

HEARUSA INC
Form 10-K
March 27, 2009

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-K
ANNUAL REPORT
PURSUANT TO SECTIONS 13 OR 15(d) OF THE
SECURITIES EXCHANGE ACT OF 1934

(Mark One)

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

For the fiscal year ended DECEMBER 27, 2008

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

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

Securities registered pursuant to Section 12(b) of the Act:

Title of each class

Name of each exchange on which registered

Common Stock, par value \$0.10 per share

NYSE Amex

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark whether the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes No

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 if disclosure of delinquent filers pursuant to item 405 of Regulation S-K is not contained herein and will not be contained, to the best of the registrant's knowledge, in definitive proxy or information statements incorporated by reference in PART III of this Form 10-K or any amendment to this

Form 10-K.

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 the definitions of "large accelerated filer", "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
(Do not check if a 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

As of June 30, 2008, the aggregate market value of the registrant's Common Stock held by non-affiliates (based upon the closing price of the Common Stock on the NYSE Amex, formerly known as the American Stock Exchange) was approximately \$53,665,692.

On March 5, 2009, 44,836,964 shares of the registrant's Common Stock including 503,061 of exchangeable shares were outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of registrant's definitive proxy statement for the 2008 Annual Meeting of the registrant's stockholders ("2009 Proxy Statement"), to be filed with the Securities and Exchange Commission, are incorporated by reference in Part III hereof.

PART I

Item 1. Business

HearUSA, Inc. (HearUSA or the Company), was incorporated in Delaware on April 11, 1986, under the name HEARx Ltd., and formed HEARx West LLC, a fifty-percent owned joint venture with Kaiser Permanente, in 1998. In July of 2002, the Company acquired Helix Hearing Care of America Corp. (Helix) and changed its name from HEARx Ltd. to HearUSA, Inc.

At December 27, 2008, HearUSA had 202 company-owned hearing care centers in ten states and the Province of Ontario, Canada. The Company also sponsors a network of approximately 1,900 credentialed audiology providers that participate in selected hearing benefit programs contracted by the Company with employer groups, health insurers and benefit sponsors in 49 states. The center professionals and the network providers provide audiological testing, products and services for the hearing impaired.

HearUSA seeks to increase market share and market penetration in its center and network markets. The Company's strategies for increasing market penetration include advertising to the non-insured self-pay market, positioning itself as the leading provider of hearing care to healthcare providers, increasing awareness of physicians about hearing care services and products in the Company's geographic markets and seeking strategic acquisitions. The Company believes it is well positioned to successfully address the concerns of access, quality and cost for the patients of managed care and other health insurance companies, diagnostic needs of referring physicians and, ultimately, the hearing health needs of the public in general.

Products

HearUSA's centers provide a complete range of quality hearing aids, with emphasis on the latest digital technology along with assessment and evaluation of hearing. While the centers may order a hearing aid from any manufacturer, the majority of the hearing aids sold by the centers are manufactured by Siemens Hearing Instruments, Inc. (Siemens) and its subsidiaries, Rexton and Electone. The Company has a supply agreement with Siemens for HearUSA centers. The Company has agreed to sell certain minimum percentages of the centers' hearing aid requirements of Siemens products. The centers also sell hearing aids manufactured by other manufacturers including Phonak, Oticon, Starkey, Sonic Innovations and Unitron.

HearUSA's centers also offer a large selection of assistive listening devices and other products related to hearing care. Assistive listening devices are household and personal technology products designed to assist the hearing impaired in day-to-day living, including such devices as telephones and television amplifiers, telecaptioners and decoders, pocket talkers, specially adapted telephones, alarm clocks, doorbells and fire alarms. Hearing loss prevention products are designed to protect against hearing loss for people exposed to loud sounds. These ancillary products include special ear molds for musicians, hunters and specialized molds for iPods and similar devices.

The hearing care network providers also provide hearing aids, assistive listening devices and other products related to hearing care as well as audiology services.

Acquisition Program

In 2008, the Company continued its strategic acquisition program in order to accelerate its growth. The program consists of acquiring hearing care centers located in the Company's core and target markets. The Company often can benefit from the synergies of combined staffing and can use advertising more efficiently. The payment terms on a specific acquisition have typically been a combination of cash and notes. The source of funds for the cash portion of the acquisition price has been cash on hand or the Siemens acquisition credit line (see Note 6 Long-Term Debt, Notes to Consolidated Financial Statements included herein).

In order to maximize the return on its investment in acquisitions and to ensure integration of the acquired centers, the Company has established an integration program. This program covers the implementation of our center management system, including the conversion of the acquired center patient database, transfer of vendors to the Company's existing vendors to benefit from better pricing, employee training and marketing programs. The performance of each acquired center is monitored closely for a period of three to six months or until management is fully satisfied that the center has been successfully integrated into the Company.

Managed Care, Institutional Contracts and Benefit Providers

Since 1991, the Company has entered into arrangements with institutional buyers relating to the provision of hearing care products and services. HearUSA believes that contractual relationships with institutional buyers of hearing aids are essential to the success of the Company's business plan. These institutional buyers include managed care companies, employer groups, health insurers, benefit sponsors, senior citizen buying groups and unions. By developing contractual arrangements for the referral of patients, the plan members have access to standardized care and relationships with local area physicians are enhanced. Critical to providing care to members of these groups are the availability of distribution sites, quality and control and standardization of products and services. The Company believes its system of high quality, uniform company-owned centers meets the needs of the patients and their hearing benefit providers and that the network providers can expand available distribution sites for these patients. In the past two years, the Company has expanded its managed care contracts into areas serviced by the affiliated network providers.

HearUSA enters into provider agreements with benefit providers for the provision of hearing care using three different arrangements: (a) a discount arrangement on products and services which is payable by the member; (b) a fee for service arrangement which is partially subsidized by the sponsor and the member pays the balance; or (c) a per capita basis, which is a fixed payment per member per month from the benefit provider to HearUSA, determined by the benefit offered to the patient and the number of patients, and the balance, if any, paid by the individual member. When the agreement involves network providers, HearUSA pays the network provider an encounter fee, net of administration fees.

The terms of these provider agreements are generally renegotiated annually, and may be terminated by either party, usually on 90-days notice. The early termination of or failure to renew the agreements could adversely affect the operation of the centers located in the related market area.

The Company and its subsidiary, HEARx West, currently receive a per-member-per-month fee for more than 2 million managed care members. In total, HearUSA services over 400 benefit programs for hearing care with various health maintenance organizations, preferred provider organizations, insurers, benefit administrators and healthcare providers.

Sales Development

The Company has a sales development department in order to assist its professionals in developing the necessary skills to perform successfully. By providing training on methods, techniques, trouble shooting, dispensing and counseling skills, the Company believes this department helps provide a better service to patients and improves key performance indicators such as conversion, binaural fitting rates and reduced return rates.

Marketing

HearUSA's marketing plan includes:

Newspaper and Special Events: HearUSA places print ads in its markets promoting different hearing aids at a variety of technology levels and prices, along with special limited time events. Advertising also emphasizes the need to seek help for hearing loss as well as promoting the qualitative differences and advantages offered by HearUSA.

Direct Marketing: Utilizing HearUSA's database, HearUSA conducts direct mailings and offers free seminars in its markets on hearing aids and hearing loss.

Physician Marketing: HearUSA attempts to educate both physicians and their patients on the need for regular hearing testing and the importance of hearing aids and other assistive listening devices. HearUSA works to further its image as a provider of highly professional services, quality products, and comprehensive post-sale consumer education.

Telemarketing: HearUSA has a domestic national call center, which supports all HearUSA centers. The national call center is responsible for both inbound calls from consumers and outbound telemarketing. The Company uses a predictive dialer system which has improved call center productivity and increased the number of qualified appointments in its centers.

Facilities and Services

Each HearUSA center is staffed by a licensed and credentialed audiologist or hearing instrument specialist and at least one office manager or patient care coordinator. Experienced audiologists supervise the clinical operations. The majority of the Company's centers are conveniently located in shopping or medical centers and the centers are typically 1,000 to 2,500 square feet in size. The Company's goal is to have all centers similar in design and exterior marking and signage, because a uniform appearance reinforces the message of consistent service and quality of care.

Each center provides hearing services that meet or exceed applicable state and federal standards, including:

- Comprehensive hearing testing using standardized practice guidelines

- Interactive hearing aid selection and fitting processes

- Aural rehabilitation and follow up care

- Standardized reporting and physician communications

In some markets, a full range of audiovestibular testing is also available to assist in the diagnosis of medical and vestibular disorders.

Each of the 1,900 network providers operates independently from the Company. To ensure compliance with its hearing benefit programs, the Company performs annual credential verification for each of the network providers. The Company also performs random patient surveys on the quality of network providers' services.

Revenues

For the fiscal years 2008, 2007 and 2006, HearUSA net revenues were approximately \$112.0 million, \$102.8 million, and \$88.8 million, respectively. During these years the Company did not have revenues from a single customer which totaled 10% or more of total net revenues. Financial information about revenues by geographic area is set out in Note 19 Segments, Notes to Consolidated Financial Statements included herein.

Segments

The Company operates three business segments: the company-owned centers, the network of independent providers and an e-commerce business line. Financial information regarding these business segments is provided in Note 19 Segments, Notes to Consolidated Financial Statements included herein.

Centers

At the end of 2008, the Company owned 202 centers in Florida, New York, New Jersey, Massachusetts, Ohio, Michigan, Missouri, North Carolina, Pennsylvania, California (through HEARx West) and the Province of Ontario, Canada. These centers offer patients a complete range of services and products, including diagnostic audiological testing, the latest technology in hearing aids and assistive listening devices to improve their quality of life.

The centers owned through HEARx West are located in California. HearUSA is responsible for the daily operation of the centers. All clinical and quality issues are the responsibility of a joint committee comprised of HearUSA and Kaiser Permanente clinicians. HEARx West centers concentrate on providing hearing aids and audiology testing to Kaiser Permanente's members and self-pay patients in the state of California. At the end of 2008, there were 28 full-time and 4 part-time HEARx West centers.

Under the terms of the joint venture agreement between the Company and Kaiser Permanente, HEARx West has the right of first refusal for any new centers in southern California; Atlanta, Georgia; Hawaii; Denver, Colorado; Portland, Oregon; Cleveland, Ohio; Washington, D.C. and Baltimore, Maryland. In addition, should HearUSA make a center acquisition in any of these markets, HEARx West has the right to purchase such center. Such a sale would be made at arm's length, with HEARx West paying HearUSA the fair market value for any of the centers it acquires.

Network

The Company sponsors a network (known as the HearUSA Hearing Care Network) of approximately 1,900 credentialed audiology providers that supports hearing benefit programs with employer groups, health insurers and benefit sponsors in 49 states.

Unlike the company-owned centers, the network is comprised of hearing care practices owned by independent audiologists. Through the network, the Company can pursue national hearing care contracts and offer managed hearing benefits in areas outside of the company-owned center markets. The network's revenues are derived mainly from administrative fees paid by employer groups, health insurers and benefit sponsors to administer their benefits. In addition, the network provides Provider Advantage purchasing programs, whereby affiliated providers purchase products through HearUSA volume discounts and the Company receives royalties or rebates.

E-commerce

The Company offers online information about hearing loss, hearing aids, assistive listening devices and the services offered by hearing health care professionals. The Company's web site also offers online purchases of hearing-related products, such as batteries, hearing aid accessories and assistive listening devices. In addition to online product sales, e-commerce operations are also designed as a marketing tool to inform the public and generate referrals for centers and for network providers.

Distinguishing Features

Integral to the success of HearUSA's strategy is increased awareness of the impact of hearing loss and the medical necessity of treatment, in addition to the enhancement of consumer confidence and the differentiation of HearUSA from other hearing care providers. To this end, the Company has taken the following unique steps:

Utilization Review Accreditation Commission

HearUSA was originally accredited by the Joint Commission of the Accreditation of Healthcare Organizations (JCAHO). Recently, the JCAHO determined that it would not continue to accredit network (preferred provider organizations). Therefore, the Company took action to continue its pursuit of distinctive quality and underwent and secured its first three-year health network accreditation through Utilization Review Accreditation Commission (URAC), an independent nonprofit organization which is a recognized leader in promoting health care quality. URAC provides a symbol of excellence for organizations to validate their commitment to quality and accountability and ensures that all stakeholders are represented in establishing meaningful quality measures for the entire health care industry.

Center Management System, Medical Reporting and HearUSA Data Link

The Company has developed a proprietary center management and data system called the Center Management System (CMS). CMS primarily has two functions: to manage patient information and to process point-of-sale customer transactions. The CMS system is operated over a wide area network that links all locations with the corporate office. The Company s wide area network leverages technologies including data and telephony deliveries. This system is only used in the company-owned centers. As the Company acquires new centers, a critical part of the integration process is the inclusion of the new center into the CMS.

The Company s corporate system is fully integrated with CMS to provide additional benefits and functionality that can be better supported centrally. Data redundancy is built into the system architecture as data is currently stored both at the regional facilities and at the central facility. The consolidated data repository is constructed to support revenues in excess of \$550 million, to accommodate approximately 500 unique business units and to manage 500,000 new patients annually.

One of the outputs of CMS is a computerized reporting system that provides referring physicians the test results and recommended action for every patient examined by HearUSA staff in a company-owned center. To the Company s knowledge, no other dispenser or audiologist presently offers any referring physician similar documentation. Consistent with the Company s mission of making hearing care a medical necessity, this reporting system makes hearing a part of the individual s health profile, and increases awareness of hearing conditions in the medical community. Another unique aspect of CMS is its data mining capability which allows for targeted marketing to its customer base. The national call center also has the ability to access the CMS system and can directly schedule appointments.

