,500,000 shares of common stock. Because the shares were sold at a \$0.05 per share discount to the quoted market price of \$1.05 per share, additional compensation expense of approximately \$40,000 was incurred for the quarter ended March 30, 2002. The fair value of the warrants was not significant. Subsequent to the closing, the directors agreed with the Company to pay an additional \$0.05 per share such that each director's

HearUSA, Inc
Notes to Consolidated Financial Statements
(unaudited)

purchase would be at the then quoted market price of \$1.05 per share. These additional amounts were paid to the Company in June 2003.

1998 Convertible Preferred Stock

On August 27, 2003, the Company exchanged all 4,563 outstanding shares of its 1998 Convertible Preferred Stock for 4,563 shares of a newly designated convertible preferred stock, 1998 E Series Convertible Preferred Stock (1998 E Convertible Preferred Stock). All 1998 E Convertible Preferred Stock not converted or redeemed by December 18, 2006 must be redeemed by the Company on December 18, 2006. The 1998 E Convertible Preferred Stock is presented as Mandatorily Redeemable Convertible Preferred Stock in the accompanying consolidated balance sheet as of September 27, 2003. The old 1998 Convertible Preferred Stock was scheduled to convert by its terms into common stock on August 27, 2003. The Company has the right to redeem the newly designated preferred stock at its stated value plus accrued but unpaid premiums for sixteen months and thereafter until the maturity date at 108% of its stated value plus accrued but unpaid premiums.

As part of the transaction, the Company has agreed that accrued but unpaid premiums on the 1998 Convertible Preferred Stock and the newly designated preferred stock will be paid in cash each month beginning in November 2003 and continuing until December 2006. The holders have agreed that they will not convert the newly designated preferred stock into the Company's common stock prior to November 1, 2005, except in the event of a default in payment of premiums or unless on or after December 10, 2004 the price of the common stock reaches a trading price at or above \$3.00 per share and the holders sell at or above \$3.00 per share. If converted during the period from December 10, 2004 until November 1, 2005 based on the trading price reaching \$3.00 per share, the holders can convert only a number of shares of the newly designated preferred stock that would yield upon conversion no more than 744,911 shares of HearUSA common stock.

3. Investment in and Advances to Affiliated Company

On November 16, 2001, the Company loaned \$700,000 to Helix for use by Helix as part of the \$3.5 million acquisition by Helix of substantially all of the capital stock of Auxiliary Benefits Corporation, a Colorado corporation doing business as National Ear Care Plan (NECP). The note was secured by substantially all of the assets of NECP, bore interest at a rate of prime plus 1% (6% at December 29, 2001) per annum and originally matured on November 16, 2002. On January 10, 2002, the Company loaned to Helix an additional \$2 million to complete the NECP transaction. On January 14, 2002, the Company and Helix entered into a subscription agreement pursuant to which the Company purchased 4,853,932 common shares of Helix for an aggregate purchase price of \$2.7 million. The purchase price was paid using the \$2.7 million in loans to Helix. Upon consummation of the purchase of the 4,853,932 Helix common shares, the Company became an approximate 10.5 percent owner of Helix common shares. Prior to the closing of the combination with Helix, the Company accounted for this investment using the equity method. Approximately \$631,000 was recorded as equity in loss of affiliated company for the nine months ended September 28, 2002, representing the Company's equity in the net loss of Helix from the January 14, 2002 acquisition date to June 29, 2002.

HearUSA, Inc
Notes to Consolidated Financial Statements
(unaudited)

In connection with the combination with Helix, the fiscal year end of Helix for financial reporting purposes was changed from November 30 to the last Saturday in December to conform to the Company's fiscal year end. As a result, the following components of the Company's consolidated statements of operations for the three months ended March 30, 2002 and June 29, 2002 would be restated for the effect on the Company's equity in Helix's net loss.

	<u>Three Months Ended</u> March 30, 2002	<u>Three Months Ended</u> June 29, 2002
Equity in net loss of affiliated company,	\$ (61,405)	\$ (27,015)
Equity in net loss of affiliated company, as restated	\$ (72,086)	\$ (558,715)
Net loss applicable to common stockholders	\$ (1,552,804)	\$ (846,174)
Net loss applicable to common stockholders, as restated	\$ (1,563,485)	\$ (1,377,874)
Net loss per common share-basic and diluted	\$ (0.11)	\$ (0.05)
Net loss per common share-basic and diluted, as restated	\$ (0.11)	\$ (0.09)

4. Goodwill and Other Intangible Assets

At September 27, 2003 and December 28, 2002, the Company had goodwill of approximately \$32,400,000 and \$32,459,000. The Company acquired goodwill of approximately \$2,485,000 resulting from its purchase of 10.5% of Helix in January 2002, and approximately \$29,915,000 resulting from the Helix combination effective June 30, 2002. Approximately \$60,000 of goodwill associated with the Quebec operations (acquired as part of the Helix combination and disposed of on July 15, 2003 - see Note 1) was included in Other assets of discontinued operations in the accompanying consolidated balance sheet as of December 28, 2002. In addition, approximately \$7,200,000 of trademarks and tradenames, not subject to amortization, were acquired in the Helix combination.

