

HEARUSA INC
Form 10-Q
June 27, 2011

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

FORM 10-Q

(Mark One)

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

For the quarterly period ended April 2, 2011

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 001-11655

HearUSA, Inc.
(Exact Name of Registrant as Specified in Its Charter)

Delaware
(State of Other Jurisdiction of
Incorporation or Organization)

22-2748248
(I.R.S. Employer
Identification No.)

1250 Northpoint Parkway, West Palm Beach, Florida
(Address of Principal Executive Offices)

33407
(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 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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

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Yes

No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definition of "large accelerated filer," and "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange act. (Check one):

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting Company

Indicate by check mark whether the registrant is a shell company (as defined by Rule 12b-2 of the Exchange Act).

Yes No

On June 8, 2011, 45,609,757 shares of the Registrant's Common Stock were outstanding.

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Part I – Financial Information

Item 1. Financial Statements

HearUSA, Inc.
Consolidated Balance Sheets

(unaudited)

	April 2, 2011	December 25, 2010
	(Dollars in thousands, except per share amounts)	
ASSETS		
Current assets		
Cash and cash equivalents	\$ 1,916	\$ 3,902
Short-term marketable securities	-	500
Accounts and notes receivable, less allowance for doubtful accounts of \$453 and \$484	3,850	4,485
Inventories	1,424	1,493
Prepaid expenses and other	550	354
Total current assets	7,740	10,734
Property and equipment, net	3,234	3,317
Goodwill	-	51,927
Intangible assets, net	11,901	12,123
Deposits and other	632	664
Restricted cash and cash equivalents	2,263	2,261
Total Assets	\$ 25,770	\$ 81,026
LIABILITIES AND STOCKHOLDERS' EQUITY (Deficit)		
Current liabilities		
Accounts payable	\$ 9,557	\$ 10,928
Accrued expenses	2,248	1,623
Accrued salaries and other compensation	2,962	3,097
Current maturities of long-term debt	33,573	34,928
Dividends payable	38	35
Total current liabilities	48,378	50,611
Long-term debt	846	1,134
Deferred income taxes	2,261	8,215
Total long-term liabilities	3,107	9,349
Commitments and contingencies	-	-
Stockholders' equity (deficit)		
Preferred stock (aggregate liquidation preference \$2,330, \$1 par, 7,500,000 shares authorized)		
Series H Junior Participating (none outstanding)	-	-
Series J (233 shares outstanding)	-	-
Total preferred stock	-	-
Common stock: \$.10 par; 75,000,000 shares authorized 45,491,702 and 45,451,160 shares issued		
	4,549	4,545

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Additional paid-in capital	139,139	138,931
Accumulated deficit	(170,205)	(122,858)
Treasury stock, at cost: 523,662 common shares	(2,485)	(2,485)
Total HearUSA, Inc. Stockholders' Equity (Deficit)	(29,002)	18,133
Noncontrolling interest	3,287	2,933
Total Stockholders' equity (deficit)	(25,715)	21,066
Total Liabilities and Stockholders' Equity (Deficit)	\$ 25,770	\$ 81,026

See accompanying notes to consolidated financial statements

HearUSA, Inc
 Consolidated Statements of Operations
 Three Months Ended April 2, 2011 and March 27, 2010

(unaudited)

	April 2, 2011	March 27, 2010
	(Dollars in thousands, except per share amounts)	
Net revenues		
Hearing aids and other products	\$ 19,928	\$ 17,993
Services	1,396	1,600
Total net revenues	21,324	19,593
Operating costs and expenses		
Hearing aids and other products	5,813	4,576
Services	406	424
Total cost of products sold and services excluding depreciation and amortization	6,219	5,000
Center operating expenses	11,133	11,402
General and administrative expenses	3,977	4,016
Depreciation and amortization	457	570
Gain on settlement of litigation	(329)	-
Goodwill impairment loss	51,927	-
Total operating costs and expenses	73,384	20,988
Loss from operations	(52,060)	(1,395)
Non-operating income (expenses)		
Gain (loss) on foreign exchange	(21)	17
Interest income	31	2
Interest expense	(857)	(949)
Loss before income tax benefit (expense)	(52,907)	(2,325)
Income tax benefit (expense)	5,954	(220)
Net Loss	(46,953)	(2,545)
Net income attributable to noncontrolling interest	(354)	(74)
Net loss attributable to HearUSA, Inc.	(47,307)	(2,619)
Dividends on preferred stock	(40)	(37)
Net loss attributable to HearUSA, Inc. common stockholders	\$ (47,347)	\$ (2,656)
Net loss attributable to HearUSA, Inc. common stockholders per common share – basic and diluted	\$ (1.05)	\$ (0.06)
Weighted average number of shares of common stock outstanding – basic and diluted	44,940	44,865

