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REHABILICARE INC
Form 10-Q
May 15, 2002

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

|X| QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE

SECURITIES EXCHANGE ACT OF 1934

For the Quarterly period Ended March 31, 2002

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 No. 0-9407
REHABILICARE INC.

(Exact name of registrant as specified in its charter)

MINNESOTA 41-0985318
(State or other jurisdiction of (I.R.S. Employer Identification No.)
incorporation or organization)

1811 OLD HIGHWAY 8
NEW BRIGHTON, MINNESOTA 55112
(Address of principal executive offices)

(651) 631-0590
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes X No

Indicate the number of shares outstanding of each of the issuer's classes of common stock as of May 3, 2002 was:

COMMON STOCK, \$.10 PAR VALUE 10,935,118 SHARES

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CAUTIONARY STATEMENT REGARDING FORWARD LOOKING STATEMENTS

The following Quarterly Report on Form 10-Q contains various "forward looking statements" within the meaning of federal securities laws. These forward looking statements represent management's expectations or beliefs concerning future events, including statements regarding anticipated product introductions; changes in markets, customers and customer order rates; changes in third party reimbursement rates; expenditures for research and development; growth in revenue; taxation levels; and the effects of pricing decisions. When used in this 10-Q, the words "anticipate," "believe," "expect," "estimate" and similar expressions are generally intended to identify forward-looking statements. These and other forward looking statements made by the Company must be evaluated in the context of a number of factors that may affect the Company's financial condition and results of operations, including, but not limited to, the following:

- Like many medical device companies, the Company has a large balance of uncollected receivables. If it cannot collect an amount of receivables that is consistent with historical collection rates, it might be required to charge off a portion of uncollected receivables.
- In the United States, the Company's products are subject to reimbursement by private and public healthcare reimbursement agencies that impose limits on reimbursement and strict rules on applications for reimbursement. Changes in the rates, eligibility or requirements for reimbursement, or failure to comply with reimbursement requirements, could cause a reduction in income from operations or fines or both.
- The Company maintains significant amounts of inventory on consignment at clinics for distribution to patients. It may not be able to completely control losses of this inventory and, if inventory losses are not consistent with historical experience, it might be required to write off a portion of the carrying value of inventory.
- The clinical effectiveness of the Company's electrotherapy products has periodically been challenged. Publicity about the effectiveness of electrotherapy for pain relief or other clinical applications could negatively impact revenue and income from operations.
- The Company has periodically been the subject of litigation that has caused it additional expense, including a Medicare whistleblower suit settled in 2000 for approximately \$1.6 million and, currently, a \$2.3 million product liability suit that proceeded to a default judgment without the Company's knowledge. The costs of these actions, and other actions that may arise, have negatively affected, and may continue to negatively affect, the Company's operating results.

PART I - FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

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Included herein is the following unaudited condensed financial information:

Consolidated Balance Sheets as of March 31, 2002 and June 30, 2001

Consolidated Statements of Operations for the three months and nine months ended March 31, 2002 and 2001

Consolidated Statements of Cash Flows for the nine months ended March 31, 2002 and 2001

Notes to Consolidated Financial Statements

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REHABILICARE INC. AND SUBSIDIARIES CONSOLIDATED BALANCE SHEETS

| | March 31, 2002 ----- |
|---|----------------------------|
| ASSETS | |
| Current Assets: | |
| Cash and cash equivalents | \$ 2,067,383 |
| Receivables, less reserve for uncollectible accounts of \$9,429,162 and \$8,062,378 | 21,323,694 |
| Inventories - | |
| Raw materials | 2,326,039 |
| Work in process | 55,654 |
| Finished goods | 6,437,562 |
| Deferred tax assets | 4,075,317 |
| Prepaid expenses | 1,339,218 |
| | ----- |
| Total current assets | 37,624,867 |
| Property, plant and equipment, net | 4,742,232 |
| Intangible assets, net | 11,050,497 |
| Deferred tax assets | 471,015 |
| Other assets | 119,675 |
| | ----- |
| | \$ 54,008,286 ===== |
| LIABILITIES AND STOCKHOLDERS' EQUITY | |
| Current Liabilities: | |
| Note payable | \$ 400,000 |
| Current maturities of long-term debt | 2,491,870 |
| Accounts payable | 2,514,437 |