As of September 27, 2003 and December 28, 2002, the gross carrying amount of the Company's intangible assets subject to amortization, which consist of patient files, was \$5,358,000 and \$6,115,000, respectively, and the accumulated amortization was approximately \$1,108,000 and \$748,000, respectively. The Company had a patient file intangible asset of approximately \$790,000 relating to the Quebec operations with a net carrying amount of approximately \$712,000 (see Note 1) which was included in Other assets of discontinued operations in the accompanying consolidated balance sheets as of December 28, 2002. The aggregate amortization expense for the Quebec patient file intangible for the six months ended June 28, 2003 was approximately \$42,000. For each of the nine months ended September 27, 2003 and September 28, 2002, the aggregate amortization expense for these assets was approximately \$412,000 and \$142,000, respectively. At September 27, 2003, the estimated amortization expense for the next five fiscal years is approximately: 2003 - \$127,000, 2004 - \$460,000, 2005 - \$448,000, 2006 - \$434,000, 2007 - \$418,000, and thereafter - \$2,363,000.

5. Recent Accounting Pronouncements

In December 2002, the FASB issued SFAS, No. 148, Accounting for Stock-Based Compensation - Transition and Disclosure. This statement amends SFAS 123, Accounting for Stock-Based Compensation, to provide alternative methods of transition for a voluntary change to the fair value

HearUSA, Inc
Notes to Consolidated Financial Statements
(unaudited)

based method of accounting for stock-based employee compensation. In addition, this statement amends the disclosure requirements of SFAS 123 to require prominent disclosures in both annual and interim financial statements about the method of accounting for stock-based accounting for employee compensation and the effect of the method used on reported results. SFAS 148 is generally effective for financial statements for fiscal years ending after December 15, 2002. The effect of the adoption of SFAS 148 on the Company's financial position and results of operations was not material as the Company continues to use the intrinsic value method.

In November 2002, the FASB issued FASB Interpretation No. 45, "Guarantors Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees and Indebtedness of Others" (FIN 45). FIN 45 elaborates on the disclosures that a guarantor should make in its interim and annual financial statements regarding its obligations relating to the issuance of certain guarantees. It also requires a guarantor to recognize, at the inception of a guarantee, a liability for the fair value of the obligation undertaken in issuing the guarantee. The initial recognition and measurement provisions of this interpretation are applicable on a prospective basis to guarantees issued or modified after December 31, 2002. The impact of adopting FIN 45 on the Company's financial position and results of operations was not material.

In January 2003, the FASB issued FIN 46, "Consolidation of Variable Interest Entities", which clarifies the application of Accounting Research Bulletin No. 51, "Consolidated Financial Statements", to certain entities in which equity investors do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support from other parties. FIN 46 is applicable immediately for variable interest entities created after January 31, 2003. For variable interest entities created prior to January 31, 2003, the provisions of FIN 46 are applicable no later than July 1, 2003. This Interpretation did not have a material effect on the Company's consolidated financial statements.

In May 2003, the FASB issued SFAS No. 150, "Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity". It is effective for financial instruments entered into or modified after May 31, 2003, and otherwise is effective at the beginning of the first interim period beginning after June 15, 2003. This Statement establishes standards for how an issuer classifies and measures certain financial instruments with characteristics of both liabilities and equity. It requires that an issuer classify a financial instrument that is within its scope as a liability (or an asset in some circumstances). Many of those instruments were previously classified as equity. This Statement did not have a material effect the Company's consolidated results of operations or financial position.

6. Liquidity

As of September 27, 2003, the Company has an excess of current liabilities over current assets of approximately \$5.8 million. For the nine months ended September 27, 2003, the Company generated income from continuing operations of approximately \$943,459. The Company is dependent upon generating sufficient cash flow from operations or financings to repay its liabilities. Additionally, the Company's supply agreement with Siemens requires full payment for hearing aids purchased from Siemens within 60 days, from statement date. As of September 27, 2003, the Company was in compliance with those payment provisions See Note 7 below.. On October 3, 2003, the Company paid Siemens approximately \$2.8 million and is now current on its supply agreement payment obligation. Upon noncompliance, Siemens may declare the Company to be in default of the supply agreement by written notification, which, if not cured within 60 days of the date of written notification, would be an event of default under the Company's \$51,875,000 secured credit facility with Siemens and Siemens would have the right to declare all amounts outstanding under the credit facility immediately due and payable. Any non-compliance with the supply agreement could have a material adverse effect on the Company's financial condition and continued operations.

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The Company believes that current cash, cash equivalents and revenues from operations, at current net revenue levels, will be sufficient to support the Company's operational needs through the next twelve months, although there can be no assurance that the Company can maintain compliance with Siemens' loan covenants, that net revenue levels will remain at or higher than current levels or that unexpected cash needs will not arise for which cash, cash equivalents and revenues from operations will be sufficient. Cash flow for the final quarter of 2003 is expected to be impacted by the approximate \$700,000 payment of accrued dividends the Company must make to holders of the 1998-E Series Convertible Preferred Stock in late November and certain tax and other annual payments due in December. The Company is considering various financing options to address the current shortfall in working capital and to repay the \$2 million notes payable. See Note 7 below. The Company might consider short term debt, or additional equity or debt offerings. There can be no assurance, however, that such financing will be available to the Company on favorable terms or at all. The Company also is continuing its aggressive cost controls and gross margin improvements.

7. Subsequent Event

On October 3, 2003, the Company completed a private placement of \$2 million in unsecured notes payable and common stock purchase warrants with a number of investors, including three members of the Company's board of directors. The non-participating directors approved the transaction. The notes bear interest at a rate of 15 percent for the first six months and 18 percent for the second six months with principal and unpaid interest due on maturity of October 1, 2004. The financing included seven-year warrants, which cannot be exercised during the first two years, to purchase a total of 800,000 shares of the Company's common stock. The outside lenders' warrants have an exercise price of \$1.25 per share while the participating directors' warrants have an exercise price of \$1.31 per share, the quoted closing price of the common stock on the day of the financing. Proceeds from the financing were used to raise additional cash to pay Siemens under the supply agreement. If not repaid at the end of the one-year term, the notes and unpaid interest will convert into shares of the Company's common stock at a rate of \$0.75 per share, and the holders will be entitled to an aggregate of 800,000 additional common stock purchase warrants.