See accompanying notes to consolidated financial statements

HearUSA, Inc.
 Consolidated Statements of Cash Flows
 Three Months Ended April 2, 2011 and March 27, 2010
 (unaudited)

	April 2, 2011	March 27, 2010
(Dollars in thousands)		
Cash flows from operating activities		
Net loss	\$(46,953)	\$(2,545)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	457	570
Stock-based compensation	212	218
(Gain) loss on foreign exchange	21	(17)
Gain on settlement of litigation	(329)	-
Goodwill impairment loss	51,927	-
Provision for doubtful accounts	128	121
Deferred income tax (benefit) expense	(5,954)	220
Non-cash interest on notes payable and warrants	27	20
Principal payments on long-term debt made through rebate credits	(752)	(764)
Other	1	(2)
(Increase) decrease in:		
Accounts and notes receivable	510	618
Inventories	69	425
Prepaid expenses and other	(164)	40
Increase (decrease) in:		
Accounts payable and accrued expenses	(668)	(1,821)
Accrued salaries and other compensation	(136)	(182)
Net cash used in operating activities	(1,604)	(3,099)
Cash flows from investing activities		
Purchase of property and equipment	(141)	(80)
Net proceeds from the sale of short-term marketable securities	500	500
Net cash provided by investing activities	359	420
Cash flows from financing activities		
Proceeds from issuance of long-term debt	-	200
Principal payments on long-term debt	(660)	(1,010)
Dividends paid on preferred stock	(40)	(37)
Net cash used in financing activities	(700)	(847)
Effects of exchange rate changes on cash	(41)	20
Net decrease in cash and cash equivalents	(1,986)	(3,506)
Cash and cash equivalents at the beginning of period	3,902	7,037
Cash and cash equivalents at the end of period	\$1,916	\$3,531
Supplemental disclosure of cash flows information:		
Cash paid for interest	\$77	\$155
Cash paid for income taxes	\$-	\$1,923

Supplemental schedule of non-cash investing and financing activities:

Principal payments on long-term debt made through rebate credits	\$ (752)	\$ (764)
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Issuance of capital lease in exchange for property and equipment	\$ 32	\$ -
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See accompanying notes to 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 8 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 three month period ended April 2, 2011 are not necessarily indicative of the results that may be expected for the year ending December 31, 2011. 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 25, 2010.

1. Description of the Company and Summary of Significant Accounting Policies

The Company

The Company's fiscal year ends on the last Saturday in December and customarily consists of four 13-week quarters for a total of 52 weeks. Every sixth year includes 53 weeks. The current year includes 53 weeks and the additional week is included in the first quarter of 2011.

HearUSA Inc. ("HearUSA" or "the Company"), a Delaware corporation, was established in 1986. As of April 2, 2011, the Company had a network of 172 company-owned hearing care centers in eleven states, including HEARx West centers in California. The Company also sponsors a network of credentialed hearing care providers, with over 2,600 access points, that participate in selected hearing benefit programs contracted by the Company with employer groups, health insurers and benefit sponsors in 49 states including HEARx West centers in California. The centers and the network providers provide audiological products and services for the hearing impaired. The Company is also the administrator of the American Association of Retired Persons ("AARP") Hearing Care program, designed to help members of AARP who have hearing loss. HearUSA is the only hearing care program endorsed by AARP. Under this program, the Company has agreed to provide to the members of AARP in the fifty states, the District of Columbia, and the five U.S. Territories, discounts on hearing aids and related services through the Company's company-owned centers and independent network of participating hearing care providers. Hearing aids sold under the program will come with a three year limited warranty and a three year supply of batteries included in the price of the hearing aid.

See Chapter 11 Case described in Notes 4 and 11 below.

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.

During the first quarters of 2011 and 2010, the Company's 50%-owned joint venture, HEARx West, LLC generated net income of approximately \$707,000 and \$163,000, respectively. Because the Company is the general manager of HEARx West and its day to day operations, the Company has significant control over the joint venture. Therefore, the accounts of HEARx West, LLC and its wholly owned subsidiary, HEARx West, Inc. are consolidated in these financial statements.

In accordance with Financial Accounting Standards Board (“FASB”) Accounting Standards Codification (“ASC”) 810-10, “Consolidations” (see Note 6 Noncontrolling Interest below), the Company generally records 50% of the joint venture’s net income (loss) as income (loss) attributable to noncontrolling interests in the Company’s consolidated statements of operations with a corresponding noncontrolling interest in stockholders’ equity on its consolidated balance sheets. The Company’s accompanying consolidated financial statements reflect this guidance.