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| | |
|--|---------------|
| Accrued liabilities - | |
| Payroll | 564,656 |
| Commissions | 341,109 |
| Income taxes | 1,635,513 |
| Other | 4,760,685 |
| | ----- |
| Total current liabilities | 12,708,270 |
| Long-Term Liabilities: | |
| Long term-debt | 7,881,322 |
| Deferred tax liabilities | 381,368 |
| | ----- |
| Total liabilities | 20,970,960 |
| Stockholders' Equity: | |
| Common stock, \$.10 par value: 25,000,000 shares authorized; issued and outstanding 10,927,618 and 10,792,060 shares, respectively | 1,092,762 |
| Preferred stock, no par value; 5,000,000 shares authorized; none issued and outstanding | -- |
| Additional paid-in capital | 21,761,613 |
| Less note receivable from officer/stockholder | (168,417) |
| Unearned compensation on restricted stock | (105,000) |
| Accumulated other non-owner changes in equity | (180,421) |
| Retained earnings | 10,636,789 |
| | ----- |
| Total stockholders' equity | 33,037,326 |
| | ----- |
| | \$ 54,008,286 |
| | ===== |

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REHABILICARE INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS

| | Three Months Ended March 31 | | Nine Months March |
|-------------------------------------|--------------------------------|---------------|----------------------|
| | 2002 | 2001 | 2002 |
| | ----- | ----- | ----- |
| Net sales and rental revenue | \$ 17,777,430 | \$ 15,171,676 | \$ 51,409,302 |
| Cost of sales and rentals | 5,703,410 | 4,822,818 | 16,880,368 |
| | ----- | ----- | ----- |
| Gross profit | 12,074,020 | 10,348,858 | 34,528,934 |
| Operating expenses: | | | |
| Selling, general and administrative | 9,687,439 | 8,048,582 | 26,180,229 |
| Research and development | 473,381 | 493,643 | 1,575,644 |
| | ----- | ----- | ----- |
| Total operating expenses | 10,160,820 | 8,542,225 | 27,755,873 |
| | ----- | ----- | ----- |

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| | | | |
|--|--------------|------------|--------------|
| Income from operations | 1,913,200 | 1,806,633 | 6,773,061 |
| Other income (expense): | | | |
| Interest expense | (144,380) | (313,035) | (559,580) |
| Other | 3,911 | 14,376 | 14,237 |
| | ----- | ----- | ----- |
| Income before income taxes | 1,772,731 | 1,507,974 | 6,227,718 |
| Income tax provision | 744,000 | 646,000 | 2,616,000 |
| | ----- | ----- | ----- |
| Net income | \$ 1,028,731 | \$ 861,974 | \$ 3,611,718 |
| | ===== | ===== | ===== |
| Net income per common and common equivalent share | | | |
| Basic | \$ 0.09 | \$ 0.08 | \$ 0.33 |
| | ===== | ===== | ===== |
| Diluted | \$ 0.09 | \$ 0.08 | \$ 0.32 |
| | ===== | ===== | ===== |
| Weighted average number of shares outstanding | | | |
| Basic | 10,907,755 | 10,788,277 | 10,849,310 |
| | ===== | ===== | ===== |
| Diluted | 11,307,273 | 10,844,363 | 11,189,131 |
| | ===== | ===== | ===== |

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REHABILICARE INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS

| | Nine Months Ended March 31 | |
|---|-------------------------------|------------------------|
| | ----- 2002 ----- | ----- 2001 ----- |
| Operating Activities: | | |
| Net income | \$ 3,611,718 | \$ 2,811,718 |
| Adjustments to reconcile net income to net cash provided by operating activities | | |
| Depreciation and amortization | 1,208,951 | 1,711,718 |