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

On July 11, 2002, the Company completed its acquisition of Helix Hearing Care of America Corp., a Canadian corporation (Helix). Helix owned or managed, prior to the combination, 126 hearing healthcare clinics located in Massachusetts, New York, Ohio, Michigan, Wisconsin, Minnesota, Washington and Missouri as well as in the Provinces of Ontario and Quebec. The transaction was effective June 30, 2002 for financial reporting purposes. In connection with the completion of the business combination, on July 8, 2002 the Company changed its name from HEARx Ltd. to HearUSA, Inc. and increased its authorized capital. The Company's common stock continues to trade on the American Stock Exchange under the symbol EAR . The exchangeable shares of HEARx Canada, Inc., the Company's Canadian subsidiary, trade on the Toronto Stock Exchange under the symbol HUX .

The Company's current network consists of 158 company-owned centers in 11 states and one Canadian province and approximately 1400 affiliated providers in 49 states. The Company intends, as its long-term goal, to establish a nationwide network of affiliated providers and company-owned hearing care centers.

RESULTS OF OPERATIONS

For the three months ended September 27, 2003 compared to the three months ended September 28, 2002

On July 15, 2003, the Company sold 100% of the shares of the Company's three subsidiaries and selected assets associated with the management of the centers located in the Canadian Province of Quebec. The results of the Quebec operations have been excluded from results of operations and are classified as discontinued operations in the accompanying financial statements.

Net revenues for the quarter ended September 27, 2003 increased \$1,393,956, or 8.8%, to \$17,276,558 from \$15,882,602 in the comparable quarter of 2002. This increase is primarily the result of more hearing aids being sold for the quarter ended September 27, 2003 than during the comparable quarter of 2002, offset by a decrease in the average unit selling price.

Cost of products sold decreased \$355,068, or 7.0%, to \$4,745,705 in the quarter ended September 27, 2003 from \$5,100,773 in the comparable quarter of 2002. This decrease is primarily the result of improved product pricing the Company received as a result of the former Helix centers selling more Siemens' products for the quarter ended September 27, 2003 than the comparable quarter of 2002. The cost of products sold as a percent of net revenues was 27.5% and 32.1% for the third quarter of 2003 and 2002, respectively. Included in the cost of product sold are preferred pricing discounts of approximately \$982,000 and \$814,000 for the quarters ended September 2003 and 2002, respectively. Such pricing reductions from Siemens are accounted for as reductions of cost of products sold for financial reporting purposes.

Center operating expenses decreased \$461,965, or 4.9%, to \$8,927,598 in the quarter ended September 27, 2003 from \$9,389,563 in the comparable quarter of 2002. This decrease is attributable to the cost reduction program the Company first implemented in May 2001. The Company has continued to reduce its marketing programs costs, reducing center advertising expense to \$1,132,236, or 6.6% of revenue in the quarter ended September 27, 2003, down from \$1,354,381, or 8.5% in the comparable quarter of 2002. Also, center wages expense decreased \$265,598 or 5.9%, to \$4,229,076 in the quarter ended September 27, 2003 from \$4,494,674 from the comparable quarter of 2002, which was offset by an increase in bad debt expense of \$318,462 relating to old insurance receivables deemed uncollectible.

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General and administrative expenses decreased \$446,838, or 14.4%, to \$2,657,870 in the quarter ended September 27, 2003 from \$3,104,708 in the comparable quarter of 2002. This decrease is primarily the result of the sale of the Quebec operation, which allowed the Company to eliminate the Montreal corporate office and consolidate those functions in West Palm Beach, Florida. In the comparable quarter of 2002, the Company had an approximately \$140,000 loss on the disposal of fixed assets for a closed location.

Depreciation and amortization expense decreased \$36,422, or 4.9%, to \$700,011 in the quarter ended September 27, 2003 from \$736,433 in the comparable period of 2002. This decrease is primarily the result of certain equipment becoming fully depreciated during 2003.

Interest income decreased \$9,633, or 67.0%, to \$4,740 in the quarter ending September 27, 2003 from \$14,373 in the comparable quarter of 2002. This decrease is primarily attributable to the decline in the average daily balance of cash and investments. Interest expense decreased \$79,221 to \$493,179 in the quarter ended September 27, 2003 from \$572,400 in the comparable quarter of 2002. This decrease is attributable to approximately \$258,000 less interest expense in Ontario offset by an increase of approximately \$90,000 in interest on the credit facility with Siemens due to issuance of Tranche E in March 2003.

For the nine months ended September 27, 2003 compared to the nine months ended September 28, 2002

On July 15, 2003, the Company sold 100% of the shares of the Company's three subsidiaries and selected assets associated with the management of the centers located in the Canadian Province of Quebec. The results of the Quebec operations have been excluded from results of operations and are classified as discontinued operations in the accompanying financial statements.

Net revenues increased \$13,111,014, or 32.3%, to \$53,664,664 for the nine months ended September 27, 2003 from \$40,553,650 in the comparable period of 2002. The increase in revenues is principally from the revenues of the centers acquired in the Helix acquisition of July 2002 of approximately \$10,900,000 for the first six months of 2003, which was not included in the first six months of 2002. In addition the Company sold more hearing aids in the nine months ended September 27, 2003 than the comparable period of 2002, which was offset by a decrease in the average unit selling price.