HearUSA, Inc
Notes to Consolidated Financial Statements
(unaudited)

None of the goodwill impairment described in Note 4 below was attributable to the non-controlling interest.

Net income (loss) attributable to controlling interest per common share

Basic earnings per share (“EPS”), is computed by dividing net income or loss attributable to HearUSA, Inc. common stockholders by the weighted average of common shares outstanding for the period. Basic EPS is computed by dividing income (loss) attributable to HearUSA, Inc.’s common stockholders, by the weighted average of common shares outstanding for the period. Diluted EPS reflects the potential dilution that could occur if securities or other contracts to issue common stock (warrants to purchase common stock, restricted stock units and options) were exercised or converted into common stock. Potential common shares in the diluted EPS computation are excluded where their effect would be antidilutive.

Common stock equivalents for restricted stock units, outstanding options and warrants to purchase common stock, of approximately 325,000 and 1.6 million, were excluded from the computation of earnings per share – diluted for the quarters ended April 2, 2011 and March 27, 2010, respectively, because the loss attributable to HearUSA, Inc. would make them anti-dilutive.

2. Restricted Cash and Cash Equivalents

Restricted cash and cash equivalents at both April 2, 2011 and December 25, 2010 consist of certificates of deposit with contractual maturities of one year or less of approximately \$2.3 million. Cash and cash equivalents of \$2.0 million are pledged as collateral for a standby letter of credit provided to AARP in 2009. The commitment to maintain a standby letter of credit decreases by \$1.0 million on January 1, 2012 and will end on September 1, 2012, if the conditions of the agreement are met. If the conditions of the agreement are not met, the cash and cash equivalents pledged will be paid to AARP. There is also \$232,000 cash restricted for automated clearing house exposure in both 2011 and 2010.

3. Going Concern

Our financial statements are prepared using generally accepted accounting principles in the United States of America applicable to a going concern which contemplates the realization of assets and liquidation of liabilities in the normal course of business. Our sources of revenues are not sufficient to cover our operating costs for the next twelve months and this raises substantial doubt about our ability to continue as a going concern.

The Company was in dispute with its lender, Siemens Hearing Instruments, Inc. (“Siemens”), in regard to the amount of cash prepayment due to Siemens pursuant to the Siemens Credit Agreement as a result of the sale by the Company of the Company’s Canadian operations in 2009. On March 17, 2011, the Company received a notice of default from Siemens. The notice stated that as a result of the Company’s failure to pay \$2.3 million which Siemens had claimed was due as a pre-payment under the Siemens Credit Agreement, Siemens declared Company in default under the Siemens Credit Agreement. Siemens also claimed in the notice that it was entitled to accelerate all of the remaining payments under the Siemens Credit Agreement and demanded the immediate payment of \$32.7 million, the full amount of the Siemens debt at that time. The notice stated that Siemens intended to pursue its rights and remedies to recover the total amount, including enforcing its security interests in the Company’s assets (See Note 5 Notes Payable to Siemens). The Company does not have sufficient funds to repay the debt.

HearUSA, Inc
Notes to Consolidated Financial Statements
(unaudited)

On May 16, 2011, HearUSA, Inc., the parent company, and Auxiliary Health Benefits Corporation d/b/a National Ear Care Plan, a subsidiary, (the "Filing Companies") filed a voluntary petition for reorganization relief under Chapter 11 of the United States Bankruptcy Code (the "Bankruptcy Code") in the United States Bankruptcy Court (the "Chapter 11 Case"). The Company plans to sell substantially all of the assets of the Company to William Demant Holdings A/S or its permitted assigns, as purchaser (the "Purchaser") and entered into an Asset Purchase Agreement dated May 16, 2011 (the "Asset Purchase Agreement") pursuant to Sections 105, 363 and 365 of the Bankruptcy Code, subject to court approval and certain conditions. The proceeds of this sale are expected to allow the Company to repay its debts and claims to Siemens and its other creditors. As part of the agreement, the Company has entered into a Debtor-in-Possession ("DIP") financing arrangement of up to \$10 million with the Purchaser. Because the sale to the Purchaser will be conducted under the provisions of Section 363 of the Bankruptcy Code, it is subject to bidding procedures to be entered by the Bankruptcy Court and to receipt of a higher and better bid at auction. See Note 11, Subsequent Events.) HEARx West, LLC and its wholly owned subsidiary, HEARx West, Inc. did not file Chapter 11.

The accompanying financial statements do not include any adjustments to reflect our inability to continue as a going concern.