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| | | |
|---|--------------|--------|
| Amortization of unearned compensation | 81,563 | |
| Change in long-term portion of deferred taxes | 13,769 | 1 |
| Change in current assets and liabilities | | |
| Receivables | (2,144,051) | 1,6 |
| Inventories | (30,278) | 2 |
| Prepaid expenses | 909,033 | (6 |
| Accounts payable | (1,634,172) | (1,9 |
| Accrued liabilities | 1,375,925 | (1,5 |
| | ----- | ----- |
| Net cash provided by operating activities | 3,392,458 | 2,4 |
| | ----- | ----- |
| Investing Activities: | | |
| Purchases of property and equipment | (670,308) | (2 |
| Change in other assets, net | 8,089 | (4 |
| | ----- | ----- |
| Net cash used in investing activities | (662,219) | (7 |
| | ----- | ----- |
| Financing Activities: | | |
| Principal payments on long-term obligations | (2,469,523) | (2,3 |
| Proceeds from (payments on) line of credit, net | 400,000 | (1 |
| Proceeds from exercise of stock options | 242,946 | 3 |
| Proceeds from employee stock purchase plan | 111,845 | 1 |
| | ----- | ----- |
| Net cash used in financing activities | (1,714,732) | (2,0 |
| | ----- | ----- |
| Effect of exchange rates on cash and cash equivalents | 292,265 | (3 |
| | ----- | ----- |
| Net increase (decrease) in cash and cash equivalents | 1,307,772 | (6 |
| | ----- | ----- |
| Cash and Cash Equivalents at Beginning of Period | 759,611 | 2,2 |
| | ----- | ----- |
| Cash and Cash Equivalents at End of Period | \$ 2,067,383 | \$ 1,6 |
| | ===== | ===== |
| Supplemental Cash Flow Information | | |
| Interest paid | \$ 554,378 | \$ 1,0 |
| | ===== | ===== |
| Income taxes paid | \$ 2,662,220 | \$ 2,5 |
| | ===== | ===== |

REHABILICARE INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
MARCH 31, 2002

1. Accounting Policies

The amounts set forth in the preceding financial statements are unaudited as of and for the periods ended March 31, 2002 and 2001 but, in the opinion of management, reflect all adjustments (consisting only of normal recurring

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adjustments) necessary for a fair statement of the results for the periods presented. Such results are not necessarily indicative of results for the full year. The accompanying financial statements of the Company should be read in conjunction with the audited consolidated financial statements for the year ended June 30, 2001 included in the Company's Annual Report on Form 10-K.

Certain previously reported amounts have been reclassified to conform to classifications adopted in fiscal year 2002. These reclassifications had no effect on net income, cash flows or stockholders' equity.

2. Recently Issued Accounting Standards

In June 2001, the Financial Accounting Standards Board issued Statements of Financial Accounting Standards No. 141, Business Combinations, and No. 142, Goodwill and Other Intangible Assets, effective for fiscal years beginning after December 15, 2001, with early adoption permitted for companies with fiscal years beginning after March 15, 2001. Under the new rules, goodwill and intangible assets deemed to have indefinite lives will no longer be amortized but will be subject to annual impairment tests in accordance with the statements. Other intangible assets will continue to be amortized over their useful lives.

The Company adopted the new rules on accounting for goodwill and other intangible assets beginning in the first quarter of fiscal 2002. Amounts previously recorded as separately identifiable intangibles for acquired work force and customer list have been subsumed to goodwill in accordance with FAS 141, increasing goodwill by \$1.6 million as of the date of adoption. Effective with the July 1, 2002 adoption of FAS 142, goodwill is no longer amortized but is instead subject to an annual impairment test. The transitional impairment test conducted in connection with the adoption of FAS 142 resulted in no required provision for impairment.

Goodwill and other intangible assets resulting from acquisitions of business and the formation of the Company consist of the following:

| | June 30, 2001 | March 31, 2002 |
|-------------------------------|---------------|----------------|
| | ----- | ----- |
| Goodwill | \$11,504,520 | \$11,504,520 |
| Less accumulated amortization | 1,671,430 | 1,671,430 |
| | ----- | ----- |
| Net goodwill | 9,833,090 | 9,833,090 |
| | ----- | ----- |
| Other intangible assets: | 1,783,686 | 1,783,686 |
| Less accumulated amortization | 366,015 | 566,249 |
| | ----- | ----- |
| Net other intangible assets | 1,417,671 | 1,217,407 |
| | ----- | ----- |
| Total intangible assets, net | \$11,250,761 | \$11,050,497 |
| | ===== | ===== |

With the adoption of FAS 142, the Company ceased amortization of goodwill as of July 1, 2001. The following table presents the results of the Company for all periods presented on a comparable basis:

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| | Nine Months Ended March 31 | |
|---|----------------------------|--------------|
| | 2002 | 2001 |
| Reported net income attributed to common shareholders | \$ 3,611,718 | \$ 2,806,237 |
| Add back goodwill amortization, net of tax provision | -- | 354,459 |
| Adjusted net income attributed to common shareholders | \$ 3,611,718 | \$ 3,160,696 |
| Diluted net income per share: | | |
| Reported net income attributed to common shareholders | \$.32 | \$.26 |
| Goodwill amortization | -- | .03 |
| Adjusted net income attributed to common shareholders | \$.32 | \$.29 |

3. Note Payable and Long Term Debt

The Company has a \$20,000,000 credit facility which provides for both term and revolving borrowings at varying rates based either on the bank's prime rate or LIBOR. As of March 31, 2002, there were borrowings outstanding of \$8,597,000 under the long-term note and \$400,000 under the revolving credit line.