Cost of products sold increased \$3,410,859, or 28.9%, to \$15,202,201 in the nine months ended September 27, 2003 from \$11,791,342 in the comparable period of 2002. The increase is the direct result of inclusion of cost of products sold at the former Helix centers of approximately \$3,029,000 for the first six months of 2003, which was not included in the comparable period of 2002. In addition, HearUSA's cost of products sold increased approximately \$382,000. This increase is primarily the result of increase in revenues offset by a reduction resulting from improved product pricing the Company received as a result of the former Helix centers selling more Siemens' products during the third quarter of 2003 as compared to the same period in 2002. Included in the cost of products sold are preferred pricing reductions of approximately \$2,978,000 and \$2,490,000 for the nine months ended September 27, 2003 and September 28, 2002, respectively. Such pricing reductions from Siemens are accounted for as reductions of cost of products sold for financial reporting purposes. The cost of products sold as a percent of net revenues was 28.3% and 29.1% for the nine months ended September 2003 and 2002, respectively.

Center operating expenses increased \$3,128,973, or 13.6%, to \$26,062,405 in the nine months ended September 27, 2003 from \$22,933,432 in the comparable period of 2002. This increase is related to inclusion of operating expenses for the former Helix centers of approximately \$5,116,000 for the first six months of 2003, which were not included in the comparable period of 2002. HearUSA's center operating expenses, excluding the former Helix centers, decreased approximately \$1,927,000 for the nine months ended September 27, 2003. This decrease is attributable to the cost reduction program the Company first implemented in May 2001. The Company continued to reduce its marketing programs, reducing center advertising expense to

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\$2,763,300, or 7.4% of revenue, excluding the former Helix centers, in the nine months ended September 27, 2003, down from \$4,047,500, or 11.6% in the comparable period of 2002. In addition, center wages expense and regional office costs also decreased \$322,543 or 3.4%, and \$352,991 or 27.9%, respectively, to \$9,298,656 and \$913,636, respectively, in the nine months ended September 27, 2003 from \$9,621,199 and \$1,266,627, respectively, from the comparable period of 2002.

General and administrative expenses decreased \$439,565, or 5.5%, to \$7,529,998 in the nine months ended September 27, 2003 from \$7,969,563 in the comparable period of 2002. This decrease is attributable to less expense of approximately \$270,000 from the elimination of the Montreal corporate office at the beginning of the third quarter of 2003 following the divestiture of the Quebec subsidiaries. In addition, the Company reduced its marketing programs, reducing corporate advertising \$119,068 to \$185,204 in the nine months ended September 27, 2003 compared with \$304,272 in the comparable period of 2002.

Depreciation and amortization expense increased \$557,417, or 31.4%, to \$2,334,585 in the nine months ended September 27, 2003 from \$1,777,168 in the comparable period of 2002. This increase is related to the former Helix's depreciation and amortization expense of approximately \$331,000 for the first six months of 2003, which was not included in the comparable period of 2002 and approximately \$234,000 of additional amortization of certain intangible assets acquired in the combination.

Interest income decreased \$90,424, or 84.4%, to \$16,701 in the nine months ended September 27, 2003 from \$107,125 in the comparable period of 2002. This decrease is primarily attributable to the decline in the average daily balance of cash and investments. Interest expense increased \$412,692 to \$1,608,717 in the nine months ended September 27, 2003 from \$1,196,025 in the comparable period of 2002. This increase is attributable to the former Helix's interest expense of \$310,000 for the first six months of 2003, which was not included in the comparable period of 2002 and approximately \$197,000 in interest on the credit facility with Siemens due to the issuance of Tranche E in March 2003.

LIQUIDITY AND CAPITAL RESOURCES

During the first nine months of 2003, working capital increased \$4,454,871 to a negative \$5,776,501 as of September 27, 2003 from a negative \$10,231,372 as of December 28, 2002. This is a direct result of the additional \$3.5 million financing the Company received from Siemens in March 2003 and the income generated by the Company. The working capital of negative \$5,776,501 includes approximately \$2.9 million which represents the current portion of the long-term debt to Siemens, which may be repaid through preferred pricing reductions.

On December 7, 2001, the Company obtained a secured credit facility from Siemens comprised of (a) a \$10,875,000 secured five-year term loan credit facility (the Tranche A Loan); (b) a \$25,000,000 secured five-year revolving loan credit facility (the Tranche B Loan); (c) a \$3,000,000 secured five-year term loan facility (the Tranche C Loan) and (d) a \$13,000,000 secured five-year term loan credit facility (the Tranche D Loan). On March 14, 2003, the Company obtained an additional \$3,500,000 secured five-year term loan from Siemens bearing interest at a rate of 10% annually (the Tranche E Loan). Tranche E Loan was obtained pursuant to an amendment to the Company's credit agreement with Siemens and is otherwise subject to the terms and conditions of the credit agreement and related security agreement. At September 27, 2003 \$6,475,000, \$89,167, \$2,250,000, \$13,000,000 and \$3,500,000, representing principal on the Tranche A, Tranche B, Tranche C, Tranche D, and Tranche E Loans, respectively, were outstanding. As of September 27, 2003, approximately \$24,900,000 is available to the Company for acquisitions under Tranche B of the credit facility.

The Siemens credit facility imposes certain financial and other covenants on the Company, which are customary for loans of this size and nature including restrictions on the conduct of the Company's business, the occurrence of indebtedness, merger or sale of assets, the modification of material agreements, changes in capital structure, making certain payments and paying dividends.

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If the Company cannot maintain compliance with these covenants, Siemens may terminate future funding under the credit facility and declare all then outstanding amounts under the facility immediately due and payable.