4. Goodwill Impairment

During the first quarter of 2011, as a result of Siemens' notice of default, our operating results and lack of liquidity, we concluded that there were significant indicators to require us to perform an interim impairment analyses. We prepared separate analyses of long-lived assets, intangible assets subject to amortization and the indefinite lived trade name. No adjustments were required in the first quarter of 2011 to the carrying value of our long-lived assets, intangible assets subject to amortization or the indefinite lived trade name based on the analysis performed. We then performed a Step 1 goodwill impairment test as of the end of the first quarter of 2011, which indicated the carrying amounts of goodwill for the center and network reporting units exceeded their implied fair value.

In light of the Chapter 11 Case, we based our estimate of the fair value of the reporting unit on negotiations with independent third parties based on the terms of the Asset Purchase Agreement. Based on the Company's Step 2 analysis, we recorded an estimated \$51.9 million pre-tax non-cash impairment charge to write down the goodwill associated with these reporting units.

As part of the impairment, the Company recorded a deferred income tax benefit of approximately \$6.0 million related to the impairment loss of goodwill. The remaining deferred tax liability relates to the indefinite-lived trade name.

5. Long-term Debt

Long-term debt, net of discounts, consists of the following:

Dollars in thousands	April 2, 2011	December 25, 2010
Notes payable to Siemens		
Tranche B	\$3,996	\$ 4,092
Tranche C	27,495	28,151
Total notes payable to Siemens	31,491	32,243

Notes payable from business acquisitions and other	2,928	3,819
	34,419	36,062
Less current maturities	33,573	34,928
	\$846	\$ 1,134

The approximate aggregate maturities on long-term debt obligations are as follows (in thousands) and include the payments due under the Siemens notes payable based on their contractual maturities under the Siemens' Credit Agreement. Based on the notice of default and management's plan to file for voluntary protection under Chapter 11 resulting in our intent to repay the debt within one year, the entire \$31.5 million and \$32.2 million fixed rate debt due to Siemens has been classified as a current liability in our April 2, 2011 and December 25, 2010 consolidated balance sheets, respectively:

HearUSA, Inc
Notes to Consolidated Financial Statements
(unaudited)

For the twelve months ended March:

2012	\$4,549
2013	2,931
2014	2,615
2015	24,412
2016	13

Notes Payable to Siemens

The Company is a party to each of a Credit Agreement, Supply Agreement, Investor Rights Agreement and Security Agreement with Siemens. The term of the current agreements extends to February 2015.

Pursuant to these agreements, Siemens extended to the Company a \$50 million credit facility and the Company agreed to purchase at least 90% of its hearing aid purchases from Siemens and its affiliates. If the 90% minimum purchase requirement is met, the Company earns rebates which are then used to liquidate principal and interest payments due under the Credit Agreement.

Credit Agreement

The Second Amended and Restated Credit Agreement dated December 30, 2006 between the Company, as borrower, and Siemens, as lender, as subsequently amended by the parties (the "Credit Agreement") includes a revolving credit facility of \$50 million that bears interest at 9.5%, matures in February 2015 and is secured by substantially all of the Company's assets. Amounts available to be borrowed under the credit facility are to be used solely for acquisitions unless otherwise approved by Siemens. The Company may not borrow further under their line for acquisitions until such time as it is generating cash from operations. Borrowings under the credit facility are accessed through Tranche B and Tranche C. Borrowing for acquisitions under Tranche B is generally based upon a formula equal to 1/3 of 70% of the acquisition target's trailing 12 months revenues, and any amount greater than that may be borrowed under Tranche C with Siemens' approval. Principal borrowed under Tranche B was repaid quarterly at a rate of \$65 per Siemens unit purchased by the acquired businesses through September 2009. In October 2009, the parties agreed to reduce the rebate to a rate of \$50 per Siemens' unit purchased by the acquired businesses in exchange for more favorable pricing. Principal borrowed under Tranche C is repaid at \$500,000 per quarter. The required quarterly principal and interest payments on Tranches B and C are forgiven by Siemens through rebate credits of similar amounts as long as 90% of hearing aid units purchased by the Company are from Siemens. Amounts not forgiven through rebate credits are payable in cash each quarter. The Company has met the minimum purchase requirements since inception of the arrangement with Siemens.

The Credit Agreement requires that the Company reduce the principal balance by making annual payments in an amount equal to 20% of Excess Cash Flow (as defined in the agreement), and by paying Siemens 50% of the proceeds of any net asset sales (as defined) and 25% of proceeds from any equity offerings the Company may complete. The Company did not have any Excess Cash Flow (as defined) in the first quarter of 2011 or fiscal 2010.