Competition

The U.S. hearing care industry is highly fragmented with approximately 9,000 independent practitioners providing hearing care products and services. The Company competes on the basis of price and service and, as described above, tries to distinguish itself as a leading provider of hearing care to health care providers and the self-pay patient. The Company competes for the managed care customer on the basis of access, quality and cost.

In the Canadian Province of Ontario, the traditional hearing instrument distribution system is primarily made up of small independent practices where associations are limited to two or three centers. Most centers are relatively small and are located in medical centers, professional centers or in small shopping centers.

It is difficult to determine the precise number of the Company s competitors in every market where it has operations, or the percentage of market share enjoyed by the Company. Some competitors are large distributors, including Amplifon of Italy, which owns a network of franchised centers (Miracle Ear and National Hearing Center) and company-owned centers (Sonus) in the United States and Canada, and Beltone Electronics Corp., a hearing aid manufacturer owned by Great Nordic that distributes its products primarily through a national network of authorized distributors in the United States and Canada. Large discount retailers, such as Costco, also sell hearing aids and present a competitive threat in selected HearUSA markets. All of these companies have greater resources than HearUSA, and there can be no assurance that one or more of these competitors will not expand and/or change their operations to capture the market targeted by HearUSA.

The Company's network business will also face competition by companies offering similar network services. These companies attempt to aggregate demand for hearing products and sell marketing and other services to network participants. In addition, some of these networks are able to offer discounts to managed care payors, insurers and membership organizations. Many independent hearing care providers belong to more than one network. In addition, contract terms for membership are typically short and may be terminated by either party at will. There can be no assurance, however, that the largely fragmented hearing care market cannot be successfully consolidated by the establishment of co-operatives, alliances, confederations or the like, which would then compete more directly with HearUSA's network and its company-owned centers.

Reliance on Manufacturers

The Company's supply agreement with Siemens requires that a significant portion of the company-owned centers' sales will be of Siemens devices. Siemens has a well-diversified product line (including Electone) with a large budget devoted to research and development. However, there can be no guarantee that Siemens' technology or product line will remain desirable in the marketplace. Furthermore, if Siemens' manufacturing capacity cannot keep pace with the demand of HearUSA and other customers, HearUSA's business may be adversely affected.

In the event of a disruption of supply from Siemens or another of the Company's current suppliers, the Company believes it could obtain comparable products from other manufacturers. Few manufacturers offer dramatic product differentiation. HearUSA has not experienced any significant disruptions in supply in the past.

Regulation

Federal

The practice of audiology and the dispensing of hearing aids are not presently regulated on the federal level in the United States, except to the extent that those services are governed by the Center for Medicare and Medicaid Services. The United States Food and Drug Administration (FDA) is responsible for monitoring the hearing care industry. The FDA enforces regulations that deal specifically with the manufacture and sale of hearing aids. FDA requires that all dispensers meet certain conditions before selling a hearing aid relating to suitability of the patient for hearing aids and the advisability of medical evaluation prior to being fitted with a hearing aid. The FDA requires that first time hearing aid purchasers receive medical clearance from a physician prior to purchase; however, patients may sign a waiver in lieu of a physician's examination. The FDA has mandated that states adopt a return policy for consumers offering them the right to return their products, generally within 30 days. HearUSA offers all its customers a full 30-day return period or the return period applicable to state guidelines and extends the return period to 60 days for patients who participate in the family hearing counseling program. FDA regulations require hearing aid dispensers to provide customers with certain warnings and statements regarding the use of hearing aids. Also, the FDA requires hearing aid dispensers to review instructional manuals for hearing aids with patients before the hearing aid is purchased.

In addition, a portion of the Company's revenues comes from participation in Medicare and Medicaid programs. Federal laws prohibit the payment of remuneration in order to receive or induce the referral of Medicare or Medicaid patients, or in return for the sale of goods or services to Medicare or Medicaid patients. Furthermore, federal law limits physicians and other healthcare providers from referring patients to providers of certain designated services in which they have a financial interest. HearUSA believes that all of its managed care and other provider contracts and its relationships with referring physicians are in compliance with these federal laws.

The Health Insurance Portability and Accountability Act of 1996 (HIPAA) requires the use of uniform electronic data transmission standards for health care claims and payment transactions submitted or received electronically. The Department of Health and Human Services (HHS) adopted regulations establishing electronic data transmission standards that all health care providers must use when submitting or receiving certain health care transactions electronically. In addition, HIPAA required HHS to adopt standards to protect the security and privacy of health-related information. Final regulations containing privacy standards are now effective. HearUSA believes it has taken the necessary steps to be in full compliance with these regulations.

The Federal Trade Commission (FTC) issued the amended Telemarketing Sales Rule on January 29, 2003. The amended rule gave effect to the Telemarketing and Consumer Fraud and Abuse Prevention Act. This legislation gave the FTC and state attorney generals law enforcement tools to combat telemarketing fraud, gave consumers added privacy protections and defenses against unscrupulous telemarketers, and was intended to help consumers tell the difference between fraudulent and legitimate telemarketing. One significant provision of the Telemarketing Sales Rule was inclusion of the prohibition on calling consumers who have put their telephone numbers on the national Do Not Call registry unless one of several exceptions is applicable to the call or to the consumer. Other FTC guidelines pertinent to the Company involve professional business practices relating to issues such as transmitting the caller's telephone number on caller ID, abandoning calls and speaking to consumers in a non-professional manner.

On July 25, 2003 the Federal Communications Commission issued a revised Final Rule Implementing the Telephone Consumer Protection Act of 1991 (TCPA Rule). The original TCPA Rule, issued in 1992, required telemarketers to honor all requests by a consumer that the telemarketer not make future calls on behalf of a specified seller to that consumer, restricted the use of recorded messages in telemarketing, and prohibited unsolicited commercial facsimile transmissions. The revised TCPA Rule prohibits telemarketing calls to telephone numbers on the national Do Not Call registry unless one of several exceptions is applicable to the call or consumer, and also contains provisions similar to those in the revised Telemarketing Sales Rule regarding the transmission of caller ID and abandoned calls. Among other provisions, the revised TCPA rule prohibits the uses of predictive dialers to place telephone calls to cellular telephones. The Company adheres to policies set forth by the FTC and the FCC, and has established policies and practices to ensure its compliance with FTC and FCC regulations, including the requirements related to the national Do Not Call registry.

In addition, the FTC is responsible for monitoring the business practices of hearing aid dispensers and vendors. The FTC can take action against companies that mislead or deceive consumers. FTC regulations also require companies offering warranties to fully disclose all terms and conditions of their warranties.

The FTC is also engaged in enforcement relating to the protection of sensitive customer data. The FTC has announced a program of enforcement actions to ensure that businesses implement reasonable data security practices to protect sensitive consumer data such as Social Security numbers.

The CAN-SPAM Act of 2003 regulates commercial electronic mail on a nationwide basis. It imposes certain requirements on senders of commercial electronic mail. The Company adheres to the law by properly representing the nature of its commercial email messages in the subject line, not tampering with source and transmission information in the email header, and obtaining email addresses through lawful means. The Company adheres to the specific disclosure requirements of the law by including a physical mail address and a clearly identified and conspicuous opt-out mechanism in all commercial email. The Company honors all consumer requests to stop receiving future commercial emails in a timely manner.

The Company cannot predict the effect of future changes in federal laws, including changes that may result from proposals for federal health care reform, or the impact that changes in existing federal laws or in the interpretation of those laws might have on the Company. The Company believes it is in material compliance with all existing federal regulatory requirements.

State

State regulations of the hearing care industry exist in every state and are concerned primarily with the formal licensure of audiologists and those who dispense hearing aids, including procedures involving the fitting and dispensing of hearing aids. There can be no assurance that regulations will not exist in jurisdictions in which the Company plans to open centers or will not be promulgated in states in which the Company currently operates centers which may have a material adverse effect upon the Company. Such regulations might include more stringent licensure requirements for dispensers of hearing aids, inspections of centers for the dispensing of hearing aids and the regulation of advertising by dispensers of hearing aids. The Company knows of no current or proposed state regulations with which it, as currently operated, could not comply.

Many states have laws and regulations that impose additional requirements related to telemarketing and to the use of commercial email. These include telemarketing registration requirements and anti-fraud protections related to telemarketing and email. In some cases, state laws and regulations may be more restrictive than federal laws and regulations.

State regulation may include the oversight of the Company's advertising and marketing practices as a provider of hearing aid dispensing services. The Company's advertisements and other business promotions may be found to be in violation of these regulations from time to time, and may result in fines or other sanctions, including the prohibition of certain marketing programs that may ultimately harm financial performance.

The Company employs licensed audiologists and hearing aid dispensers. Under the regulatory framework of certain states, business corporations are not able to employ audiologists or offer hearing services. California has such a law, restricting the employment of audiologists to professional corporations owned by audiologists or similar licensees. The Company believes, however, that because the State of California's Department of Consumer Affairs has indicated that speech-language pathologists may be employed by business corporations, the Company may employ audiologists. The similarity of speech-language pathology to audiology, and the fact that speech-language pathologists and audiologists are regulated under similar statutes and regulations, leads the Company to believe that business corporations and similar entities may employ audiologists. No assurance can be given that the Company's interpretation of California's laws will be found to be in compliance with laws and regulations governing the corporate practice of audiology or, if its activities are not in compliance, that the legal structure of the Company's California operations can be modified to permit compliance.

In addition, state laws prohibit any remuneration for referrals, similar to federal laws discussed above.

Generally, these laws follow the federal statutes described above. State laws also frequently impose sanctions on businesses when there has been a breach of security of sensitive customer information.

The Company believes it is in material compliance with all applicable state regulatory requirements. However, the Company cannot predict future state legislation which may affect its operations in the states in which it does business, nor can the Company assure that interpretations of state law will remain consistent with the Company's understanding of those laws as reflected through its operations.

Canada

Laws and regulations for the Province of Ontario, Canada are concerned primarily with the formal licensure of audiologists and dispensers who dispense hearing aids and with practices and procedures involving the fitting and dispensing of hearing aids. All Ontario audiologists must be members of the College of Audiologists and Speech and Language Pathologists of Ontario and hearing aid dispensers practicing in Ontario must be members of the Association of Hearing Instrument Practitioners. Both audiologists and hearing instrument practitioners are governed by a professional code of conduct. There can be no assurance that regulations will not be promulgated in the Province of Ontario which may have a material adverse effect upon the Company. Such regulations might include more stringent licensure requirements for dispensers of hearing aids, inspections of centers for the dispensing of hearing aids and the regulation of advertising by dispensers of hearing aids. The Company knows of no current or proposed Ontario regulations with which it, as currently operated, could not comply. The Company employs licensed audiologists and hearing aid dispensers in the Province of Ontario. Ontario regulations and codes of conduct of audiologists and hearing instrument practitioners may include the oversight of the Company's advertising and marketing practices as a provider of hearing aid dispensing services. The Company's advertisements and other business promotions may be found to be in violation of these regulations from time to time, and may result in fines or other sanctions, including the prohibition of certain marketing programs that may ultimately harm financial performance.

In addition, Ontario regulations and codes of conduct of audiologists and hearing instrument practitioners prohibit any remuneration for referrals. The Company has structured its operations in Canada to assure compliance with these regulations and codes and believes it is in full compliance with Canadian law.

Product and Professional Liability

In the ordinary course of its business, HearUSA may be subject to product and professional liability claims alleging the failure of, or adverse effects claimed to have been caused by products sold or services provided by the Company. The Company maintains insurance at a level which the Company believes to be adequate. A successful claim in excess of the policy limits of the Company's liability insurance, however, could adversely affect the Company. As the distributor of products manufactured by others, the Company believes it would properly have recourse against the manufacturer in the event of a product liability claim; however, there can be no assurance that recourse against a manufacturer by the Company would be successful or that any manufacturer will maintain adequate insurance or otherwise be able to pay such liability.

Seasonality

The Company is subject to regional seasonality, the impact of which is minimal.

Employees

At December 27, 2008, HearUSA had 531 full-time employees and 76 part-time employees

Where to Find More Information

The Company makes information available free of charge on its website (www.hearusa.com). Through the website, interested persons can access the Company's annual report on Form 10-K, quarterly reports on Form 10-Q and current reports on Form 8-K after such material is electronically filed with the SEC. In addition, interested persons can access the Company's code of ethics and other governance documents on the Company's website.

Item 1A. Risk Factors

This Annual Report on Form 10-K, including the management discussion and analysis set out below, contains or incorporates a number of forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Act Exchange of 1934. These forward-looking statements are based on current expectations, estimates, forecasts and projections about the industry and markets in which we operate and management's beliefs and assumptions. Any statements that are not statements of historical fact should be considered forward-looking statements and should be read in conjunction with our consolidated financial statements and notes to the consolidated financial statements included in this report as well as the risk factors set forth below. The statements are not guarantees of future performance and involve certain risks, uncertainties and assumptions that are difficult to predict. The risks and uncertainties described below are not the only ones facing us. Additional risks and uncertainties that we are unaware of may become important factors that affect us. If any of the following risks occur, our business, financial condition and results of operations could be materially and adversely affected.

HearUSA has a history of operating losses and may never be profitable.

HearUSA has incurred net losses in each year since its organization. Our accumulated deficit at December 27, 2008 was approximately \$116.4 million and at December 29, 2007 was approximately \$113.0 million. We expect quarterly and annual operating results to fluctuate, depending primarily on the following factors:

- Timing of product sales;
- Level of consumer demand for our products;
- Timing and success of new centers and acquired centers; and
- Timing and amounts of payments by health insurance and managed care organizations.

There can be no assurance that HearUSA will achieve profitability in the near or long term or ever.

The current severe economic downturn is adversely affecting our sales.

Our business is affected by general economic conditions. As the downturn in the economy affects consumer spending, our sales are affected directly because many consumers forego attending to their hearing health care or select lower cost hearing aids in order to conserve cash. This adversely affects our unit sales. A sustained downturn in the economy in our local areas of operations, as well as on the state, national and international levels, will adversely affect the performance of our centers and our network providers.