The Tranche A, B and C Loans are payable quarterly over five years with the outstanding principal and interest at 10%, due and payable on the final maturity date. Principal and interest, at the prime rate (as defined) plus 1%, on the Tranche D Loan is payable on the final maturity date. The Company is required to make monthly payments of interest only on the Tranche E Loan in the first year. In years two through five, the Company must make monthly principal and interest payments. Quarterly principal and interest payments on the Tranche A, B and C Loans may be paid through preferred pricing reductions received from Siemens by HearUSA as long as the Company purchases certain minimum percentages of its requirements of hearing aids from Siemens. The Company is also required to make additional payments on the Tranche D Loan under the following conditions. The Company must make a payment equal to 25% of net proceeds it receives from the issuance of stock or stock equivalents. In addition, within 120 days of any fiscal year end, the Company must make a payment equal to 20% of Excess Cash Flow (as defined in the credit agreement) for such fiscal year end.

As of September 27, 2003, the Company has an excess of current liabilities over current assets of approximately \$5.8 million. For the nine months ended September 27, 2003 the Company generated income from continuing operations of \$943,459. The Company is dependent upon generating sufficient cash flow from operations or financings to repay its liabilities. Cash on hand as of September 27, 2003 was approximately \$3.6 million, of which approximately \$1.0 million was used for the October 3, 2003 payment of approximately \$2.8 million to Siemens under the supply agreement. The Company's supply agreement with Siemens requires full payment for hearing aids purchased from Siemens within 60 days from statement date. As of September 27, 2003, the Company was in compliance with those payment provisions and upon the October 3, 2003 payment is now current. Upon noncompliance, Siemens may declare the Company to be in default of the supply agreement by written notification, which, if not cured within 60 days of the date of written notification, would be an event of default under the Company's credit facility with Siemens and Siemens would have the right to declare all amounts outstanding under the credit facility immediately due and payable. Any non-compliance with the supply agreement could have a material adverse effect on the Company's financial condition and continued operations.

On October 3, 2003, the Company completed a private placement of \$2 million in unsecured notes payable and common stock purchase warrants with a number of investors including three members of the Company's board of directors. The notes bear interest at a rate of 15 percent for the first six months and 18 percent for the second six months with principal and unpaid interest due on maturity of October 1, 2004. The financing included seven-year warrants, which cannot be exercised during the first two years, to purchase a total of 800,000 shares of the Company's common stock. The outside lenders' warrants have an exercise price of \$1.25 per share while the participating directors' warrants have an exercise price of \$1.31 per share, the quoted closing price of the common stock on the day of the financing. The financing was completed to raise additional cash to pay Siemens under the supply agreement. If not repaid at the end of the one-year term, the notes and unpaid interest would convert into shares of the Company's common stock at a rate of \$0.75 per share, and the holders will be entitled to an aggregate of 800,000 additional common stock purchase warrants.

The Company believes that current cash, cash equivalents and revenues from operations, at current net revenue levels, will be sufficient to support the Company's operational needs through the next twelve months, although there can be no assurance that the Company can maintain compliance with the Siemens loan covenants, that net revenue levels will remain at or higher than current levels or that unexpected cash needs will not arise for which the cash, cash equivalents and revenues from operations will be sufficient. Cash flows for the final quarter of 2003 are expected to be impacted by the approximate \$700,000 payment of accrued dividends the Company must make to the holders of the 1998-E Series Convertible Preferred Stock in late November and certain tax

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and other annual payments due in December. The Company is considering various financing options to address the current shortfall in working capital and to repay the \$2 million notes payable. The Company might consider short term debt, or additional equity or debt offerings. There can be no assurance however, that such financing will be available to the Company on favorable terms or at all. The Company also is continuing its aggressive cost controls and gross margin improvements.

Below is a chart setting forth the Company's contractual cash payment obligations which have been aggregated to facilitate a basic understanding of the Company's liquidity as of September 27, 2003:

Contractual Obligations	Total	Payments Due by Period			
		Less than 1 Year	1 3 Years	4 5 Years	After 5 Years
Long-Term Debt	\$27,771,000	\$4,245,000	\$ 7,467,000	\$16,059,000	\$
Operating Leases	13,098,000	4,967,000	7,227,000	753,000	151,000
Total Contractual Cash Obligations	\$40,869,000	\$9,212,000	\$14,694,000	\$16,812,000	\$151,000

Net cash used by operating activities decreased from \$344,774 in the first nine months of 2002 to cash being provided by operating activities of \$383,445 in the first nine months of 2003. The decrease in net cash used by operating activities was primarily the result of a decrease in net loss between periods of approximately \$6,800,000, offset by a net increase in the change in accounts receivable, inventories and prepaid expenses of approximately \$1,582,000 and a decrease in the change in accounts payable and accrued expenses of the periods of approximately \$4,285,000 and cash used by discontinued operations of approximately \$372,000.

Net cash used by investing activities decreased from \$12,380,917 in the first nine months of 2002, to cash being provided by investing activities of \$941,392 in the first nine months of 2003. Cash used to purchase a common stock investment in Helix prior to the combination totaled approximately \$2,000,000 in January 2002. Cash used to fund a note receivable and advances to Helix prior to the merger as of June 30, 2002 totaled approximately \$9,547,000, less cash acquired in the combination with Helix of approximately \$1,162,803. Costs incurred for the Helix acquisition during the first nine months of 2002 were approximately \$1,569,000. During the first nine months of 2003, the Company received approximately \$1,165,000 of proceeds from the sale of discontinued operations.

Net cash provided by financing activities decreased from \$10,536,012 in the first nine months of 2002 to cash used in financing activities of \$136,860 in the first nine months of 2003. This decrease is primarily the result of the net proceeds of \$3,500,000 from the Siemens Tranche E Loan in 2003, offset by approximately \$2,189,000 in repayments under the Siemens Tranche A, Tranche B and Tranche C loans, compared to net proceeds of \$12,625,000 from the Siemens Tranche D Loan and \$1,500,000 from the 2002 private placement of common stock.