The 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 incurrence of indebtedness, merger or sale of assets, the modification of material agreements, changes in capital structure and making certain

payments.

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HearUSA, Inc
Notes to Consolidated Financial Statements
(unaudited)

The Company had a dispute with Siemens concerning the amount of the cash prepayment due to Siemens under the credit facility from the sale of the Company's Canadian operations in 2009. Siemens claimed the Company owed an additional \$2.3 million prepayment under the Credit Agreement. The Company claimed all monies owed for the Canadian asset sale prepayment had been paid in full and no additional amount was due. The Company filed suit in the New York State Supreme Court seeking a declaratory judgment from the court that no additional prepayment was due.

On March 17, 2011, the Company received a notice of default from Siemens. The notice stated that as a result of the Company's failure to pay the disputed \$2.3 million, Siemens was declaring the Company in default under the Credit Agreement. Siemens also claimed in the notice that it was entitled to accelerate all of the remaining payments under the Credit Agreement and demanded the immediate payment of \$32.7 million. The notice stated that Siemens intended to pursue its rights and remedies to recover the total amount, including enforcing its security interests in the Company's assets.

The Company sought a temporary restraining order against Siemens. On March 29, 2011, the Appellate Division of the New York State Supreme Court granted the motion by HearUSA for a temporary restraining order against Siemens. Siemens was enjoined from declaring HearUSA to be in default under the Credit Agreement, from engaging in self help to collect under the Credit Agreement and from making any efforts to seize assets or take control of HearUSA's business pending a May 2, 2011 hearing on HearUSA's motion for a preliminary injunction, on the condition that HearUSA remain current in all of its other payments to Siemens under the Credit Agreement. The May 2, 2011 hearing was held but the court did not make a ruling on that date. The case was later dismissed without prejudice on the Company's own motion in light of the Company's bankruptcy filing. Since the Filing Companies are under protection of the bankruptcy court, Siemens cannot currently declare a default of the notes payable to Siemens. Management intends to repay the Siemens debt in full from the proceeds of the sale as discussed in Note 11, Subsequent Events.

The Company has reflected the \$31.5 million and \$32.2 million in the current portion of long-term debt in its consolidated balance sheet as of April 2, 2011 and December 25, 2010, respectively.

Supply Agreement

The Supply Agreement extends to February 2015 and requires the Company to purchase at least 90% of its hearing aid purchases from Siemens and its affiliates. The 90% requirement is computed on a cumulative four consecutive quarters. The Company has met the minimum purchase requirements of the Supply Agreement since inception of the arrangement with Siemens. Approximately \$48.8 million has been rebated since the Company entered into this arrangement in December 2001.

Additional quarterly volume rebates of \$156,250, \$312,500 or \$468,750 can be earned by meeting certain quarterly volume tests. These rebates reduce the principal due on the credit facility. Additional volume rebates of \$156,250 were recorded in each of the first quarters of 2011 and 2010, respectively.

All rebates earned are accounted for as a reduction of cost of products sold.

HearUSA, Inc
Notes to Consolidated Financial Statements
(unaudited)

The following table summarizes the rebate structure:

Calculation of Pro forma Rebates to HearUSA when at least 90% of
Units Purchased are from Siemens (1)
Quarterly Siemens Unit Sales Compared to Prior Years' Comparable Quarters

	90% but < 95%	95% to 100%	> 100% < 125%	125% and >
Acquisition rebate (2)	\$50/ unit	\$50/ unit	\$50/ unit	\$50/ unit
	Plus	Plus	Plus	Plus
Notes payable rebate	\$ 500,000	\$ 500,000	\$ 500,000	\$ 500,000
Additional volume rebate	-	156,250	312,500	468,750
Interest forgiveness rebate (3)	1,187,500	1,187,500	1,187,500	1,187,500
	\$ 1,687,500	\$ 1,843,750	\$ 2,000,000	\$ 2,156,250

(1) Calculated using trailing twelve month units purchased by the Company

(2) Siemens units purchased from acquired businesses (\$50 per unit)

(3) Assuming the \$50 million line of credit is fully utilized

The following table shows the rebates received from Siemens pursuant to the supply agreement during each of the following periods:

(Dollars in thousands)	Quarters Ended	
	April 2, 2011	March 27, 2010
Portion applied against quarterly principal payments	\$ 752	\$ 764
Portion applied against quarterly interest payments	749	825
	\$ 1,501	\$ 1,589

The Supply Agreement may be terminated by either party upon a material breach of the agreement by the other party. In addition, HearUSA may terminate the Supply Agreement in the event Siemens acquires a business which is directly competitive to the business of the Company. Termination of the Supply Agreement or a material breach of the Supply Agreement by the Company may be deemed to be a breach of the Credit Agreement and Siemens would have the right to declare all amounts outstanding under the credit facility immediately due and payable. In addition, as a result of the Chapter 11 Case and the sale under Section 363 of the Bankruptcy Code in the event the Supply Agreement is not assumed by the Purchaser, HearUSA may be required to pay a significant rejection damage claim to Siemens to terminate the Supply Agreement without cause prior to the end of the term of the Supply Agreement. While the amount of any such rejection claim is not known at this time and is subject to a number of variables, counsel for Siemens has stated in court that Siemens may claim this amount is approximately \$20 million or more.