Borrowings under the credit facility are secured by substantially all of the U.S. assets of the Company other than those pledged as collateral on previously existing lease or mortgage obligations. The interest rate on the term loan was 3.875% at March 31, 2002 and the weighted average rate on borrowings under the revolving line of credit was 5.65%.

The Company was in compliance with all financial covenants of its credit agreement as of March 31, 2002 and for the period then ended.

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4. Segment Information

Rehabiliticare and its consolidated subsidiaries operate in one reportable segment, the manufacture and distribution of electromedical pain management, rehabilitation and sports training products. The Company's chief operating decision makers use consolidated results to make operating and strategic decisions. Net revenue from the United States and foreign sources (primarily Europe) was as follows:

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For the Nine Months Ended
March 31

| | 2002 | 2001 |
|-----------------|--------------|--------------|
| U.S. revenue | \$34,180,374 | \$33,184,315 |
| Foreign revenue | 17,228,928 | 12,083,725 |
| | ----- | ----- |
| | \$51,409,302 | \$45,268,040 |
| | ===== | ===== |

Net revenue by product line was as follows:

| | 2002 | 2001 |
|--------------------------|--------------|--------------|
| Rehabilitation products | \$10,707,791 | \$ 9,194,245 |
| Pain management | 10,469,977 | 10,571,689 |
| Consumer Products | 12,477,936 | 8,592,509 |
| Accessories and supplies | 17,753,598 | 16,909,597 |
| | ----- | ----- |
| | \$51,409,302 | \$45,268,040 |
| | ===== | ===== |

During the first nine months of fiscal 2002 and 2001, one customer accounted for approximately 15% and 13%, respectively, of consolidated revenue. This customer represented approximately 9% of total accounts receivable at March 31, 2002.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

OVERVIEW

The Company designs, manufactures and distributes electrotherapy products used for pain management, rehabilitation and sports training. Its products are used in clinical, home health care, sports medicine and occupational medicine applications. It also distributes other medical products used in related applications. The Company operates in one business segment, distributing its products through sales to medical product dealers and distributors, sport shops and, in the

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United States and the United Kingdom, through direct rental or sale to patients.

The direct rental or sale approach in the United States involves placing electrotherapy units with physicians, physical therapists and other health care providers who then refer those units to patients after determining an appropriate treatment regimen. Units are left on consignment with the health care providers for such referral. The Company then bills the patient or the patient's insurance carrier directly after being notified that a unit has been prescribed and provided to the patient. The Company takes responsibility for subsequent patient follow-up, including extension of the rental period; sale of the unit, if appropriate, and sale of additional supplies required for continued use of the electrotherapy units. This distribution approach requires the Company to maintain significant investments in inventories and receivables.

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RESULTS OF OPERATIONS

The following table sets forth information from the statements of operations as a percentage of revenue for the periods indicated:

| | Three Months Ended March 31 | | Nine Months Ended March 31 | |
|-------------------------------------|--------------------------------|--------|-------------------------------|--------|
| | 2002 | 2001 | 2002 | 2001 |
| Net sales and rental revenue | 100.0% | 100.0% | 100.0% | 100.0% |
| Cost of sales and rentals | (32.1) | (31.8) | (32.8) | (31.4) |
| Gross profit | 67.9 | 68.2 | 67.2 | 68.6 |
| Operating expenses - | | | | |
| Selling, general and administrative | (54.5) | (53.0) | (50.9) | (52.6) |
| Research and development | (2.7) | (3.3) | (3.1) | (2.9) |
| Total operating expenses | (57.2) | (56.3) | (54.0) | (55.5) |
| Income from operations | 10.8 | 11.9 | 13.2 | 13.1 |
| Other income (expense), net | (0.8) | (1.9) | (1.1) | (2.2) |
| Income tax provision | (4.2) | (4.3) | (5.1) | (4.7) |
| Net income | 5.8 | 5.7 | 7.0 | 6.2 |

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Revenue was \$17,777,000 for the third quarter of fiscal 2002, a 17% increase from \$15,172,000 for the third quarter of fiscal 2001. Revenue for the nine months ended March 31, 2002 increased 14% to \$51,409,000 from \$45,268,000 for the first nine months of fiscal 2001. The largest component of those increases was the Company's Compex operation where revenue increased 70% in the third quarter and 45% in the first nine months of fiscal 2002 over the same periods in fiscal 2001. Compex's revenue increases resulted from volume increases in all markets, particularly Spain. Revenue from U.S. operations was up 2% in the third quarter and up 3% in the first nine months of fiscal 2002 compared to the same periods in fiscal 2001. Increases in revenue from direct rental or sale to patients of 5% in the third quarter and 7% in the first nine months resulted primarily from increased sales of units and supplies. Those increases were offset by declines in sales to medical product dealers and distributors as many of them converted some of their purchases to lower priced, often imported, units.