CRITICAL ACCOUNTING POLICIES

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions in certain circumstances that affect amounts reported in the accompanying consolidated financial statements and related footnotes. In preparing these financial statements, management has made its best estimates of certain amounts included in the financial statements. On an ongoing basis, management evaluates these estimates, including those related to allowances for doubtful accounts receivable and sales returns. Management bases these estimates on historical

experience and on various other assumptions that are believed to be reasonable under the circumstances. These estimates form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Management believes the following critical accounting policies affect the significant judgments and estimates used in the preparation of the financial statements. Application of these accounting policies involves the exercise of judgment and use of assumptions as to future uncertainties and, as a result, actual results could differ from these estimates.

Goodwill and Intangible Assets:

The majority of the Company's goodwill and other intangible assets resulted from the combination with Helix. On at least an annual basis, the Company is required to assess whether its goodwill is impaired. In order to do this, management applied judgment in determining its reporting units, which represent distinct parts of the Company's business. The definition of the Company's reporting units affects the Company's goodwill impairment assessments. The Company's annual goodwill impairment assessment involves estimating the fair value of a reporting unit and comparing it with its carrying amount. If the carrying value of the reporting unit exceeds its fair value, additional steps are required to calculate a potential impairment loss. Calculating the fair value of the reporting units requires significant estimates and long-term assumptions. Any changes in key assumptions about the business and its prospects, or changes in market conditions, interest rates or other externalities, could result in an impairment charge. The Company estimates the fair value of its reporting units by applying a weighted average of three methods: quoted market price, external transactions, and discounted cash flow.

Revenue Recognition

HearUSA recognizes revenues from the sale of audiological products at the time of delivery and revenues from hearing care services at the time those services are performed.

The Company has capitation contracts with certain health care organizations under which the Company is paid an amount for each enrollee of the health maintenance organization to provide to the enrollee a once every three years discount on certain hearing products and services. The amount paid to the Company by the healthcare organization is calculated on a per-capita basis and is referred to as capitation revenue. The Company defers recognition of capitation revenue until the earlier of the actual utilization by the member populations of the benefit, or the end of the contract term.

Sales returns

The Company provides to all patients purchasing hearing aids a specific return period of at least 30 days if the patient is dissatisfied with the product. The Company provides an allowance in accrued expenses for returns. The return period can be extended to 60 days if the patient attends the Company's H.E.L.P. (Hearing Educational Listening Program) program.

RECENT ACCOUNTING PRONOUNCEMENTS

In December 2002, the FASB issued SFAS, No. 148, Accounting for Stock-Based Compensation Transition and Disclosure. This statement amends SFAS 123, Accounting for Stock-Based Compensation, to provide alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. In addition, this statement amends the disclosure requirements of SFAS 123 to require prominent disclosures in both annual and interim financial statements about the method of accounting for stock-based accounting for employee compensation and the effect of the method used on reported results. SFAS 148 is generally effective for financial statements for fiscal years ending after December 15, 2002. The effect of the adoption of SFAS 148 on the Company's financial position and results of operations was not material as the Company continues to use the intrinsic value method.

In November 2002, the FASB issued FASB Interpretation No. 45, *Guarantors Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees and Indebtedness of Others* (FIN 45). FIN 45 elaborates on the disclosures that a guarantor should make in its interim and annual financial statements regarding its obligations relating to the issuance of certain guarantees. It also requires a guarantor to recognize, at the inception of a guarantee, a liability for the fair value of the obligation undertaken in issuing the guarantee. The initial recognition and measurement provisions of this interpretation are applicable on a prospective basis to guarantees issued or modified after December 31, 2002. The impact of adopting FIN 45 on the Company's financial position and results of operations was not material.

In January 2003, the FASB issued FIN 46, *Consolidation of Variable Interest Entities*, which clarifies the application of Accounting Research Bulletin No. 51, *Consolidated Financial Statements*, to certain entities in which equity investors do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support from other parties. FIN 46 is applicable immediately for variable interest entities created after January 31, 2003. For variable interest entities created prior to January 31, 2003, the provisions of FIN 46 are applicable no later than July 1, 2003. This Interpretation did not have a material effect on the consolidated financial statements of the Company.

In May 2003, the FASB issued SFAS No. 150, *Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity*. It is effective for financial instruments entered into or modified after May 31, 2003, and otherwise is effective at the beginning of the first interim period beginning after June 15, 2003. This Statement establishes standards for how an issuer classifies and measures certain financial instruments with characteristics of both liabilities and equity. It requires that an issuer classify a financial instrument that is within its scope as a liability (or an asset in some circumstances). Many of those instruments were previously classified as equity. This Statement did not have a material effect on its consolidated results of operations or financial position.

Except for historical information provided in this discussion and analysis, the discussion includes forward looking statements, including statements funds available under, current cash, cash equivalents and revenues from operations being sufficient to support the Company's operational needs; and the impact on cashflow of certain payments in the fourth quarter of 2003. Such statements involve certain risks and uncertainties that could cause actual results to differ materially from those in the forward-looking statements. Potential risks and uncertainties include market demand for the company's product; the ability to reduce operating costs, general economic and industry conditions, especially those affecting managed health care; actions by competitors, customers and suppliers, the impact of competitive products and technological changes; and unforeseen cash requirements.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

The Company does not engage in derivative transactions or issue variable rate debt. The Company is exposed to foreign currency exchange rates as a result of its combination with Helix, and the Company is not hedging that exposure. Differences in the fair value of investment securities are not material, therefore the related market risk is not significant. The Company's exposure to market risk for changes in interest rates relates primarily to the Company's long-term debt. The following table presents the Company's financial instruments for which fair value is subject to changing market interest rates:

	Long-Term Debt				
	Variable Rate	Fixed Rate			
	Prime rate + 1% note due April 2007	10% notes due 2008	10% notes due 2007	10% note due Dec 1, 2006	Other notes
As of September 27, 2003 Estimated cash inflow (outflow) by fiscal year of principal maturity					
2003	\$ (248,000)	\$	\$ (154,000)	\$ (575,000)	\$ (276,000)
2004		(555,000)	(616,000)	(2,300,000)	(689,000)
2005		(807,000)	(613,000)	(2,300,000)	(359,000)
2006		(892,000)	(610,000)	(1,300,000)	(53,000)
2007	\$ (13,777,000)	(985,000)	(346,000)		(54,000)
2008		(261,000)			
Total	\$ (14,025,000)	\$ (3,500,000)	\$ (2,339,000)	\$ (6,475,000)	\$ (1,432,000)
Estimated fair value	\$ (14,025,000)	\$ (3,500,000)	\$ (2,339,000)	\$ (6,475,000)	\$ (1,432,000)
Carrying value	\$ (13,497,000)	\$ (3,500,000)	\$ (2,339,000)	\$ (6,475,000)	\$ (1,432,000)

Item 4. Controls and Procedures

- a. The Company evaluated the effectiveness of its disclosure controls and procedures pursuant to Exchange Act rules. Based upon that evaluation, the Company's Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures are effective, as of the end of the period covered by this report, in timely alerting them to material information relating to the Company required to be included in its periodic SEC filings.
- b. There have been no material changes in the Company's internal control over financial reporting or in other factors that could significantly affect the Company's internal control over financial reporting subsequent to the date of the evaluation referenced above.

Part II Other Information

Item 2. Changes in Securities and Use of Proceeds

1998 Convertible Preferred Stock

On August 27, 2003, the Company exchanged all 4,563 outstanding shares of its 1998 Convertible Preferred Stock for 4,563 shares of a newly designated convertible preferred stock, 1998 E Series Convertible Preferred Stock ("1998 E Convertible Preferred Stock"). All 1998-E Convertible Preferred Stock not converted or redeemed by December 18, 2006 must be redeemed by the Company on December 18, 2006. The old 1998 Convertible Preferred Stock was scheduled to convert by its terms into common stock on August 27, 2003. The Company has the right to redeem the newly designated preferred stock at its stated value plus accrued but unpaid premiums for sixteen months and thereafter until the maturity date at 108% of its stated value plus accrued but unpaid premiums. The Company relied on Section 4(2) as the exemption for registration requirements of the Securities Act of 1933. The transaction qualified as a private placement to accredited investors.

As part of the transaction, the Company has agreed that accrued but unpaid premiums on the 1998 Convertible Preferred Stock and the newly designated preferred stock will be paid in cash each month beginning in November 2003 and continuing until December 2006. The holders have agreed that they will not convert the newly designated preferred stock into the Company's common stock prior to November 1, 2005, except in the event of a default in payment of premiums or unless on or after December 10, 2004 the price of the common stock reaches a trading price at or above \$3.00 per share and the holders sell at or above \$3.00 per share. If converted during the period from December 10, 2004 until November 1, 2005 based on the trading price reaching \$3.00 per share, the holders can convert only a number of _____ shares of the newly designated preferred stock that would yield upon conversion no more than 744,911 shares of HearUSA common stock.

Private Placement

On October 3, 2003, the Company completed a private placement of \$2 million in unsecured notes payable and common stock purchase warrants with a number of investors including, three members of the Company's board of directors. The notes bear interest at a rate of 15 percent for the first six months and 18 percent for the second six months with principal and unpaid interest due on maturity of October 1, 2004. The financing also included seven-year warrants, which cannot be exercised during the first two years, to purchase a total of 800,000 shares of the Company's common stock. The outside lenders' warrants have an exercise price of \$1.25 per share while the participating directors' warrants have an exercise price of \$1.31 per share, the quoted closing price of the common stock on the day of the financing. Proceeds from the financing were used to raise additional cash to pay Siemens under the supply agreement. If not repaid at the end of the one-year term, the notes and unpaid interest would convert into shares of the Company's common stock at a rate of \$0.75 per share, and the holders will be entitled to an aggregate of 800,000 additional common stock purchase warrants.

Item 6. Exhibits and Reports on Form 8-K

- (a) Exhibits:
- 2.1 The Amended and Restated Merger Agreement, dated November 6, 2001, between HEARx and Helix Hearing Care of America Corp. (incorporated herein by reference as Exhibit 2.1 to the Company's Joint Proxy Statement/Prospectus on Form S-4 (Reg. No. 333-73022)).
- 2.2 Interim Order issued by the Superior Court of Quebec and Notice of