Notes Payable from Business Acquisitions and Other

Notes payable from business acquisitions and other are primarily notes payable related to acquisitions of hearing care centers and total approximately \$2.3 million and \$3.1 million at April 2, 2011 and December 25, 2010,

respectively. They have a face value of \$2.4 million and \$3.2 million at April 2, 2011 and December 25, 2010, respectively and are payable in monthly or quarterly installments of principal and interest varying from \$3,000 to \$76,000 over periods varying from two to five years, bearing interest at rates varying from 5% to 7%. The notes have been discounted using a market rate of 10%. The discount is being accreted over the term of the notes on an effective interest method. Accreted discount of \$27,000 and \$54,000 has been included in interest expense in the quarters ended April 2, 2010 and March 27, 2010, respectively.

HearUSA, Inc
Notes to Consolidated Financial Statements
(unaudited)

Other notes payable relate mostly to capital leases totaling approximately \$639,000 and \$709,000 at April 2, 2011 and December 25, 2010, respectively, payable in monthly or quarterly installments varying from \$253 to \$10,000 over periods varying from one to five years and bear interest at rates varying from 2.3% to 16.7%.

6. Noncontrolling Interest

The Company accounts and reports for noncontrolling interests in partially owned consolidated subsidiaries and the loss of control of subsidiaries under FASB ASC 810-10, "Consolidations." The guidance requires that: (1) a noncontrolling interest, previously referred to as a minority interest, is to be reported as part of equity in the consolidated financial statements; (2) losses are to be allocated to a noncontrolling interest even when such allocation might result in a deficit balance, thereby reducing the losses attributed to the controlling interest; (3) changes in ownership interest are to be treated as equity transactions if control is maintained; (4) changes in ownership interest resulting in a gain or loss are to be recognized in earnings if control is gained or lost; and (5) in a business combination the noncontrolling interest's share of net assets acquired is to be recorded at fair value, plus its share of goodwill.

A reconciliation of noncontrolling interest of our subsidiary HEARx West, LLC for the quarter ended April 2, 2011 is as follows:

	Amount (thousands)
Balance at December 25, 2010	\$ 2,933
Joint venture earnings	354
Dividends to joint venture partners	-
Balance at April 2, 2011	\$ 3,287

7. Fair Value

As of April 2, 2011 and December 25, 2010, the fair value of the Company's long-term debt is estimated at approximately \$34.4 million and \$36.1 million, respectively, based on discounted cash flows and the application of the fair value interest rates applied to the expected cash flows, which is consistent with its carrying value. The Company has determined that the long-term debt is defined as Level 2 in the fair value hierarchy. Fair value estimates are made at a specific point in time, based on relevant market information about the financial instrument.

The book values of cash equivalents, accounts receivable and accounts payable approximate their respective fair values due to the short-term nature of these instruments. These are Level 1 in the fair value hierarchy.

The inputs used in measuring fair value into the fair value hierarchy are as follows:

Level 1 Quoted prices (unadjusted) in active markets for identical assets or liabilities;

Level 2 Inputs other than quoted prices included in Level 1 that are either directly or indirectly observable;

Level 3 Unobservable inputs in which little or no market activity exists, therefore requiring an entity to develop its own assumptions about the assumptions that market participants would use in pricing.

HearUSA, Inc
Notes to Consolidated Financial Statements
(unaudited)

There are no assets or liabilities that have recurring fair value measurements as of April 2, 2011.

As of April 2, 2011 the impairment of the fair value of the Company's goodwill was based on an estimated fair value based on negotiations with independent third parties. The Company has determined that goodwill is defined as Level 3 in the fair value hierarchy. Fair value estimates are made at a specific point in time, based on relevant market information.

The Company's short-term marketable securities at December 25, 2010 primarily consisted of money market mutual funds invested in U.S. treasury securities generally maturing in three months or less. These securities were classified as available for sale. There was no unrealized gain or loss as of or for the quarter ended April 2, 2011.