Gross profit was \$12,074,000 or 67.9% of revenue for the third quarter and \$34,529,000 or 67.2% of revenue for the first nine months of fiscal 2002, compared with \$10,349,000 or 68.2% of revenue for the third quarter and \$31,049,000 or 68.6% of revenue for the first nine months of fiscal 2001. The decline in the gross margin percentage resulted from continued growth of Compex revenue as a percent of total revenue and further reductions in the Compex gross margin percentage as a result of changes in product mix toward lower price sport and fitness products. Overall margins are expected to continue in the mid-sixties.

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Selling, general and administrative expenses increased 20% to \$9,687,000 in the third quarter of fiscal 2002 from \$8,049,000 in fiscal 2001. As a percent of revenue, those expenses increased to 54% in the third quarter of fiscal 2002 from 53% in fiscal 2001. U.S. expenses for the third quarter included a charge of \$563,000 for accrued compensation payable to David B. Kaysen, who resigned as President and CEO of the Company effective March 31, 2002. For the nine months ended March 31, 2002, selling, general and administrative expenses increased 10% to \$26,180,000 from \$23,813,000 in fiscal 2001. As a percent of revenue, those expenses declined to 51% during the first nine months of fiscal 2002 from 53% in fiscal 2001. The decline in the nine-month period resulted from Compex expenses increasing at a rate slower than the related increase in its revenue as newer markets achieve significant growth. In the U.S., those expenses are essentially unchanged as a percent of revenue after adjusting for the effect of discontinuing amortization of goodwill as described in Note 2 to the financial statements.

Research and development expense decreased 4% to \$473,000 in the third quarter of fiscal 2002. In the nine months ended March 31, 2002, those costs increased 18% to \$1,576,000 from \$1,334,000 in fiscal 2001. The increase in the nine-month period reflects the cost of new product development activities both in the U.S. and Compex operations. The most significant project in the U.S. was the new ProMax TENS unit for which production started in October 2001. In Europe, three new products have been introduced in the last nine months. The Company anticipates that research and development expenses will remain relatively constant as a percentage of revenue in future periods.

Interest expense decreased 54% from \$313,000 in the third quarter of fiscal 2001

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to \$144,000 in the third quarter of fiscal 2002 and decreased 45% from \$1,026,000 in the first nine months of fiscal 2001 to \$560,000 in fiscal 2002. The decreases resulted from lower interest rates and overall lower borrowings under the Company's credit facility. The Company expects interest expense to continue to decline with the lower overall balance of its indebtedness.

The provision for income taxes is 42% of income before taxes for the first nine months of fiscal 2002 compared to 43% for the same period of fiscal 2001. The Company operates in various countries in Europe as well as the United States. Some countries have higher tax rates than the United States as well as different rules on the deductibility of certain expenses and the availability of certain credits for taxes paid to other jurisdictions. The Company believes that 42% is a reasonable estimate of the effective rate for fiscal 2002 based on most recent estimates of expected sources of revenue and expenses for the entire year. The Internal Revenue Service has recently completed an examination of the Company's federal income tax returns for the years ended June 30, 1997 and 1998 and has proposed adjustments pursuant to such audit, most of which relate to the timing of revenue or expense recognition. The Company has filed a formal appeal of certain proposed adjustments and believes its provision for income taxes and related reserves are adequate.

As a result of the above activity, net income increased from \$853,000 in the third quarter of fiscal 2001 to \$1,029,000 in the third quarter of fiscal 2002. For the nine months ended March 31, 2002, net income increased to \$3,612,000 from \$2,806,000 during the same period in fiscal 2001. Diluted earnings per share increased from \$.08 to \$.09 for the third quarter and \$.26 to \$.32 per share for the nine month period.