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- Application (incorporated herein by reference as Exhibit 2.2 to the Company's Joint Proxy Statement/Prospectus Form S-4 (Reg. No. 333-73022)).
- 2.3 Plan of Arrangement, including exchangeable share provisions (incorporated herein by reference as Exhibit 2.3 to the Company's Joint Proxy Statement/Prospectus on Form S-4 (Reg. No. 333-73022))
- 3.1 Restated Certificate of Incorporation of HEARx Ltd., including certain certificates of designations, preferences and rights of certain preferred stock of the Company (incorporated herein by reference as Exhibit 3 to the Company's Current Report on Form 8-K, filed May 17, 1996 (File No. 001-11655)).
- 3.2 Amendment to the Restated Certificate of Incorporation (incorporated herein by reference as Exhibit 3.1A to the Company's Quarterly Report on Form 10-Q for the period ended June 28, 1996 (File No. 001-11655)).
- 3.3 Amendment to Restated Certificate of Incorporation including one for ten reverse stock split and reduction of authorized shares (incorporated herein as Exhibit 3.5 to the Company's Quarterly Report on Form 10-Q for the period ending July 2, 1999 (File No. 001-11655)).
- 3.4 Amendment to Restated Certificate of Incorporation including an increase in authorized shares and change of name (incorporated herein by reference as Exhibit 3.1 to the Company's Current Report on Form 8-K, filed July 17, 2002 (File No. 001-11655)).
- 3.5 Certificate of Designations, Preferences and Rights of the Company's 1998 Convertible Preferred Stock (incorporated herein by reference as Exhibit 3 to the Company's Current Report on Form 8-K, filed August 27, 1998 (File No. 001-11655)).
- 3.6 Certificate of Designations, Preferences and Rights of the Company's 1999 Series H Junior Participating Preferred Stock (incorporated herein by reference as Exhibit 4 to the Company's Current Report on Form 8-K, filed December 17, 1999 (File No. 001-11655)).
- 3.7 Certificate of Designations, Preferences and Rights of the Company's Special Voting Preferred Stock (incorporated herein by reference as Exhibit 3.2 to the Company's Current Report on Form 8-K, filed July 19, 2002 (File No. 001-11655)).
- 3.8 Amendment to Certificate of Designations, Preferences and Rights of the Company's 1999 Series H Junior Participating Preferred Stock (incorporated herein by reference as Exhibit 4 to the Company's Current Report on Form 8-K, filed July 17, 2002 (File No. 001-11655)).
- 3.9 Amendment to Certificate of Designations, Preferences and Rights of the Company's 1998-E Series Convertible Preferred Stock (incorporated herein by reference as Exhibit 4.1 to the Company's Current Report on Form 8-K, filed August 26, 2003 (File No. 001-11655)).
- 3.10 Amended and Restated By-Laws of HearUSA, Inc. (incorporated by reference as Exhibit 3.9 to the Company's Annual Report on Form 10-K)

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for the period ended December 28, 2002 (File No. 001-11655)).

- 4.1 Form of Placement Agent Warrant (to purchase up to 1,125,000 shares of Common Stock at an exercise price equal to \$1.80 per share) (incorporated herein by reference as Exhibit 4.3 to the Company's Current Report on Form 8-K, filed August 27, 1998 (Registration No. 001-11655)).
- 4.2 Form of Placement Agent Warrant (to purchase up to 203,390 shares of Common Stock at an exercise price equal to \$4.46 per share) (incorporated herein by reference as Exhibit 4.3 to the Company's Current Report on Form 8-K, filed May 9, 2000 (Registration No. 001-11655)).
- 4.3 Exchange and Redemption Agreement, dated as of December 4, 2001, by and between HEARx Ltd. and Advantage Fund II Ltd. (incorporated herein by reference as Exhibit 10.1 to the Company's Current Report on Form 8-K, filed December 26, 2001 (Registration No. 001-11655)).
- 4.4 Amended and Restated Rights Agreement, dated July 11, 2002 between HEARx Ltd. and the Rights Agent, which includes an amendment to the Certificate of Designations, Preferences and Rights of the Company's 1999 Series H Junior Participating Preferred Stock (incorporated herein by reference as Exhibit 4.9.1 to the Company's Joint Proxy/Prospectus on Form S-4 (Reg. No. 333-73022)).
- 4.5 Form of Support Agreement among HEARx Ltd., HEARx Canada, Inc. and HEARx Acquisition ULC (incorporated herein by reference as Exhibit 99.3 to the Company's Joint Proxy Statement/Prospectus on Form S-4 (Reg No. 333-73022)).
- 10.1 Amendment to Credit Agreement, dated March 12, 2003 between HearUSA, Inc. and Siemens Hearing Instruments, Inc. (incorporated herein by reference as Exhibit 10.1 to the Company's Form 10Q for the period ended March 29, 2003.)
- 10.2 Amendment to Security Agreement, dated March 12, 2003 between HearUSA, Inc. and Siemens Hearing Instruments, Inc. (incorporated herein by reference as Exhibit 10.2 to the Company's Form 10Q for the period ended March 29, 2003.)
- 10.3 Exchange Agreement, dated August 26, 2003 between HearUSA, Inc., Zanett Lombardier Master Fund, LLC and The San Miguel Trust (incorporated herein by reference as Exhibit 10.1 to the Company's Form 8-K, filed August 26, 2003 (File No. 001-11655)).
- 31.1 CEO Certification, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2 CFO Certification, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32 CEO and CFO Certification, pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

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(b) Reports on Form 8-K:

An Item 5 and 7 current report on Form 8-K, dated July 15, 2003, was filed with the Securities and Exchange Commission on July 24, 2003.

An Item 7 and 12 current report on Form 8-K, dated August 5, 2003, was filed with the Securities and Exchange Commission on August 11, 2003.

An Item 5 and 7 current report on Form 8-K, dated August 26, 2003, was filed with the Securities and Exchange Commission on August 28, 2003.

SIGNATURES

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

HearUSA, Inc.
(Registrant)

Date: November 12, 2003

By: /s/ Stephen J. Hansbrough

Stephen J. Hansbrough
Chief Executive Officer

Date: November 12, 2003

By: /s/ Gino Chouinard

Gino Chouinard
Chief Financial Officer

Exhibit Index

31.1	Section 302 of Sarbanes-Oxley CEO Certification
31.2	Section 302 of Sarbanes-Oxley CFO Certification
32	Section 906 of Sarbanes-Oxley CEO and CFO Certification