We may not effectively compete in the hearing care industry.

The hearing care industry is highly fragmented and barriers to entry are low. Approximately 9,000 practitioners provide testing and dispense products and services that compete with those sold and provided by HearUSA. We also compete with small retailers, as well as large networks of franchisees and distributors established by larger companies, such as those manufacturing and selling Miracle Ear and Beltone products. Some of the larger companies have far greater resources than HearUSA and could expand and/or change their operations to capture the market targeted by HearUSA. Large discount retailers, such as Costco Wholesale Corporation, also sell hearing aids and present a competitive threat in our markets. In addition, it is possible that the hearing care market could be effectively consolidated by the establishment of cooperatives, alliances or associations that could compete more successfully for the market targeted by us.

We are dependent on manufacturers who may not perform.

HearUSA is not a hearing aid manufacturer. We rely on major manufacturers to supply our hearing aids and to supply hearing enhancement devices. A significant disruption in supply from any or all of these manufacturers could materially adversely affect our business. Our strategic and financial relationship with Siemens Hearing Instruments, Inc. requires us to purchase from Siemens a significant portion of our requirements of hearing aids at specified prices for a period of seven years (December 2008 to February 2015). Although Siemens is the world's largest manufacturer of hearing devices, there can be no assurance that Siemens' technology and product line will remain desirable in the marketplace. Furthermore, if Siemens' manufacturing capacity cannot keep pace with the demand of HearUSA and other customers, our business may be adversely affected.

We may not be able to access funds under our credit facility with Siemens if we cannot maintain compliance with the restrictive covenants contained therein and in our supply agreement with Siemens.

HearUSA and Siemens Hearing Instruments Inc. are parties to a credit agreement pursuant to which HearUSA has obtained a \$50 million secured credit facility from Siemens. As of December 27, 2008, an aggregate of approximately \$47 million in loans was outstanding under the credit facility. To continue to access the credit facility, we are required to comply with the terms of the amended credit facility, including compliance with restrictive covenants. There can be no assurance that we will be able to comply with these covenants in the future and, accordingly, may be unable to access the funds provided under the credit facility. If we are unable to comply with these covenants, we may be found in default by Siemens and all loans would be immediately due and payable under the credit agreement. In addition, we have entered into a supply agreement with Siemens, which imposes certain purchase requirements on us. If we fail to comply with the supply agreement, Siemens may declare us in default under the credit agreement and all loans would be immediately due and payable. This would have a material adverse effect on our ability to do business.

Current credit and financial market conditions could prevent or delay us from obtaining financing if our Siemens facility is unavailable to us, which would adversely affect our business, our operating results and financial condition.

Due to the recent severe tightening of credit markets and concerns regarding the availability of credit around the world, we may not be able to obtain necessary financing if the Siemens facility becomes unavailable to us because of a default by us under that facility or any other reason. Current market conditions could severely limit our ability to access capital. Because our stock has a low trading volume, we may not be able to access the equity market or may be limited in the amount of equity financing. If we need to obtain equity or debt financing, we may not be able to do so on satisfactory terms. This could adversely affect our business, operating results and financial condition.

We rely on qualified audiologists, without whom our business may be adversely affected.

HearUSA currently employs approximately 245 licensed hearing professionals, of whom approximately 179 are audiologists and 66, are licensed hearing aid specialists. If we are not able to attract and retain qualified audiologists, we will be less able to compete with networks of hearing aid retailers or with the independent audiologists who also sell hearing aids and our business may be adversely affected. Many audiologists are obtaining doctorate degrees, and the increased educational time required at the doctoral level is further restricting the pool of audiologists available for employment.

We may not be able to maintain existing agreements or enter into new agreements with health insurance and managed care organizations, which may result in reduced revenues.

HearUSA enters into provider agreements with health insurance companies and managed care organizations for the furnishing of hearing care in exchange for fees. The terms of most of these agreements are to be renegotiated annually, and these agreements may be terminated by either party, usually on 90 days or less notice at any time. There is no certainty that we will be able to maintain these agreements on favorable terms or at all. If we cannot maintain these contractual arrangements or enter into new arrangements, there will be a material adverse effect on our revenues and results of operations. In addition, the early termination of or failure to renew the agreements that provide for payment to HearUSA on a per-patient-per-month basis would cause us to lower our estimates of revenues to be received over the life of the agreements. This could have a material adverse effect on our results of operations.

We depend on our joint venture for our California operations and may not be able to attract sufficient patients to our California centers without it.

HEARx West LLC, our joint venture with Kaiser Permanente, operates 32 full-service centers in California. Since their inception, HEARx West centers have derived approximately two-thirds of their revenues from sales to Kaiser Permanente members, including revenues through an agreement between the joint venture and Kaiser Permanente's California division servicing its hearing benefited membership. If Kaiser Permanente does not perform its obligations under the agreement, or if the agreement is not renewed upon expiration, the loss of Kaiser patients in the HEARx West centers would adversely affect our business. In addition, HEARx West centers would be adversely affected by the loss of the ability to market to Kaiser members and promote the business within Kaiser's medical centers, including the referral of potential customers by Kaiser.

We rely on the efforts and success of managed care companies that may not be achieved or sustained.

Many managed care organizations, including some of those with whom we have contracts, have experienced and are continuing to experience significant difficulties arising from the widespread growth and reach of available plans and benefits. If the managed care organizations are unable to attract and retain covered members in our geographic markets, we may be unable to sustain the operations of our centers in those geographic areas. In addition, managed care organizations are subject to changes in federal legislation affecting healthcare. Administration changes in 2009 may have an effect on the way these organizations deliver services to their members. If these changes result in contract cancellations with these organizations, there can be no assurance that we can maintain all of our centers. We will close centers where warranted and such closures could have a material adverse effect on us.

We may not be able to maintain accreditation, and our revenues may suffer.

HearUSA had a three-year accreditation from the Joint Committee on Accreditation of Healthcare Organizations (JCAHO) that ended in 2008. The Network PPO (preferred provider organization) accreditation by JCAHO is no longer available. Accordingly, the Company continued its distinctive quality assurance by undergoing health network accreditation through the Utilization Review Accreditation Commission (URAC). HearUSA is now accredited by URAC. There can be no assurance that URAC accreditation will provide the same quality assurance to the public as the JCAHO accreditation provided or that we can maintain our accreditation. If we are not able to maintain our accredited status, our revenues may suffer.

We are exposed to potential product and professional liability that could adversely affect us if a successful claim is made in excess of insurance policy limits.

In the ordinary course of its business, HearUSA may be subject to product and professional liability claims alleging that products sold or services provided by the company failed or had adverse effects. We maintain liability insurance at a level which we believe to be adequate. A successful claim in excess of the policy limits of the liability insurance could materially adversely affect our business. As the distributor of products manufactured by others, we believe we would properly have recourse against the manufacturer in the event of a product liability claim. There can be no assurance, however, that recourse against a manufacturer by HearUSA would be successful, or that any manufacturer will maintain adequate insurance or otherwise be able to pay such liability.

Risks Relating to HearUSA Common Stock

The price of our common stock is volatile and could decline.

The price of HearUSA common stock could fluctuate significantly, and you may be unable to sell your shares at a profit. There are significant price and volume fluctuations in the market generally that may be unrelated to our operating performance, but which nonetheless may adversely affect the market price for HearUSA common stock. The price of our common stock could change suddenly due to factors such as:

- the amount of our cash resources and ability to obtain additional funding;
- economic conditions in markets we are targeting;
- fluctuations in operating results;
- changes in government regulation of the healthcare industry;
- failure to meet estimates or expectations of the market; and
- rate of acceptance of hearing aid products in the geographic markets we are targeting.

Any of these conditions may cause the price of HearUSA common stock to fall, which may reduce business and financing opportunities available to us and reduce your ability to sell your shares at a profit, or at all.

HearUSA might fail to maintain a listing for its common stock on the NYSE Amex, making it more difficult for stockholders to dispose of or to obtain accurate quotations as to the value of their HearUSA stock.

HearUSA common stock is presently listed on the NYSE Amex. The NYSE Amex will consider delisting a company's securities if, among other things,

the company fails to maintain stockholder's equity of at least \$2 million if the company has sustained losses from continuing operations or net losses in two of its three most recent fiscal years;

the company fails to maintain stockholder's equity of \$4 million if the company has sustained losses from continuing operations or net losses in three of its four most recent fiscal years;

the company fails to maintain stockholder's equity of \$6 million if the company has sustained losses from continuing operations or net losses in its five most recent fiscal years; or

the company has sustained losses which are so substantial in relation to its overall operations or its existing financial resources, or its financial condition has become so impaired that it appears questionable, in the opinion of the NYSE Amex, as to whether such issuer will be able to continue operations and/or meet its obligations as they mature.

HearUSA may not be able to maintain its listing on the NYSE Amex, and there may be no public market for the HearUSA common stock. In the event that HearUSA common stock is delisted from the NYSE Amex, trading, if any, in the common stock would be conducted in the over-the-counter market. As a result, you would likely find it more difficult to dispose of, or to obtain accurate quotations as to the market value of, your HearUSA common stock.

If penny stock regulations apply to HearUSA common stock, you may not be able to sell or dispose of your shares.

If HearUSA common stock is delisted from the NYSE Amex, the penny stock regulations of the Securities and Exchange Commission might apply to transactions in the common stock. A penny stock generally includes any over-the-counter equity security that has a market price of less than \$5.00 per share. The Commission regulations require the delivery, prior to any transaction in a penny stock, of a disclosure schedule prescribed by the Commission relating to the penny stock. A broker-dealer effecting transactions in penny stocks must make disclosures, including disclosure of commissions, and provide monthly statements to the customer with information on the limited market in penny stocks. These requirements may discourage broker-dealers from effecting transactions in penny stocks. If the penny stock regulations were to become applicable to transactions in shares of HearUSA common stock, they could adversely affect your ability to sell or otherwise dispose of your shares.

Exercise of outstanding HearUSA options and warrants could cause substantial dilution.

As of December 27, 2008, outstanding warrants and options of HearUSA included:

Warrants to purchase approximately 2.5 million shares of common stock and

Options to purchase approximately 5.4 million shares of common stock.

To the extent outstanding options or warrants are exercised or additional shares of capital stock are issued, stockholders will incur additional dilution.

Future sales of shares may depress the price of HearUSA common stock.

If substantial stockholders sell shares of HearUSA common stock into the public market, or investors become concerned that substantial sales might occur, the market price of HearUSA common stock could decrease. Such a decrease could make it difficult for HearUSA to raise capital by selling stock or to pay for acquisitions using stock. In addition, HearUSA employees hold a significant number of options to purchase shares, many of which are presently exercisable. Employees may exercise their options and sell shares soon after such options become exercisable, particularly if they need to raise funds to pay for the exercise of such options or to satisfy tax liabilities that they may incur in connection with exercising their options.

Because of the HearUSA rights agreement and the related rights plan for the exchangeable shares, a third party may be discouraged from making a takeover offer which could be beneficial to HearUSA and its stockholders.

HearUSA has entered into a rights agreement with The Bank of New York, as rights agent. HEARx Canada Inc. has adopted a similar rights plan relating to the exchangeable shares of HEARx Canada Inc. issued in connection with the acquisition of Helix. The rights agreements contain provisions that could delay or prevent a third party from acquiring HearUSA or replacing members of the HearUSA board of directors, even if the acquisition or the replacements would be beneficial to HearUSA stockholders. The rights agreements could also result in reducing the price that certain investors might be willing to pay for HearUSA capital stock.

Terms of our agreement with Siemens may discourage a third party from making a takeover offer which could be beneficial to HearUSA and its stockholders.

Pursuant to the terms of the Investor Rights Agreement with Siemens, the Company is obligated to provide Siemens with a right of first refusal in the event the Company proposes a transaction that would constitute a change of control with, or primarily involving, a person in the hearing aid industry. The existence of this right may discourage a third party in the hearing aid industry from making a takeover offer which could be beneficial to HearUSA and its stockholders.

Other Risks Relating to the Business of HearUSA

We may not be able to obtain additional capital on reasonable terms, or at all, to fund our operations.

If capital requirements vary from those currently planned or losses are greater than expected, HearUSA may require additional financing. If additional funds are raised through the issuance of convertible debt or equity securities, the percentage ownership of existing stockholders may be diluted, the securities issued may have rights and preferences senior to those of stockholders, and the terms of the securities may impose restrictions on operations. If adequate funds are not available on reasonable terms, or at all, we may be unable to take advantage of future opportunities to develop or enhance our business or respond to competitive pressures and possibly even to remain in business.

Acquisitions or investments could negatively affect our operations and financial results or dilute the ownership percentage of our stockholders.

We have implemented a strategic acquisition program. We may have to devote substantial time and resources in order to integrate completed acquisitions or complete potential acquisitions. We may not identify or complete acquisitions in a timely manner, on a cost-effective basis, or at all. Acquired operations may not be effectively integrated into our operations and may fail. In the event of any future acquisitions, HearUSA could:

- issue additional stock that would further dilute our current stockholders' percentage ownership;
- incur debt;
- assume unknown or contingent liabilities; or
- experience negative effects on reported operating results from acquisition-related charges and amortization of acquired technology, goodwill and other intangibles.

These transactions involve numerous risks that could harm operating results and cause the price of HearUSA common stock price to decline, including:

- potential loss of key employees of acquired organizations;
- problems integrating the acquired business, including its information systems and personnel;
- unanticipated costs that may harm operating results;
- diversion of management's attention from business concerns; and
- adverse effects on existing business relationships with customers.

Any of these risks could harm the business and operating results of HearUSA

If the Company is required to write down goodwill and other intangible assets, the Company's financial condition and results would be negatively affected.