8. Stock-based Compensation

Under the terms of the Company's equity compensation plans, officers, certain other employees and non-employee directors may be granted options to purchase the Company's common stock at a price equal to the closing price of the Company's common stock on the date the option is granted as well as restricted stock and restricted stock units. We recognize stock-based compensation expense based on the estimated grant date fair value using a Black-Scholes valuation model. Stock-based compensation expense is included in general and administrative expenses and totaled approximately \$212,000 and \$218,000 (of which approximately \$22,000 and \$20,000 relates to restricted stock units) in the first quarter of 2011 and 2010, respectively.

In the first quarter of 2011, the Company granted 50,000 options at an exercise price of \$0.51. These options vest ratably over the four years following the first anniversary of the grant date.

The expected term of the options represents the estimated period of time from grant until exercise and is based on historical experience of similar awards, giving consideration to the contractual terms, vesting schedules and expectations of future employee behavior. Expected stock price volatility is based on historical volatility of our stock for a period of at least equal to the expected term. The risk-free interest rate is based on the implied yield available on United States Treasury zero-coupon issues with an equivalent remaining term. We have not paid dividends in the past and do not plan to pay any dividends in the foreseeable future.

Stock-based payment award activity

The following table provides additional information regarding options outstanding and options that were exercisable as of April 2, 2011 (options and intrinsic value in thousands):

	Shares	Weighted Average Exercise Price	Weighted Average Contractual Term (in years)	Aggregate Intrinsic Value
Outstanding at December 25, 2010	6,752	\$ 1.14		-
Granted	50	\$ 0.51		-
Exercised	-	-		-

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Forfeited/expired/cancelled	(527)	\$ 0.97			-
Outstanding at April 2, 2011	6,275	\$ 1.15	5.41	\$	84
Exercisable at April 2, 2011	4,754	\$ 1.16	4.52	\$	84

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The aggregate intrinsic value is calculated as the difference between the exercise price of the underlying awards and the quoted price of our common stock for the options that were in-the-money at April 2, 2011. There was approximately \$1.3 million of total unrecognized compensation cost related to share-based compensation under our stock award plans as of April 2, 2011. That cost is expected to be recognized over the remaining average life of 5 years as of April 2, 2011. At April 2, 2011, the aggregate intrinsic value of the employee and non-employee director options outstanding and exercisable was approximately \$84,000, of which \$12,000 is non-employee director aggregate intrinsic value.

A summary of the status and changes in our non-vested options related to our equity incentive plans as of and during the three months ended April 2, 2011 is presented below:

	Shares (in thousands)	Weighted Average Grant- Date Fair Value
Non-vested at December 25, 2010	1,925	\$ 1.08
Granted	50	0.51
Vested	(332)	0.80
Forfeited unvested	(121)	1.36
Non-vested at April 2, 2011	1,522	\$ 1.10

Restricted stock units

The Company began granting restricted stock units pursuant to its 2002 Flexible Stock Plan and Amended and Restated 2007 Incentive Compensation Plan in 2008. Restricted stock units are awards that, upon vesting, will result in the delivery to the holder shares of the Company's common stock. Some restricted stock units are service based and vest ratably over a period of time, and some are performance-based and subject to forfeiture if certain performance criteria are not met.

No restricted stock units were granted in the first quarter of 2011.

Using the most probable award, the Company recorded approximately \$22,000 and \$20,000 in stock-based compensation expense for restricted stock units which are included in total stock-based compensation expense of approximately \$212,000 and \$218,000 in the first quarter of 2011 and 2010, respectively.

A summary of the Company's restricted stock unit activity and related information for the quarter ended April 2, 2011 is as follows:

	Service-based Restricted Stock Units (1)	Performance-based Restricted Stock Units (1)
Outstanding Balance at December 25, 2010	45,500	124,422
Awarded	-	-

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Vested	(45,500)	(62,211)
Forfeited	-	-
Outstanding at April 2, 2011	-	62,211

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(1) Each stock unit represents the fair market value of one share of common stock.

The fair value of the 107,711 shares vested during the first quarter of 2011 was approximately \$54,000.

The weighted average grant-date fair value per share for the restricted stock units was \$0.90 at April 2, 2011. The weighted average remaining contractual terms is 1.2 years at April 2, 2011.

Based on the closing price of the Company's common stock of \$0.47 on April 2, 2011, the total pretax value of all outstanding restricted stock units on that date was approximately \$29,000.