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LIQUIDITY AND CAPITAL RESOURCES

For the nine months ended March 31, 2002, the Company's operations provided cash of \$3,392,000, mainly from net income of \$3,612,000 plus depreciation and amortization and less the net increase in current assets. Prepaid expenses declined due to lower value added tax prepayments by Compex. Accounts receivable increased \$2,144,000, mainly from higher sales and slower collections for Compex. The decrease in accounts payable relates to timing differences and the payment of year-end accruals.

The Company used \$662,000 in investing activities for the first nine months of fiscal 2002 for net purchases of property and equipment, including clinical and rental equipment.

The Company's financing activities used \$1,715,000 of cash during the first nine months of fiscal 2002, mainly for the repayment of \$2,470,000 of long-term debt under its \$20,000,000 credit facility, less net borrowings of \$400,000 under that facility. Borrowings were used primarily to build inventories in connection with new product introductions. At March 31, 2002, a total of \$8,997,000 is outstanding under this facility, including \$400,000 of short-term debt under the revolving line of credit.

This credit facility has a maturity date of June 30, 2004, at which time all outstanding borrowings are to be repaid. The Company anticipates all or substantially all borrowings under this credit facility will be repaid prior to

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the maturity date. If any borrowings are still outstanding at maturity, the Company believes that the agreement could be extended with the current financial institution or another facility put in place.

Managing receivables represents one of the biggest business challenges to the Company. The process of determining what products will be reimbursed by third party payors and the amounts to be paid for those products is very complex and the reimbursement environment is constantly changing. That risk is spread across many payors throughout the United States. The determination of an appropriate reserve for uncollectible accounts at the end of each reporting period is based on various factors including historical trends and relationships and experience with insurance companies or other third party payors. The Company believes that the reserve at March 31, 2002 is adequate to cover future losses on its receivables based on collection history and trends. The provision for uncollectible accounts recorded in the income statement may continue to fluctuate significantly from quarter to quarter as such trends change. The reserve was 31% of receivables at March 31, 2002 compared to 30% at June 30, 2001.

The Company has no material commitment for capital expenditures. The Company believes that available cash and borrowings under its credit line will be adequate to fund cash requirements for the current fiscal year and the foreseeable future.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The Company is exposed to market risk from changes in the interest rates on certain of its outstanding debt. The outstanding loan balance under the \$20 million credit facility bears interest at a variable rate based on the bank's prime rate or LIBOR. Based on the average outstanding bank debt for the period ended March 31, 2002, a 100 basis point change in interest rates would not change interest expense by a material amount.

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PART II - OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

In late January 2001, Rehabilitare was served with documents in connection with a product liability case brought in the California Superior Court for Solano County. Although Rehabilitare had no record of the proceedings, the action had progressed to the entry of a default judgment on January 11, 2001.

Rehabilitare appealed the default judgment to the California Court of Appeals in March 2001. On May 10, 2002, the appeals court overturned the default judgment holding that there was no valid complaint against Rehabilitare on file.

ITEM 2. CHANGES IN SECURITIES AND USE OF PROCEEDS - None

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ITEM 3. DEFAULTS UPON SENIOR SECURITIES - None

ITEM 4 SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

The annual meeting of shareholders of Rehabilicare was held on January 10, 2002. Shareholders holding 8,814,831 shares, or approximately 81.4% of outstanding shares, were represented at the meeting by proxy or in person. The only matter submitted at the meeting for vote by the shareholders was as follows:

a. Election of Directors

The following nominees were elected to serve as members of the Board of Directors until the annual meeting of shareholders in 2002 or until such time as a successor may be elected.

| | In Favor ----- | Withheld ----- |
|--------------------|-------------------|-------------------|
| Frederick H. Ayers | 8,746,145 | 68,686 |
| Richard E. Jahnke | 8,740,280 | 74,551 |
| David B. Kaysen | 8,735,559 | 79,272 |
| John H.P. Maley | 8,739,168 | 75,663 |
| Robert C. Wingrove | 8,747,004 | 67,827 |

Mr. Kaysen subsequently resigned as an executive officer and director effective March 31, 2002.

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ITEM 5. OTHER INFORMATION - None

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) Exhibits

10.1 Separation Agreement dated March 31, 2002 between the Company and David B. Kaysen

(b) Reports on Form 8-K

None filed during the quarter ended March 31, 2002

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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.

REHABILICARE INC.

May 15, 2002

/s/ John H.P. Maley

Date

John H.P. Maley
Chief Executive Officer

May 15, 2002

/s/ W. Glen Winchell

Date

W. Glen Winchell
Vice President of Finance
(Principal Financial and Accounting Officer)