When the Company acquires a business, a substantial portion of the purchase price of the acquisition is allocated to goodwill and other identifiable intangible assets. The amount of the purchase price which is allocated to goodwill and other intangible assets is determined by the excess of the purchase price over the net identifiable assets acquired. As of December 27, 2008, goodwill of \$66 million represented 276.0% of the Company's total stockholders' equity. As of December 27, 2008, other intangible assets, including customer files, non-competes and trade names, of \$15.6 million represented 65% of the Company's total stockholders' equity.

The Company accounts for goodwill in accordance with Statement of Financial Accounting Standards No. 142, Goodwill and Other Intangible Assets (SFAS 142), which addresses the financial accounting and reporting standards for the acquisition of intangible assets outside of a business combination and for goodwill and other intangible assets subsequent to their acquisition. This accounting standard requires that goodwill and intangible assets deemed to have indefinite lives no longer be amortized but instead be tested for impairment at least annually (or more frequently if impairment indicators arise). Other intangible assets will continue to be amortized over their useful lives.

Under current accounting standards, if the Company determines goodwill or intangible assets are impaired, the Company will be required to write down these assets. Any write-down would have a negative effect on the consolidated financial statements. During the fourth quarter of 2008, there was a significant deterioration in the Company's market capitalization which declined below the net book value. The decrease of the market capitalization below the net book value is a triggering event for an impairment test. Therefore the Company was required to perform the goodwill impairment test under SFAS 142 during the fourth quarter of 2008. Based upon this test, the Company concluded that the decline in market capitalization did not require the Company to recognize an impairment. See also

Management's Discussion and Analysis of Financial Condition and Results of Operations Critical Accounting Policies Impairment of goodwill and other intangible assets found elsewhere in this report. If the market capitalization remains below the net book value, or other negative business factors exist as outlined in SFAS 142, the Company may be required to perform another goodwill impairment analysis, which could result in an impairment of up to the entire balance of the Company's goodwill.

Increased exposure to currency fluctuations could have adverse effects on our reported earnings.

Most of HearUSA's revenues and expenses are denominated in U.S. dollars. Some of our revenues and expenses are denominated in Canadian dollars and, therefore, we are exposed to fluctuations in the Canadian dollar. As a result, our earnings will be affected by increases or decreases in the Canadian dollar. Increases in the value of the Canadian dollar versus the U.S. dollar would tend to increase reported earnings (or reduce losses) in U.S. dollar terms, and decreases in the value of the Canadian dollar versus the U.S. dollar would tend to reduce reported earnings (or increase losses).

Item 1B. Unresolved Staff Comments

None

Item 2. Properties

HearUSA's corporate offices, network management and national call center are located in West Palm Beach, Florida. The leases on these properties are for ten years and expire in 2018. As of December 27, 2008, the Company operated 43 centers in Florida, 14 in New Jersey, 29 in New York, 6 in Massachusetts, 8 in Ohio, 20 in Michigan, 7 in Missouri, 4 in Pennsylvania, 8 in North Carolina and 32 HEARx West centers in California. HearUSA also operates 31 centers in the Province of Ontario. All of the locations are leased for one to ten year terms pursuant to generally non-cancelable leases (with renewal options in some cases). The Company believes these locations are suitable to serve its patients' needs. The network is operated from the Company's corporate office in West Palm Beach. The Company has no interest or involvement in the network providers' properties or leases. The e-commerce business is operated from the Company's corporate office in West Palm Beach.

Item 3. Legal Proceedings

The Company has from time to time been a party to lawsuits and claims arising in the normal course of business. In the opinion of management, there are no pending claims or litigation, in which the outcome would have a material effect on the Company's consolidated financial position or results of operations.

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

None

EXECUTIVE OFFICERS OF THE COMPANY

The following sets forth certain information as of the date hereof with respect to the Company's executive officers.

| Name and Position | Age | First Served as Executive Officer |
|---|------------|--|
| Gino Chouinard President and Chief Operating Officer | 40 | 2002 |

| | | |
|--|----|------|
| Francisco Puñal Senior Vice President and Chief Financial Officer | 50 | 2008 |
|--|----|------|

Messrs. Hansbrough and Chouinard are serving pursuant to employment agreements with 3-year terms, expiring in 2011, which will be renewed for successive one-year terms unless a party provides notice of non-renewal.

Stephen J. Hansbrough, Chairman, Chief Executive Officer and Director, was formerly the Senior Vice President of Dart Drug Corporation and was instrumental in starting their affiliated group of companies (Crown Books and Trak Auto). Mr. Hansbrough subsequently became Chairman and CEO of Dart Drug Stores. After leaving Dart, Mr. Hansbrough was an independent consultant specializing in turnaround and start-up operations, primarily in the retail field, until he joined HearUSA in December 1993.

Gino Chouinard, President and Chief Operating Officer, was president and chief financial officer of the Company from August 2008 to February 2009. Prior to that, Mr. Chouinard served as the Company's executive vice president and chief financial officer. Mr. Chouinard joined HearUSA in July 2002 with its acquisition of Helix. Mr. Chouinard served as Helix's Chief Financial Officer from November 1999 until its acquisition by HearUSA. Mr. Chouinard is a Chartered Accountant who previously worked for Ernst & Young LLP, an international accounting firm, as Manager from 1996 until 1999 and as Senior Accountant from 1994 until 1996.

Francisco (Frank) Puñal, Senior Vice President and Chief Financial Officer, has been the Company's senior vice president and chief accounting officer since April 2008. Prior to that, Mr. Puñal served as the chief financial officer International Bedding Group, Inc., a privately held company based in Pompano Beach, Florida, from June 2007 to April 2008. Before that position, Mr. Puñal served for over six years as vice president and controller of Jacuzzi Brands, Inc., a NYSE-listed company. Earlier in his career, Mr. Puñal was a senior audit manager for Ernst & Young LLP.

PART II**Item 5. Market for Registrant's Common Equity and Related Stockholder Matters**

The common stock of the Company is traded on the NYSE Amex under the symbol **EAR** and the exchangeable shares of HEARx Canada Inc. are traded on the Toronto Stock Exchange under the symbol **HUX**. Holders of exchangeable shares may tender their holdings for common stock on a one-for-one basis at any time. As of March 5, 2009, the Company had 44,333,903 shares of common stock and 503,061 exchangeable shares outstanding. The closing price on March 5, 2009 was US\$0.43 for the common stock and CDN\$0.75 for the exchangeable shares. The following table sets forth the high and low sales prices for the common stock as reported by the NYSE Amex for the fiscal quarters indicated:

| Fiscal Quarter | Common Stock | |
|----------------|--------------|---------|
| | High | Low |
| 2008 | | |
| First | \$ 1.58 | \$ 1.04 |
| Second | \$ 1.82 | \$ 1.15 |
| Third | \$ 1.76 | \$ 1.21 |
| Fourth | \$ 1.32 | \$ 0.22 |
| 2007 | | |
| First | \$ 1.91 | \$ 1.00 |
| Second | \$ 1.95 | \$ 1.50 |
| Third | \$ 1.77 | \$ 1.28 |
| Fourth | \$ 1.70 | \$ 1.28 |

As of February 20, 2009, there were 1,134 holders of record of the common stock.

Dividend Policy

HearUSA has never paid and does not anticipate paying any dividends on the common stock in the foreseeable future but intends to retain any earnings for use in the Company's business operations. Payment of dividends is restricted under the terms of the Company's credit agreement, as amended, with Siemens.

Item 6. Selected Financial Data

The following selected financial data of the Company should be read in conjunction with the consolidated financial statements and notes thereto and the following Management's Discussion and Analysis of Financial Condition and Results of Operations. The financial data set forth on the next two pages has been derived from the audited consolidated financial statements of the Company.

CONSOLIDATED STATEMENT OF OPERATIONS DATA:

| | December 27 2008 | December 29 2007 | Year Ended December 30 2006 | December 31 2005 | December 25 2004 |
|--|------------------------|------------------------|--------------------------------------|------------------------|------------------------|
| Dollars in thousands | | | | | |
| Total net revenues | \$ 111,988 | \$ 102,804 | \$ 88,786 | \$ 76,672 | \$ 68,749 |
| Income from operations (1 and 2) | 3,917 | 6,823 | 3,809 | 3,715 | 2,338 |
| Non-operating income: | | | | | |
| Gain from insurance settlement (3) | | | 203 | 430 | |
| Gain on settlement of intangible asset (4) | 981 | | | | |
| Interest income | 42 | 164 | 152 | 54 | 18 |
| Interest expense (5) | (5,755) | (8,022) | (5,964) | (4,641) | (4,564) |
| Income tax expense | (1,126) | (769) | (741) | (1,759) | (690) |
| Minority interest | (1,260) | (1,478) | (633) | | |
| Loss before dividends on preferred stock | (3,201) | (3,282) | (3,174) | (2,264) | (3,449) |
| Net loss applicable to common stockholders | (3,340) | (3,419) | (3,312) | (2,965) | (4,157) |
| Loss per common share: | | | | | |
| Basic and diluted, loss after dividends on preferred stock | (0.09) | (0.09) | (0.10) | (0.09) | (0.12) |
| Basic and diluted net loss applicable to common stockholders | (0.09) | (0.09) | (0.10) | (0.09) | (0.14) |

(1) Income from operations in 2008, 2007 and 2006 includes approximately \$849,000, \$606,000 and \$976,000, respectively of non-cash employee stock-based compensation expense, which did not exist in prior years.

- (2) Income from operations includes approximately \$1,450,000, \$896,000, \$815,000, \$618,000 and \$478,000, in 2008, 2007, 2006, 2005 and 2004, respectively, of intangible assets amortization.
- (3) The gain from insurance settlement is from insurance proceeds and final payment resulting from 2005 and 2004 hurricane damages and business interruption claims sustained in Florida hearing care centers.
- (4) The gain on settlement of intangible asset is the result of the December 22, 2008 Amendment to the license agreement with AARP, which eliminated the fixed \$7.6 million annual license payment. The Company is currently in

negotiations with AARP for restructuring the royalty compensation provision.

- (5) Interest expense includes approximately \$763,000 of non-cash interest expense on a long-term contractual commitment in 2008, \$421,000 and \$117,000 of non-cash interest expense on discounted notes payable in 2008 and 2007, \$192,000, \$3.5 million, \$2.7 million, \$2.5 million and \$2.1 million in 2008, 2007, 2006, 2005 and 2004, respectively, of non-cash debt discount amortization (including \$1.4 million in 2007 due to the reduction in the price of warrants related to the 2003 Convertible Subordinated Notes) and approximately \$319,000 and \$513,000 in 2006 and 2005, respectively, of non-cash

decreases in
interest expense
related to a
decrease in the
fair market
value of the
warrant liability.

BALANCE SHEET DATA:

| | December 27 2008 | December 29 2007 | As of December 30 2006 | December 31 2005 | December 25 2004 |
|--|------------------------|------------------------|---------------------------------|------------------------|------------------------|
| Dollars in thousands | | | | | |
| Total assets | \$ 100,601 | \$ 100,542 | \$ 83,276 | \$ 71,044 | \$ 61,774 |
| Working capital deficit (1) | (7,247) | (16,012) | (14,896) | (3,549) | (4,898) |
| Long-term debt: | | | | | |
| Long-term debt, net of current maturities | 49,099 | 36,499 | 28,599 | 19,970 | 17,296 |
| Convertible subordinated notes and subordinated notes, net of debt discount of \$278,000, \$2,078,000 and \$5,444,000 in 2006, 2005 and 2004, respectively | | | 3,762 | 6,222 | 2,056 |
| Mandatorily redeemable convertible preferred stock | | | | | 4,710 |

(1) Includes approximately \$2.7 million, \$2.6 million, \$3.5 million, \$2.2 million and \$2.9 million in 2008, 2007, 2006, 2005 and 2004, respectively, representing the current maturities of the long-term debt to Siemens which may be repaid through rebate credits and approximately \$2.5 million and \$652,000, net of debt discount, in 2006 and 2005 respectively, related to the

\$7.5 million convertible subordinated notes that could be repaid by either cash or stock, at the option of the Company.

Item 7. Management's Discussion and Analysis of Results of Operations and Financial Condition
GENERAL

In 2008, the Company continued to focus on its acquisition program and closed on thirteen transactions representing twenty centers with annual estimated revenues of approximately \$7.1 million. Since the beginning of the acquisition program in 2005, the Company has acquired a total of 80 centers, representing \$39.0 million of annual estimated revenues. Revenues resulting from the centers acquired in 2007 (for those that were not owned for the entire year in 2007) and from centers acquired in 2008, combined, were approximately \$9.8 million. From centers acquired in 2008, only approximately \$4.7 million of revenues were recorded in 2008 due to the timing of the acquisition closings throughout the year. As a result of the acquisition program, the average number of centers increased from 173 in 2007 to 195 in 2008. The number of centers at the end of 2008 was 202.

In December 2008, we amended our agreements with Siemens to restructure the credit agreement, extend the credit and supply agreement by two years and eliminate the conversion provision of the credit agreement, among other things. In the amendments, the required \$4.2 million prepayment of Tranche D and the \$3.0 million Tranche E loan repayment was transferred to Tranche C. The outstanding amounts of Tranche D and Tranche E at December 23, 2008 were transferred to Tranche C. In addition, approximately \$6.2 million in outstanding trade payables were converted into long-term indebtedness under Tranche C and \$3.8 million in outstanding trade payables were converted into 6.4 million shares of the Company's Common Stock.

In December 2008, we amended our license agreement with AARP, Inc. to eliminate the \$7.6 million annual licensing payment provision of the agreement. We have agreed to negotiate in good faith a revised royalty compensation structure. If we are unable to reach agreement, AARP may terminate the agreement and engage another entity to provide the program to its members.