9. Segments

The following operating segments represent identifiable components of the Company for which separate financial information is available. The following table represents key financial information for each of the Company's business segments, which include the operation and management of centers; and the establishment, maintenance and support of an affiliated network of independent providers. The centers offer people afflicted with hearing loss a complete range of services and products, including diagnostic audiological testing and the latest technology in hearing aids and listening devices to improve their quality of life. Center hearing aids and other products revenues include hearing devices sold by our centers under the AARP program. The network, unlike the Company-owned centers, is comprised of hearing care practices owned by independent audiologists. Hearing aids and other products revenues attributable to the network relate to units sold under the AARP program through our network. Network service revenues are mainly derived from administrative fees paid by employer groups, health insurers and benefit sponsors to administer their benefit programs as well as maintain the affiliated provider network

The following is the Company's segment information:

Dollars in thousands

	Centers	Network	Corporate	Total
Hearing aids and other products revenues				
3 months ended April 2, 2011	\$ 19,576	\$ 352	\$ -	\$ 19,928
3 months ended March 27, 2010	\$ 17,980	\$ 13	\$ -	\$ 17,993
Service revenues				
3 months ended April 2, 2011	\$ 1,043	\$ 335	\$ 18	\$ 1,396
3 months ended March 27, 2010	\$ 1,156	\$ 156	\$ 288	\$ 1,600
Income (loss) from operations				
3 months ended April 2, 2011	\$ (47,051)	\$ (952)	\$ (4,057)	\$ (52,060)
3 months ended March 27, 2010	\$ 3,011	\$ (546)	\$ (3,860)	\$ (1,395)
3 months ended April 2, 2011				
Depreciation and amortization	\$ 349	\$ 10	\$ 98	\$ 457
Total assets	\$ 14,701	\$ 8	\$ 11,061	\$ 25,770
Capital expenditures	\$ 123	\$ -	\$ 18	\$ 141

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3 months ended March 27, 2010

Depreciation and amortization	\$ 434	\$ 4	\$ 132	\$ 570
Total assets	\$ 66,017	\$ 897	\$ 18,700	\$ 85,614
Capital expenditures	\$ 51	-	\$ 29	\$ 80

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Hearing aids and other products revenues consisted of the following:

	Three months ended			
	April 2, 2011		March 27, 2010	
Hearing aid revenues	97.1	%	96.6	%
Other products revenues	2.9	%	3.4	%

Services revenues consisted of the following:

	Three months ended			
	April 2, 2011		March 27, 2010	
Hearing aid repairs	53.8	%	49.0	%
Testing and other income	46.2	%	51.0	%

Income (loss) from operations at the segment level is computed before the following, the sum of which is included in the column "Corporate" as loss from operations:

	Three months ended	
	April 2, 2011	March 27, 2010
Dollars in thousands		
Contract service revenue on Canadian support agreement	\$(18)	\$(288)
General and administrative expense	3,977	4,016
Corporate depreciation and amortization	98	132
Corporate loss from operations	\$4,057	\$3,860

10. Commitments and Contingencies

Legal Proceedings

On February 4, 2011, the Company filed a complaint against Siemens Hearing Instruments, Inc. in the Supreme Court of the State of New York. The Company was seeking a declaratory judgment of the court concerning a claim by Siemens for an additional loan prepayment under the credit agreement of \$2.3 million arising from the Company's sale of its Canadian assets in 2009. The Company believes it has satisfied the loan prepayment requirement related to the 2009 Canadian sale and that no additional amounts should be due. On March 17, 2011, before the matter had come before the court, Siemens issued to the Company a notice of default. The notice stated that as a result of the Company's failure to pay the \$2.3 million related to the Canadian asset sale, Siemens was declaring the Company in default under the Credit Agreement. Siemens also claimed in the notice that it was entitled to accelerate all of the remaining payments under the Credit Agreement and demanded the immediate payment of \$32.7 million. The notice stated that Siemens intended to pursue its rights and remedies to recover the total amount, including enforcing its security interests in the Company's assets. On March 17, 2011, the Company filed a motion for a temporary restraining order against Siemens to prevent Siemens from declaring the default, accelerating the full amount under the Credit Agreement and from employing self-help measures to enforce its rights under the Credit Agreement. The trial court denied the motion and HearUSA appealed.

On March 29, 2011, the Appellate Division of the New York State Supreme Court granted the Company's motion for the temporary restraining order against Siemens. As a result, Siemens was enjoined from declaring HearUSA to be in default under the Credit Agreement, from engaging in self help to collect under the Credit Agreement and from making any efforts to seize assets or take control of HearUSA's business pending a May 2, 2011 hearing on HearUSA's motion for a preliminary injunction, on the condition that HearUSA remain current in all of its other payments to Siemens under the Credit Agreement.

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Following and in light of the May 16, 2011, Chapter 11 filing by the Company, the Company moved the case to federal court and moved to dismiss the case without prejudice. That motion was granted.