RESULTS OF OPERATIONS

2008 compared to 2007 (in thousands of dollars)

Revenues

| Revenues | 2008 | 2007 | Change | % Change |
|---|-------------------|-------------------|-----------------|-----------------|
| Hearing aids and other products | \$ 104,392 | \$ 95,936 | \$ 8,456 | 8.8% |
| Services | 7,596 | 6,868 | 728 | 10.6% |
| Total net revenues | \$ 111,988 | \$ 102,804 | \$ 9,184 | 8.9% |
| | | | | % Change |
| | 2008 | 2007 | Change | (3) |
| Revenues from centers acquired in 2007 (1) | \$ 5,127 | \$ | \$ 5,127 | 5.0% |
| Revenues from centers acquired in 2008 | 4,670 | | 4,670 | 4.5% |
| Revenues from acquired centers | 9,797 | | 9,797 | 9.5% |
| Revenues from comparable centers (2) | 102,191 | 102,804 | (613) | (0.6)% |
| Total net revenues | \$ 111,988 | \$ 102,804 | \$ 9,184 | 8.9% |

(1) Represents that portion of revenues from the 2007

acquired centers
recognized for
those
acquisitions that
had less than
one full year of
revenues
recorded in
2007 due to the
timing of their
acquisition.

- (2) Also includes revenues from the network business segment as well as the impact of fluctuation of the Canadian exchange rate.
- (3) The revenues from acquired centers percentage changes are calculated by dividing those revenues by the total of 2007 total net revenues.

The \$9.2 million or 8.9% increase in net revenue over 2007 is principally a result of revenues from acquired centers of approximately \$9.8 million. Organic revenue increased during the first half but declined in the later part 2008 as a result of worsening economic conditions. The average selling price of units sold in 2008 increased by 2.6% primarily due to a different mix of products resulting from patients selecting higher technology hearing aids.

The number of hearing aids sold in 2008 increased 6.3% over 2007 primarily as a result of acquired centers.

Cost of Products Sold and Services

| Cost of products sold and services | 2008 | 2007 | Change | % |
|---|------------------|------------------|-----------------|---------------|
| Hearing aids and other products | \$ 30,171 | \$ 26,017 | \$ 4,154 | 16.0% |
| Services | 2,311 | 2,088 | 223 | 10.7% |
| Total cost of products sold and services | \$ 32,482 | \$ 28,105 | \$ 4,377 | 15.60% |
| Percent of total net revenues | 29.0% | 27.3% | 1.7% | 6.2% |

The cost of products sold includes the effect of rebate credits pursuant to our agreements with Siemens. The following table reflects the components of the rebate credits which are included in the above cost of products sold for hearing aids (see Note 6 Long-term Debt, Notes to Consolidated Financial Statements included herein):

| Rebate credits included above | 2008 | 2007 | Change | % |
|--|-----------------|-----------------|-----------------|----------------|
| Base required payments on Tranche C forgiven | \$ 3,099 | \$ 3,945 | \$ (846) | (21.4)% |
| Required payments of \$65 per Siemens unit from acquired centers on Tranche B forgiven | 684 | 546 | 138 | 25.3% |
| Interest expense on Tranches B and C forgiven | 2,832 | 2,696 | 136 | 5.0% |
| Total rebate credits | \$ 6,615 | \$ 7,187 | \$ (572) | (8.0)% |
| Percent of total net revenues | 5.9% | 7.0% | (1.1)% | (15.7)% |

Cost of products sold as a percent of total net revenues before the impact of the Siemens rebate credits was 34.9% in 2008 and 34.3% 2007.

Expenses

| Operating expenses | 2008 | 2007 | Change | % |
|--|------------------|------------------|-----------------|---------------|
| Center operating expenses | \$ 57,450 | \$ 50,401 | \$ 7,049 | 14.0% |
| Percent of total net revenues | 51.3% | 49.0% | 2.3% | 4.7% |
| General and administrative expenses | \$ 15,176 | \$ 15,227 | \$ (51) | (0.3)% |
| Percent of total net revenues | 13.6% | 14.8% | (1.2)% | (8.1)% |
| Depreciation and amortization | \$ 2,963 | \$ 2,248 | \$ 715 | 31.8% |
| Percent of total net revenues | 2.6% | 2.2% | 0.4% | 18.2% |

The increase in center operating expenses in 2008 is mainly attributable to additional expenses of approximately \$5.2 million related to acquired centers owned less than twelve months. The remaining increase of approximately \$1.8 million is attributable to expenses of \$407,000 in the implementation of the AARP program, \$339,000 related to

incentive compensation, \$282,000 related to increased regional management expenses, increases in gross marketing costs of approximately \$689,000 and \$235,000 of severance costs. These were partially offset by increases in advertising reimbursements from Siemens of approximately \$688,000. Center operating expenses as a percent of total net revenues increased from 49.0% in 2007 to 51.3% in 2008 principally as a result of the decrease in organic sales, higher operating expenses as a percentage of revenue of acquired centers, AARP program implementation costs and costs associated with the expiring Don Shula marketing campaign of approximately \$565,000. The operating expenses of the acquired centers were 53.2% of the related net revenues during 2008.

General and administrative expenses decreased by approximately \$51,000 in 2008 as compared to 2007. The decrease in general and administrative expenses is attributable to decreases in professional fees of approximately \$132,000 and the benefit of vendor rebates of \$200,000 recorded in reduction of communication expense. These were partially offset by increases in employee and director stock-based compensation expense of approximately \$255,000. Included in general and administrative expense in 2008 and 2007 are \$811,000 and \$518,000, respectively, of severance costs.

Depreciation was \$1.5 million in 2008 and \$1.4 million in 2007. Amortization expense was \$1.5 million in the 2008 and \$896,000 in 2007. The increase in amortization expense is primarily the result of amortization of the AARP license agreement of approximately \$391,000.

Interest Expense

| Interest expense | 2008 | 2007 | Change | % |
|---|-----------------|-----------------|-------------------|----------------|
| Notes payable from business acquisitions and others (1) | \$ 978 | \$ 642 | \$ 336 | 52.3% |
| Long-term contractual commitment to AARP (2) | 763 | | 763 | 100.0% |
| Siemens Tranches B and C (3) | 2,832 | 2,696 | 136 | 5.0% |
| Siemens Tranche D and E | 935 | 691 | 244 | 35.3% |
| 2003 Convertible Subordinated Notes (4) | | 3,168 | (3,168) | (100.0)% |
| 2005 Subordinated Notes (5) | 247 | 825 | (578) | (70.1)% |
| Total interest expense | \$ 5,755 | \$ 8,022 | \$ (2,267) | (28.3)% |
| | 2008 | 2007 | Change | % |
| Total cash interest expense (6) | \$ 1,617 | \$ 1,703 | \$ (86) | (5.0)% |
| Total non-cash interest expense (7) | 4,138 | 6,319 | (2,181) | (34.5)% |
| Total interest expense | \$ 5,755 | \$ 8,022 | \$ (2,267) | (28.3)% |

(1) Includes \$421,000 and \$117,000 in 2008 and 2007, respectively, of non-cash interest expense related to recording of notes at their present value by discounting future payments to market rate of interest (see Note 6 Long-term Debt, Notes to Consolidated Financial Statements included herein).

(2)

Includes \$763,000 of non-cash interest expense related to recording of long-term contractual commitment to AARP at its present value by discounting future payments to market rate of interest (see Note 6 Long-term Debt, Notes to Consolidated Financial Statements included herein).

- (3) The interest expense on Tranches B and C is forgiven by Siemens as long as the minimum purchase requirements are met and a corresponding rebate credit is recorded as a reduction of the cost of products sold (see Note 6 Long-term Debt, Notes to Consolidated Financial Statements included herein and Liquidity and Capital Resources, below).

(4)

Includes
\$3.0 million in
2007 of
non-cash debt
discount
amortization
(see Note 7
Convertible
Subordinated
Notes, Notes to
Consolidated
Financial
Statements
included
herein).

(5) Includes
\$192,000 and
\$496,000 in
2008 and 2007,
respectively, of
non-cash debt
discount
amortization
(see Note 8
Subordinated
Notes and
Warrant
Liability, Notes
to Consolidated
Financial
Statements
included
herein).

(6) Represents the
sum of the cash
interest portion
paid on the
notes payable
for business
acquisitions and
others, the cash
interest paid on
the Siemens on
Tranches D and
E loans,
Subordinated
notes and the
cash portion
paid on the

Convertible
Subordinated in
2007.

(7) Represents the sum of the non-cash interest expense related to recording the notes payable for business acquisitions at their present value by discounting future payments to market rate of interest, long-term contractual commitment to AARP at its present value, Siemens Tranches B and C loans, the non-cash interest imputed to the 2005 Subordinated Notes and the 2003 Convertible Subordinated Notes in 2007 related to the debt discount amortization.

The decrease in interest expense in 2008 is attributable to conversion in common shares of the convertible subordinated notes in April of 2007 and the repayment of the 2005 subordinated notes in August of 2008.

Gain on Restructuring of Contract

On August 8, 2008, HearUSA, Inc. (the Company) entered into a Hearing Care Program Services Agreement with American Association of Retired Persons (AARP), Inc. and AARP Services, Inc. (the Services Agreement), and an AARP License Agreement with AARP, Inc. (the License Agreement), pursuant to which the Company will provide an AARP-branded discount hearing care program to AARP members.

Under the Services Agreement, the Company has agreed to provide to AARP members discounts on hearing aids and related services, through the Company's company-owned centers and independent network of hearing care providers. The Company will allocate \$4.4 million annually to promote the AARP program to AARP members and the general public, and will contribute 9.25% of that amount to AARP's marketing cooperative. The Company will also contribute \$500,000 annually to fund an AARP sponsored education campaign to educate and promote hearing loss awareness

and prevention to AARP members and the general public. The Company has also committed, in cooperation with AARP, to donate a number of hearing aids annually to be distributed free of charge to economically disadvantaged individuals who have experienced hearing loss. The Company was to begin the program with AARP December 1, 2008. The Services Agreement has an initial term of three years ending in December 1, 2011. At the end of the initial three year term, the Company has an option to extend the term of the Services Agreement for an additional two year period.

Pursuant to the License Agreement, AARP granted the Company a limited license to use the AARP name and related trade and service marks in connection with the operation and administration of the AARP program, including the advertising and promotion of the program. The Company originally agreed to pay AARP a fixed annual royalty of \$7.6 million for each year of the initial three year term of the AARP license. This provision was eliminated in the December 2008 amendment.

In accordance with SFAS 142 *Goodwill and Other Intangibles*, the intangible was recorded at approximately \$19.3 million based on the fair value of the payments on the date of issuance using an imputed interest rate of 10%.

In 2008, the Company recorded non-cash interest expense of approximately \$763,000 and amortization expense of approximately \$391,000 related to the long-term contractual commitment to AARP and corresponding intangible asset.

On December 22, 2008, AARP and the Company amended the License Agreement to restructure the payment terms of the agreement and eliminated the required annual royalty payment. The Company is no longer contractually committed to pay the \$7.6 million annual royalty payment. Accordingly the Company wrote off the remaining contractual liability of approximately \$20.0 million and the balance of intangible asset of approximately \$19.1 million and recorded a corresponding gain on the restructuring of the AARP agreement of approximately \$981,000. The Company is currently in negotiations with AARP for restructuring the royalty compensation provision.

Income Taxes

The Company has net operating loss carryforwards of approximately \$59.1 million for U.S. income tax purposes. In addition, the Company has temporary differences between the financial statement and tax reporting arising primarily from differences in the amortization of intangible assets and goodwill and depreciation of fixed assets. The deferred tax assets for US purposes have been offset by a valuation allowance because it was determined that these assets were not likely to be realized. The deferred tax assets for Canadian tax purposes are recorded as a reduction of the deferred income tax liability on the Company's balance sheet and were approximately \$881,000 at December 27, 2008 and \$777,000 at December 29, 2007.

During 2008, the Company recorded a deferred tax expense of approximately \$1.1 million compared to approximately \$769,000 in 2007 related to estimated taxable income generated by the Canadian operations and the estimated deduction of tax deductible goodwill from its US operations. The deferred income tax expense related to the Canadian operations of approximately \$220,000 is due to the estimated utilization of deferred tax benefit previously recorded. The additional deferred income tax expense of approximately \$831,000 in 2008 and \$595,000 in 2007 was recorded because it cannot be offset by other temporary differences as it relates to infinite-lived assets and the future timing of the reversal of the liability is unknown. Deferred income tax expense will continue to be recorded for these two items as long as the Canadian operations generate taxable income and/or tax deductible goodwill exist for US tax purposes. Tax deductible goodwill with a balance of approximately \$33.2 million at December 27, 2008, is expected to increase as we continue to purchase the assets of businesses.

Minority Interest

The Company's fifty percent owned joint venture; HEARx West generated net income of approximately \$2.5 million and \$3.0 million during 2008 and 2007, respectively. The Company records 50% of the venture's net income as minority interest in the income of a joint venture in the Company's consolidated statements of operations. The minority interest for 2008 and 2007 was approximately \$1.3 million and \$1.5 million, respectively.

2007 compared to 2006 (in thousands of dollars)**Revenues**

| Revenues | 2007 | 2006 | Change | % Change |
|---------------------------------|-------------------|------------------|------------------|-----------------|
| Hearing aids and other products | \$ 95,936 | \$ 82,820 | \$ 13,116 | 15.8% |
| Services | 6,868 | 5,966 | 902 | 15.1% |
| Total net revenues | \$ 102,804 | \$ 88,786 | \$ 14,018 | 15.8% |

| | 2007 | 2006 | Change | % Change (3) |
|---|-------------------|------------------|------------------|-------------------------|
| Revenues from centers acquired in 2006 (1) | \$ 8,193 | \$ | \$ 8,193 | 9.2% |
| Revenues from centers acquired in 2007 | 4,600 | | 4,600 | 5.2% |
| Total Revenues from acquired centers | 12,793 | | 12,793 | 14.4% |
| Revenues from comparable centers (2) | 90,011 | 88,786 | 1,225 | 1.4% |
| Total net revenues | \$ 102,804 | \$ 88,786 | \$ 14,018 | 15.8% |

(1) Represents that portion of revenue from the 2006 acquired centers recognized for those acquisitions that had less than one full year of revenues recorded in 2006 due to the timing of their acquisition.

(2) Includes revenues from the network business segment as well as the impact of fluctuation of the Canadian exchange rate.

- (3) The revenues from acquired centers percentage changes are calculated by dividing them by the total 2006 net revenues.

The \$14.0 million or 15.8% increase in net revenues over 2006 is principally a result of revenues from acquired centers which generated approximately \$12.8 million or 14.4% over 2006 revenues and a slight increase in revenues from comparable centers of approximately 1.4% above the 2006 total net revenue level. The comparable centers total net revenues also include a favorable impact of \$736,000 related to fluctuations in the Canadian exchange rate from 2006 to 2007.

The number of hearing aids sold over 2006 increased by 4.9% and was primarily the result of an increase of 7.9% from acquired centers which was offset by a decrease in the number of hearing aids sold in comparable centers. The impact of the decrease in the number of hearing aids sold from comparable centers was offset by an increase in the average unit selling price of 9.8% over 2006 the average unit selling price. The increase in average unit selling price is primarily due to a different mix of products resulting from patients selecting higher technology hearing aids. The decrease in the number of units sold is in part attributable to lower volume of Florida Medicaid business. Service revenues increased approximately \$902,000, or 15.1%, over 2006 consistent with the increase in hearing aid revenues.

Cost of Products Sold and Services

| Cost of products sold and services | 2007 | 2006 | Change | % |
|---|------------------|------------------|-----------------|---------------|
| Hearing aids and other products | \$ 26,017 | \$ 24,942 | \$ 1,075 | 4.3% |
| Services | 2,088 | 1,761 | 327 | 18.6% |
| Total cost of products sold and services | \$ 28,105 | \$ 26,703 | \$ 1,402 | 5.3% |
| Percent of total net revenues | 27.3% | 30.1% | (2.8)% | (9.3)% |

The cost of products sold as reflected above includes the effect of the rebate credits pursuant to our agreements with Siemens. The following table reflects the components of the rebate credits which are included in the above costs of products sold for hearing aids (see Note 6 Long-term Debt, Notes to Consolidated Financial Statements included herein):

| Rebate Credits included above | 2007 | 2006 | Change | % |
|--|-----------------|-----------------|-----------------|--------------|
| Base required payments on Tranches C forgiven | \$ 3,945 | \$ 2,922 | \$ 1,023 | 35.0% |
| Required payments of \$65 per Siemens unit from acquired centers on Tranche B forgiven | 546 | 190 | 356 | 187.4% |
| Interest expense on Tranches B and C forgiven | 2,696 | 626 | 2,070 | 330.7% |
| Total rebate credits | \$ 7,187 | \$ 3,738 | \$ 3,449 | 92.3% |
| Percent of total net revenues | 7.0% | 4.2% | 2.8% | 66.7% |

The decrease of total cost of products sold and services as a percentage of total net revenue, is due to the additional Siemens rebate credits provided for in the new agreements signed in December 2006. Cost of products sold as a percent of total revenues before the impact of the Siemens rebate credits were 34.3% in both 2007 and 2006.

The base required payment on Siemens Tranche C subject to the rebate credits was reduced from \$730,000 to \$500,000 per quarter beginning in the fourth quarter of 2007 (see Note 6 Long-term Debt, Notes to Consolidated Financial Statements included herein).

Expenses

| Operating expenses | 2007 | 2006 | Change | % |
|--|------------------|------------------|-----------------|--------------|
| Center operating expenses | \$ 50,401 | \$ 42,281 | \$ 8,120 | 19.2% |
| Percent of total net revenues | 49.0% | 47.6% | 1.4% | 2.9% |
| General and administrative expenses | \$ 15,227 | \$ 14,005 | \$ 1,222 | 8.7% |
| Percent of total net revenues | 14.8% | 15.8% | (1.0)% | (6.3)% |
| Depreciation and amortization | \$ 2,248 | \$ 1,988 | \$ 260 | 13.1% |
| Percent of total net revenues | 2.2% | 2.2% | 0.0% | 0.0% |

The increase in center operating expenses in 2007 is mainly attributable to additional expenses of approximately \$5.3 million related to the centers acquired and owned for less than twelve months during the year. The remaining increase relates to an increase in incentive compensation of approximately \$277,000 associated with additional net revenues, an investment in marketing expense related to the television campaign launched in the second quarter of 2007 of approximately \$700,000 and other normal annual increases. As a percent of total net revenues, however, they increased from 47.6% in 2006 to 49.0% in 2007. This increase is mostly attributable to the investment in marketing discussed above and to the fact that the increase in comparable centers revenues from one year to another of 1.5% was lower than the normal annual percentage increase in center operating expenses. Center operating expenses related to acquired centers of 42% of related total net revenues, were in line with management expectations.

General and administrative expenses increased by approximately \$1.2 million in 2007 as compared to the same period of 2006. The increase in general and administrative expenses is primarily attributable to charges due to employee severances in the amount of \$518,000 and the cost of professional services related to restatement of prior year financial statements of approximately \$200,000, and due to increases in business interruption and directors and officers insurance premium of approximately \$283,000 as well as to normal annual increases of the general and administrative expenses. These increases were partially offset by a decrease in the non-cash stock-based compensation expenses of approximately \$370,000.

Depreciation and amortization expense increased by approximately \$260,000 in 2007 compared to the same period in 2006. Depreciation was \$1.3 million in the 2007 and \$1.2 million in 2006. Amortization expense was \$896,000 in 2007 and \$815,000 in 2006. Most of the amortization expense comes from the amortization of intangible assets related to the acquisitions made by the Company.

Interest Expense

| Interest expense | 2007 | 2006 | Change | % |
|---|-----------------|-----------------|-----------------|--------------|
| Notes payable from business acquisitions and others (1) | \$ 642 | \$ 264 | \$ 371 | 140.5% |
| Siemens Tranche C2 Interest paid with monthly payments (2) | | 345 | (345) | (100.0)% |
| Siemens Tranches C1 and C3 accrued interest added to loan balance (2) | | 1,130 | (1,130) | (100.0)% |
| Siemens Tranches A, B and C interest forgiven (3) | 2,696 | 626 | 2,077 | 331.8% |
| Siemens Tranche D | 691 | | 691 | |
| 2003 Convertible Subordinated Notes (4) | 3,168 | 2,556 | 612 | 23.9% |
| 2005 Subordinated Notes (5) | 825 | 1,361 | (536) | (39.4)% |
| Warrant liability change in value (6) | | (319) | 319 | (100.0)% |
| Total interest expense | \$ 8,022 | \$ 5,963 | \$ 2,059 | 34.5% |
| | 2007 | 2006 | Change | % |
| Total cash interest expense (7) | \$ 1,703 | \$ 2,962 | \$ (1,266) | (42.7)% |
| Total non-cash interest expense (8) | 6,319 | 3,001 | 3,325 | 110.8% |
| Total interest expense | \$ 8,022 | \$ 5,963 | \$ 2,059 | 34.5% |

(1) Includes \$117,000 of non-cash interest expense related to the recording of notes at their present value by discounting future payments at an imputed rate of interest (see Note 6 Long-term Debt, Notes to Consolidated Financial Statements included herein).

(2) The loan balances related to this interest expense were

transferred to the new self-liquidating loan with Siemens under the new December 30, 2006 agreement (Tranches B and C) and will be forgiven going forward so long as minimum purchase requirements are met (see Note 6 Long-term Debt, Notes to Consolidated Financial Statements included herein and Liquidity and Capital Resources, below).

- (3) The interest expense on Tranches B and C is forgiven by Siemens as long as the minimum purchase requirements are met and a corresponding rebate credit is recorded in reduction of the cost of products sold (see Note 6 Long-term Debt, Notes to Consolidated Financial Statements included herein and Liquidity and Capital Resources,

below).

- (4) Includes \$3.0 million in 2007 and \$1.8 million in 2006 of non-cash debt discount amortization (see Note 7 Convertible Subordinated Notes, Notes to Consolidated Financial Statements included herein).
- (5) Includes \$496,000 in 2007 and \$850,000 in 2006 of non-cash debt discount amortization (see Note 8 Subordinated Notes and Warrant Liability, Notes to Consolidated Financial Statements included herein).
- (6) Relates to the change in value of the warrants related to the 2005 subordinated notes and is a non-cash item (see Note 8 Subordinated Notes and Warrant

Liability, Notes to Consolidated Financial Statements included herein).

- (7) Represents the sum of the cash interest portion paid on the notes payable for business acquisitions and others, the cash interest paid to Siemens on the Siemens loans (Tranche C2 in 2006 and Tranche D in 2007) and the cash portion paid on the Convertible Subordinated and Subordinated Notes.

- (8) Represents the sum of the non-cash interest portion imputed on the notes payable for business acquisitions to adjust the interest rates at market value, the Siemens non-cash interest imputed on Tranches C1 and C3 in 2006 and Tranches B and C in 2007 and the non-cash interest imputed

to the 2003
Convertible
Subordinated
Notes and 2005
Subordinated
Notes related to
the debt
discount
amortization.

The increase in interest expense in 2007 is attributable to the overall increase in the Siemens average loan balances resulting from monies drawn under Tranche D at the beginning of the year for working capital purposes and under Tranches B and C for new acquisitions as well as an increase in the average balance of the notes payable from business acquisitions and others, which in total contributed to a net increase in the interest expense of approximately \$1.7 million. The remaining increase of approximately \$359,000 relates to the non-cash interest charges of approximately \$2.6 million for the early conversion of the 2003 Convertible Subordinated Notes (see Note 7 Convertible Subordinated Notes, Notes to Consolidated Financial Statements included herein), partially offset by reductions due to lower principal balances following the conversion of these notes in common shares in April 2007 and the quarterly repayments made on the 2005 subordinated notes. 2006 also benefited from a reduction on interest due to reduction in value of the warrant liability related to the 2005 subordinated notes, which did not exist in 2007.

LIQUIDITY AND CAPITAL RESOURCES

Siemens Transaction

On December 23, 2008, the Company entered into a Third Amendment to Credit Agreement (Credit Agreement Amendment), Second Amendment to Supply Agreement (Supply Agreement Amendment), Amendment No. 2 to Amended and Restated Security Agreement, a Second Amendment to Investor Rights Agreement (Investor Rights Amendment) (collectively the Amendments) and a Purchase Agreement with Siemens Hearing Instruments, Inc. (Siemens). The Company and Siemens are parties to a Second Amended and Restated Credit Agreement dated December 30, 2006, as amended by a First Amendment to Credit Agreement dated as of June 27, 2007 and a Second Amendment to Credit Agreement and First Amendment to Investor Rights Agreement and Supply Agreement dated September 28, 2007 (the 2007 Amendments) (as amended, the Credit Agreement), an Amended and Restated Supply Agreement dated December 30, 2006, as amended by the 2007 Amendments (as amended, the Supply Agreement) and an Investor Rights Agreement dated December 30, 2006, as amended by the 2007 Amendments (as amended, the Investor Rights Agreement).

Pursuant to these agreements, Siemens has extended to the Company a \$50 million credit facility. The Company purchases most of the Company's requirements for hearing aids from Siemens. The December 2006 agreements represented amendments to agreements that had been in place between the parties since 2001. In 2006 when the Credit Agreement was amended, the Company granted to Siemens the right to convert a portion of the debt into common stock at certain times and upon certain conditions. Pursuant to the Supply Agreement, the Company has agreed to purchase at least 90% of its hearing aid purchases in the United States from Siemens and its affiliates. If the minimum purchase requirement of the Supply Agreement is met, the Company earns rebates which are then applied to certain payments due under the Credit Agreement to liquidate those payments. The Investor Rights Agreement provided Siemens with certain rights, including the right to have the shares of common stock underlying the debt be registered for resale and a right of first refusal on equity securities sold by the Company. In 2007 when the 2007 Amendments were made, Siemens agreed to provide the Company with an additional \$3 million revolving line of credit for working capital purposes in the form of Tranche E which would be due on December 29, 2008. In addition, in the 2007 amendments Siemens agreed that the \$4.2 million principal of Tranche D in the Credit Agreement would be due on December 19, 2008.

In the Amendments and the Purchase Agreement the parties agreed to the following:

The previous amendment of the Credit Agreement called for cash payments of \$7.2 million in December 2008 on Tranches D and E and quarterly principal payments of \$500,000 on Tranche C. The Amendment transferred the amounts due under Tranches D and E to Tranche C. Providing the Company meets the purchase requirements in the Supply Agreement, all repayments on both Tranches can now be self-liquidating.

The balances of Tranche D and E were transferred to Tranche C. Going forward the credit agreement will have only Tranches B and C.

Approximately \$3.8 million of outstanding debt under the supply agreement was converted into 6.4 million shares of the Company's Common Stock at a conversion price of \$0.60 per share. The conversion provisions of the credit agreement were eliminated from the Credit Agreement.

An additional \$6.2 million of debt under the supply agreement was converted into long-term indebtedness under Tranche C.

The maturity date of the credit and supply agreement was extended an additional two years, to February, 2015.

Siemens was granted a right of first refusal for all new issuances of equity (except issuances pursuant to employee compensation plans and pursuant to warrants outstanding on the date of the amendments) for a period of 18 months and thereafter a more limited right of first refusal and preemptive rights for the life of the investor rights agreement.

The Company will invite a representative of Siemens to attend meetings of the Board in a nonvoting observer capacity.

Financing and rebate arrangement

The revolving credit facility is a line of credit of \$50 million that bears interest of 9.5% and is secured by substantially all of the Company's assets. Approximately \$46.5 million was outstanding at December 27, 2008. Approximately, \$5.6 million has been borrowed under Tranche B for acquisitions and \$40.9 million has been borrowed under Tranche C. Borrowing for acquisitions under Tranche B is generally based upon a formula equal to 1/3 of 70% of the acquisition's trailing 12 months revenues and any amount greater than that may be borrowed from Tranche C with Siemens' approval. Amounts borrowed under Tranche B are repaid quarterly through rebates at a rate of \$65 per Siemens' units sold by the acquisition plus interest. Amounts borrowed under Tranche C are repaid quarterly at \$500,000 plus interest. The required payments are subject to the rebate credits described below.

The credit facility also 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 Amended Credit Agreement), and by paying Siemens 25% of proceeds from any equity offerings the Company may complete. The Company did not have any Excess Cash Flow (as defined) in 2008, 2007 or 2006.

Rebate credits on product sales

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 sold in the US are Siemens products. Amounts rebated are accounted for as a reduction of cost of products sold. If the Company does not maintain the 90% sales requirement, those amounts are not rebated and must be paid quarterly. The 90% requirement is computed on a cumulative twelve month calculation. The Company has always met the 90% requirement since entering into this arrangement in December 2001 and has received approximately \$32.2 million in rebates since that time.

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 and interest due on Tranches B and C and are recorded as a reduction in products sold. Volume rebates of \$1.1 million, \$1.3 million and \$1.3 million were recorded in 2008, 2007 and 2006, respectively.

The following table summarizes the rebate structure:

| | Calculation of Pro forma Rebates to HearUSA when at least 90% of Units Sold are from Siemens (1) | | | |
|---------------------------------|--|--------------|--------------------|--------------|
| | Quarterly Siemens Unit Sales Compared to Prior Years | | Comparable Quarter | |
| | 90% but < 95% | 95% to 100% | > 100% < 125% | 125% and > |
| Tranche B Rebate | \$65/ unit | \$65/ unit | \$65/ unit | \$65/ unit |
| | Plus | Plus | Plus | Plus |
| Tranche C Rebate | \$ 500,000 | \$ 500,000 | \$ 500,000 | \$ 500,000 |
| Additional Volume Rebate | | 156,250 | 312,500 | 468,750 |
| Interest Forgiveness Rebate (2) | \$ 712,500 | \$ 712,500 | \$ 712,500 | 712,500 |
| | \$ 1,212,500 | \$ 1,368,750 | \$ 1,525,000 | \$ 1,681,250 |

(1) Calculated using trailing twelve month units sold

by the Company

- (2) Assuming the first \$30 million portion of the line of credit is fully utilized

Marketing arrangement

HearUSA receives monthly cooperative marketing payments from Siemens to reimburse the Company for marketing and advertising expenses for promoting its business and Siemens products in an amount equal to up to \$200,000. Prior to the December 23, 2008 amendment of the credit facility, the Company also received monthly cooperative marketing payments equal to 3.5% of the amount outstanding under Tranche D.

Conversion of debt for equity

Prior to the December 23, 2008 amendment to the credit agreement, the Company was required to make a payment on December 23, 2008 of \$4.2 million on Tranche D and \$3 million on Tranche E by December 23, 2008 or be declared in default of the agreement. In addition, the Company was required to pay all trade payables within 90 days of the invoice date or be in default of the credit agreement. If there was an event of default, Siemens had the right to convert debt for 6.4 million shares of the Company's common stock at current market price. Rather than paying the \$7.2 million on the two Tranches and the trade payables over 90 days, Siemens agreed to convert into the 6.4 million shares at the default terms and allow conversion of the balance of the amounts currently payable into the line of credit. These terms under which Siemens converted the debt into common stock at the current market price were the terms of the original contract for an event of default.

When the Company evaluated the original contract for a beneficial conversion feature, the Company determined that assuming there were no changes to the current circumstances except for the passage of time, the most favorable conversion price would occur if the Company did not repay the \$4.2 million due under the Tranche D. That calculation did not result in a beneficial conversion feature. Since the conversion occurred under the terms that were originally agreed to for the conversion, there is no additional charge.

Investor and other rights arrangement

Pursuant to the amended Investor Rights Agreement, the Company granted Siemens resale registration rights for the common stock acquired under the Purchase Agreement. On February 13, 2009 the Company filed the required Form S-3 registration statement to register the 6.4 million shares for resale. The Company is not liable for liquidated damages or penalties.

In addition, for a period of 18 months following the December 23, 2008 amendment, the Company has granted to Siemens certain rights of first refusal in the event the Company chooses to issue equity or if there is a change of control transaction involving a person in the hearing aid industry. Thereafter, Siemens will have a more limited right of first refusal and preemptive rights for the life of the agreement.

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 incurrence of indebtedness, merger or sale of assets, the modification of material agreements, changes in capital structure and making certain payments. 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. In addition, a material breach of the supply agreement or a willful breach of certain of the Company's obligations under the Investor Rights Agreement may be declared 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. Any non-compliance with the supply agreement could have a material adverse effect on the Company's financial condition and continued operations.

Working Capital

During 2008, the working capital deficit decreased \$8.8 million to \$7.2 million at December 27, 2008 from \$16.0 million at December 29, 2007. The decrease in the deficit is mostly attributable to a decrease in trade payables and current maturities of long-term debt which arose from the conversion of approximately \$6.2 million in trade payables to long-term indebtedness under Siemens Tranche C, conversion of approximately \$3.8 million in trade payables to 6.4 million shares of the Company's Common Stock and the elimination of the current maturities of subordinated notes of approximately \$1.5 million following the repayment of these notes in August 2008 (see Note 8 Subordinated Notes and Warrant Liability, Notes to Consolidated Financial Statements included herein).

The working capital deficit of \$7.2 million includes approximately \$2.7 million representing the current maturities of the long-term debt to Siemens which may be repaid through rebate credits. In 2008, the Company generated income from operations of approximately \$3.9 million (reduced by among other things approximately \$849,000 of non-cash employee stock-based compensation expense and approximately \$1.4 million of amortization expense of intangible assets) compared to \$6.8 million (reduced by approximately \$606,000 of non-cash employee stock-based compensation expense and approximately \$896,000 of amortization expense of intangible assets) in 2007. Cash and cash equivalents as of December 27, 2008 were approximately \$3.6 million.

Cash Flows

Net cash provided by operating activities in 2008 was approximately \$8.7 million compared to approximately \$2.1 million in 2007. This improvement was mostly associated with an increase in accounts payable of \$5.4 million and income generated from operations of approximately \$3.9 million.

During 2008, cash of approximately \$4.2 million was used to complete the acquisition of centers, a decrease of approximately \$2.8 million and \$5.4 million over the \$7.0 million and \$9.6 million used in 2007 and 2006, respectively, as there were fewer acquisitions in 2008. It is expected that funds will continue to be used for Tranche B and the source of these funds is expected to primarily be from the Siemens acquisition line of credit. In accordance with the amended agreements prior to releasing these funds the Company must be cash flow positive prior to the acquisition. The increase of approximately \$765,000 in the purchase of property and equipment is due in part to expenditures related to upgrades of centers or relocations in 2008.

In 2008, funds of approximately \$6.0 million were used to repay long-term debt and subordinated notes. Proceeds of \$4.3 million were received from the Siemens Tranches B and C for acquisitions. The Company expects to continue to draw additional funds from the Siemens Tranche B in order to pay the cash portion of its 2009 acquisitions. In accordance with the amended agreements prior to releasing these funds the Company must be cash flow positive prior to the acquisition.

The Company believes that current cash and cash equivalents, cash generated at current net revenue levels and acquisition financing provided by its strategic partner, Siemens, will be sufficient to support the Company's operating and investing activities through 2009. However, 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 cash flow from operations will not be sufficient. In the event of a shortfall in cash, 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 is also continuing its aggressive cost controls and sales and gross margin improvements.

Contractual Obligations

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 December 27, 2008.

| Contractual obligations | Total | Payments due by period (000 \$) | | | |
|---|---------|---------------------------------|-------------|-------------|-------------------|
| | | Less than 1 year | 1 - 3 years | 4 - 5 Years | More Than 5 years |
| Long-term debt (1 and 3) | 56,583 | 7,011 | 10,483 | 5,499 | 33,590 |
| Subtotal of obligations recorded on balance sheet | 56,583 | 7,011 | 10,483 | 5,499 | 33,590 |
| Interest to be paid on long-term debt (2 and 3) | 23,310 | 4,773 | 8,185 | 6,869 | 3,483 |
| Operating leases | 19,036 | 6,450 | 8,718 | 2,877 | 991 |
| Employment agreements | 4,881 | 2,484 | 2,288 | 109 | |
| Purchase obligations (4) | 3,961 | 2,514 | 1,447 | | |
| Total contractual cash obligations | 107,771 | 23,232 | 31,121 | 15,354 | 38,064 |

(1) Approximately \$46.7 million can be repaid through rebate credits from Siemens, including \$2.7 million in less than 1 year and \$5.3 million in years 1-3, \$5.1 million in years 4-5 and \$33.6 million in

more than
5 years.

- (2) Interest on long-term debt includes the interest on the new Tranches B and C that can be repaid through rebate credits from Siemens pursuant to the Amended and Restated Credit Agreement, including \$4.3 million in less than 1 year and \$7.8 million in years 1-3, \$6.9 in years 4-5 and \$3.5 million in more than 5 years. Interest repaid through preferred pricing reductions was \$2.8 million in 2008. (See Note 6 Long-Term Debt, Notes to Consolidated Financial Statements included herein).
- (3) Principal and interest payments on long-term debt is based on cash payments and not the fair value of the discounted notes (See Note 6

Long-Term
Debt, Notes to
Consolidated
Financial
Statements
included
herein).

- (4) Purchase obligations includes the contractual commitment to AARP for campaigns to educate and promote hearing loss awareness and prevention and the contractual commitment to AARP for public marketing funds for the AARP Health Care Options General Program, including \$1.8 million in less than 1 year and \$907,000 in years 1-3.

CRITICAL ACCOUNTING POLICIES

Management believes the following critical accounting policies affect the significant judgments and estimates used in the preparation of the consolidated financial statements:

Business acquisitions and goodwill

We account for business acquisitions using the purchase method of accounting. As of January 1, 2009 we adopted the provisions of SFAS 141(R) and will account for acquisitions completed after December 31, 2008 in accordance with SFAS 141(R). SFAS 141(R) revises the manner in which companies account for business combinations and is described more fully elsewhere in this annual report. We determine the purchase price of an acquisition based on the fair value of the consideration given or the fair value of the net assets acquired, whichever is more clearly evident. The total purchase price of an acquisition is allocated to the underlying net assets based on their respective estimated fair values. As part of this allocation process, management must identify and attribute values and estimated lives to intangible assets acquired. Such determinations involve considerable judgment, and often involve the use of significant estimates and assumptions, including those with respect to future cash inflows and outflows, discount rates and asset lives. These determinations will affect the amount of amortization expense recognized in future periods. Assets acquired in a business combination that will be re-sold are valued at fair value less cost to sell. Results of operating these assets are recognized currently in the period in which those operations occur.

The Company evaluates goodwill and certain intangible assets with indefinite lives not being amortized in accordance with SFAS No. 142, Goodwill and Other Intangible Assets. Under SFAS No. 142, goodwill and certain intangible assets are reviewed for impairment annually or more frequently if impairment indicators arise. Indicators at the Company include, but are not limited to: sustained operating losses or a trend of poor operating performance, a decrease in the company's market capitalization below its book value and an expectation that a reporting unit will be sold or otherwise disposed of. If one or more indicators of impairment exist, the Company performs an evaluation to identify potential impairments. If an impairment is identified, the Company measures and records the amount of impairment losses. The Company performs its annual analysis on the first day of its fourth quarter.

A two-step impairment test is performed on goodwill. In order to do this, management applies judgment in determining its reporting units, which represent distinct parts of the Company's business. The reporting units determined by management are the centers, the network and e-commerce. The definition of the reporting units affects the Company's goodwill impairment assessments. In the first step, the Company compares the fair value of each reporting unit to its carrying value. Calculating the fair value of the reporting units requires significant estimates and long-term assumptions. The Company tests goodwill for impairment annually on the first day of the Company's fourth quarter, and each of these tests indicated no impairment. The Company estimates the fair value of its reporting units by applying a weighted average of two methods: quoted market prices and discounted cash flows. The weighting is 40% exchange market price and 60% discounted cash flows.

If the carrying value of the reporting unit exceeds its fair value, additional steps are required to calculate an impairment charge. The second step of the goodwill impairment test compares the implied fair value of the reporting unit's goodwill with the carrying value of the goodwill. If the carrying amount of the reporting unit's goodwill exceeds the implied fair value of that goodwill, an impairment loss is recognized in an amount equal to that excess. The implied fair value of goodwill is the fair value of the reporting unit allocated to all of the assets and liabilities of that unit as if the reporting unit had been acquired in a business combination and the fair value of the reporting unit was the purchase price paid to acquire the reporting unit. Significant changes in key assumptions about the business and its prospects, or changes in market conditions, stock price, interest rates or other externalities, could result in an impairment charge.

The market capitalization of the Company's stock temporarily declined to approximately \$17.3 million on December 11, 2008, which was substantially lower than the Company's estimated combined fair values of its three reporting units. The Company completed a reconciliation of the sum of the estimated fair values of its reporting units to its market value (based upon its stock price at December 11, 2008). We believe one of the primary reconciling differences between fair value and our market capitalization is due to a control premium. We believe the value of a control premium is the value a market participant could extract as savings and / or synergies by obtaining control, and

thereby eliminating duplicative overhead costs and obtaining discounts on volume purchasing from suppliers. The Company also considers the following qualitative items that cannot be accurately quantified and are based upon the beliefs of management, but provide additional support for the explanation of the remaining difference between the estimated fair value of the Company's reporting units and its market capitalization:

- The Company's stock is thinly traded;
- The decline in the Company's stock price during 2008 is not directly correlated to a change in the overall operating performance of the Company; and
- Previously unseen pressures are in place given the global financial and economic crisis.

At December 27, 2008 the Company's market capitalization of \$26.2 million exceeded the book value of its three reporting units. We will continue to monitor market trends in our business, the related expected cash flows and our calculation of market capitalization for purposes of identifying possible indicators of impairment. Should our market capitalization again decline below our book value or we have other indicators of impairment, as previously discussed, we will be required to perform an interim step one impairment analysis, which may lead to a step two analysis resulting in a goodwill impairment. Additionally, we would then be required to review our remaining long-lived assets for impairment.

Judgments regarding the existence of impairment indicators are based on legal factors, market conditions and operational performance of the acquired businesses. Future events could cause us to conclude that impairment indicators exist and that goodwill associated with the acquired businesses is impaired. Additionally, as the valuation of identifiable goodwill requires significant estimates and judgment about future performance, cash flows and fair value, our future results could be affected if these current estimates of future performance and fair value change. Any resulting impairment loss could have a material adverse impact on our financial condition and results of operations.

Revenue recognition

HearUSA has company-owned centers in its core markets and a network of affiliated providers who provide products and services to customers that are located outside its core markets. HearUSA enters into provider agreements with benefit providers (third party payors such as insurance companies, managed care companies, employer groups, etc.) under (a) a discount arrangement on products and service; (b) a fee for service arrangement; and (c) a per capita basis or capitation arrangements, which is a fixed per member per month fee received from the benefit providers.

All contracts are for one calendar year and are and cancelable with ninety days notice by either party. Under the discount arrangements, the Company provides the products and services to the eligible members of a benefit provider at a pre-determined discount or customary price and the member pays the Company directly for the products and services. Under the fee for service arrangements, the Company provides the products and services to the eligible members at its customary price less the benefit they are allowed (a specific dollar amount), which the member pays directly to the Company. The Company then bills the benefit provider the agreed upon benefit for the service.

Under the capitation agreements, the Company agrees with the benefit provider to provide their eligible members with a pre-determined discount. Revenue under capitation agreements is derived from the sales of products and services to members of the plan and from a capitation fee paid to the Company by the benefit provider at the beginning of each month. The members that are purchasing products and services pay the customary price less the pre-determined discount. This revenue from the sales of products to these members is recorded at the customary price less applicable discount in the period that the product is delivered. The direct expenses consisting primarily of the cost of goods sold and commissions on sales are recorded in the same period. Other indirect operating expenses are recorded in the period which they are incurred.

The capitation fee revenue is calculated based on the total members in the benefit provider's plan at the beginning of each month and is non-refundable. Only a small percentage of these members may ever purchase product or services from the Company. The capitation fee revenue is earned as a result of agreeing to provide services to members without regard to the actual amount of service provided. That revenue is recorded monthly in the period that the Company has agreed to see any eligible members.

The Company records each transaction at its customary price for the three types of arrangements, less any applicable discounts from the arrangements in the center business segment. The products sold are recorded under the hearing aids and other products line item and the services are recorded under the service line item on the consolidated statement of operations. Revenue and expense are recorded when the product has been delivered, net of an estimate for return allowances. Revenue and expense from services and repairs are recorded when the services or repairs have been performed. Capitation revenue is recorded as revenue from hearing aids since it relates to the discount given to the members.

Revenues are considered earned by the Company at the time delivery of product or services have been provided to its customers (when the Company is entitled to the benefits of the revenues).

When the arrangements are related to members of benefit providers that are located outside the Company-owned centers' territories, the revenues generated under these arrangements are included under the network business segment. The Company records a receivable for the amounts due from the benefit providers and a payable for the amounts owed to the affiliated providers. The Company only pays the affiliated provider when the funds are received from the benefit provider. The Company records revenue equal to the minimal fee for processing and administrative fees. The costs associated with these services are operating costs, mostly for the labor of the network support staff and are recorded when incurred.

No contract costs are capitalized by the Company.

Allowance for doubtful accounts

Certain of the accounts receivable of the Company are from health insurance and managed care organizations and government agencies. These organizations could take up to nine months before paying a claim made by the Company and also impose a limit on the time the claim can be billed. The Company provides an allowance for doubtful accounts equal to the estimated uncollectible amounts. That estimate is based on historical collection experience, current economic and market conditions, and a review of the current status of each customer's trade accounts receivable.

In order to calculate that allowance, the Company first identifies any known uncollectible amounts in its accounts receivable listing and charges them against the allowance for doubtful accounts. Then a specific percent per plan and per aging categories is applied against the remaining receivables to estimate the needed allowance. Any changes in the percent assumptions per plan and aging categories results in a change in the allowance for doubtful accounts. For example, an increase of 10% in the percent applied against the remaining receivables would increase the allowance for doubtful accounts by approximately \$31,000.

Sales returns

The Company provides to all patients purchasing hearing aids a specific return period of at least 30 days, or as mandated by state guidelines 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. classes. The Company calculates its allowance for returns using estimates based upon actual historical returns. The cost of the hearing aid is reimbursed to the Company by the manufacturer.

Impairment of Long-Lived Assets

Long-lived assets are subject to a review for impairment if events or changes in circumstances indicate that the carrying amount of the asset may not be recoverable. If the future undiscounted cash flows generated by an asset or asset group is less than its carrying amount, it is considered to be impaired and would be written down to its fair value. Currently we have not experienced any events that would indicate a potential impairment of these assets, but if circumstances change we could be required to record a loss for the impairment of long-lived assets.

Stock-based compensation

Share-based payments are accounted for in accordance with the provisions of SFAS No. 123 (revised 2004), *Share-Based Payment* (SFAS No. 123(R)). To determine the fair value of our stock option awards, we use the Black-Scholes option pricing model, which requires management to apply judgment and make assumptions to determine the fair value of our awards. These assumptions include estimating the length of time employees will retain their vested stock options before exercising them (the expected term), the estimated volatility of the price of our common stock over the expected term and an estimate of the number of options that will ultimately be forfeited.

The expected term 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 a historical volatility of our common stock for a period at least equal to the expected term. Estimated forfeitures are calculated based on historical experience. Changes in these assumptions can materially affect the estimate of the fair value of our share-based payments and the related amount recognized in our Consolidated Financial Statements.

Income taxes

Income taxes are calculated in accordance with SFAS No. 109, *Accounting for Income Taxes* (SFAS No. 109), which requires the use of the asset and liability method. Under this method, deferred tax assets and liabilities are recognized based on the difference between the carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using the enacted tax rates. A valuation allowance is established against the deferred tax assets when it is more likely than not that some portion or all of the deferred taxes may not be realized.

Both the calculation of the deferred tax assets and liabilities, as well as the decision to establish a valuation allowance requires management to make estimates and assumptions. Although we do not believe there is a reasonable likelihood that there will be a material change in the estimates and assumptions used, if actual results are not consistent with the estimates and assumptions, the balances of the deferred tax assets, liabilities and valuation allowance could be adversely affected.

RECENT ACCOUNTING PRONOUNCEMENTS

In December 2007, the FASB issued SFAS No. 160 (SFAS 160), Non-controlling Interests in Consolidated Financial Statements, an amendment of Accounting Research Bulletin No. 51, which requires all entities to report minority interests in subsidiaries as equity in the consolidated financial statements, and requires that transactions between entities and non-controlling interests be treated as equity transactions. SFAS 160 is effective for fiscal years beginning on or after December 15, 2008, and will be applied prospectively. The Company expects SFAS 160 to impact the accounting for HEARx West's minority interest.

In December 2007, the FASB issued SFAS No. 141(R) (SFAS 141R), Business Combinations, which will significantly change how business acquisitions are accounted for and will impact financial statements both on the acquisition date and in subsequent periods. Some of the changes, such as the accounting for contingent consideration, will introduce more volatility into earnings, and may impact a company's acquisition strategy. SFAS 141R is effective for fiscal years beginning on or after December 15, 2008, and will be applied prospectively. The Company does not expect this standard will have a significant impact on its financial position and results of operations.

In March 2008, the FASB issued SFAS No. 161, Disclosures about Derivative Instruments and Hedging Activities, an amendment of FASB Statement No. 133 (SFAS No. 161). SFAS No. 161 amends and expands the disclosure requirements of SFAS No. 133 with the intent to provide users of financial statements with an enhanced understanding of: (i) how and why an entity uses derivative instruments; (ii) how derivative instruments and related hedged items are accounted for under SFAS No. 133 and its related interpretations and (iii) how derivative instruments and related hedged items affect an entity's financial position, financial performance and cash flows. This statement is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008, with early application encouraged. The Company does not expect this standard will have a significant impact on its disclosures.

In April 2008, the FASB issued FSP FAS 142-3, Determination of the Useful Life of Intangible Assets (FSP FAS 142-3). FSP FAS 142-3 amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset under SFAS No. 142, Goodwill and Other Intangible Assets (SFAS 142). The intent of FSP FAS 142-3 is to improve the consistency between the useful life of a recognized intangible asset under SFAS 142 and the period of expected cash flows used to measure the fair value of the asset under SFAS 141(R) and other applicable accounting literature. FSP FAS 142-3 is effective for financial statements issued for fiscal years beginning after December 15, 2008. The Company does not anticipate that the adoption of FSP FAS 142-3 will have a significant impact on its financial position and results of operations.

In May 2008, the FASB issued SFAS No. 162, The Hierarchy of Generally Accepted Accounting Principles, (SFAS 162). SFAS 162 identifies the sources of accounting principles and the framework for selecting the principles used in the preparation of financial statements. SFAS 162 is effective 60 days following the SEC's approval of the Public Company Accounting Oversight Board amendments to AU Section 411, The Meaning of Present Fairly in Conformity with Generally Accepted Accounting Principles. The Company does not expect this standard will have a material impact on its results of operations, financial position and results of operations.

In May 2008, the FASB issued Staff Position No. APB 14-1, Accounting for Convertible Debt Instruments That May Be Settled in Cash upon Conversion (Including Partial Cash Settlement), or FSP APB 14-1. FSP APB 14-1 specifies that issuers of convertible debt instruments that may be settled in cash upon conversion should separately account for the liability and equity components in a manner that will reflect the entity's nonconvertible debt borrowing rate when interest cost is recognized in subsequent periods. We are required to adopt FSP APB 14-1 at the beginning of 2009 and apply FSP APB 14-1 retrospectively to all periods presented. We are currently evaluating the impact of adopting FSP APB 14-1 on our financial position and results of operations. The Company does not expect this standard will have a material impact on its results of operations, financial position and results of operations.

Item 7A. Quantitative and Qualitative Disclosure About Market Risk

The Company does not engage in derivative transactions. The Company does become exposed to foreign currency transactions as a result of its operations in Canada. The Company does not hedge such 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 and cash flows are subject to changing market interest rates:

| | Fixed Rate 9.5% Due February 2015 \$ (000 s) | Variable Rate 5% to 13.9% Other \$ (000 s) | Total \$ (000 s) |
|----------------------|--|--|------------------------|
| 2009 | (2,683) | (4,232) | (6,915) |
| 2010 | (2,676) | (2,839) | (5,515) |
| 2011 | (2,653) | (1,846) | (4,499) |
| 2012 | (2,579) | (393) | (2,972) |
| 2013 | (2,480) | (43) | (2,523) |
| Thereafter | (33,590) | | (33,590) |
| | | | |
| Total | (46,661) | (9,353) | (56,014) |
| | | | |
| Estimated fair value | (46,661) | (9,353) | (56,014) |

Item 8. Financial Statements and Supplementary Data

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Report of Independent Registered Public Accounting Firm

Board of Directors

HearUSA, Inc.

West Palm Beach, Florida

We have audited the accompanying consolidated balance sheets of HearUSA, Inc. as of December 27, 2008 and December 29, 2007, and the related consolidated statements of operations, changes in stockholders' equity and cash flows for each of the three fiscal years in the period ended December 27, 2008. In connection with our audits of the financial statements, we have also audited the financial statement schedule listed in the accompanying index. These financial statements and schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and schedule based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform an audit of its internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements and schedule. We believe that our audits provide a reasonable basis for our opinion.

As discussed in Note 8 to the consolidated financial statements, the Company changed its method of accounting for Registration Rights Agreements when it adopted FSP EITF 00-19-2, Accounting for Registration Payment Arrangements, on December 31, 2006.

In our opinion, the consolidated financial statements referred to above presents fairly, in all material respects, the financial position of HearUSA, Inc. at December 27, 2008 and December 29, 2007, and the results of its operations and its cash flows for each of the three fiscal years in the period ended December 27, 2008, in conformity with accounting principles generally accepted in the United States of America.

Also in our opinion, the financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly, in all material respects, the information set forth therein.

BDO Seidman, LLP

Certified Public Accountants

West Palm Beach, Florida

March 27, 2009

HearUSA, Inc.
Consolidated Balance Sheets

| | December 27, 2008 | December 29, 2007 |
|--|----------------------------------|------------------------------|
| | (Dollars in thousands) | |
| ASSETS | | |
| Current assets | | |
| Cash and cash equivalents | \$ 3,553 | \$ 3,369 |
| Accounts and notes receivable, less allowance for doubtful accounts of \$506,000 and \$498,000 | 7,371 | 8,825 |
| Inventories | 1,682 | 2,441 |
| Prepaid expenses and other | 502 | 1,283 |
| Deferred tax asset | | 62 |
| Total current assets | 13,108 | 15,980 |
| Property and equipment, net (Notes 3 and 4) | 4,876 | 4,356 |
| Goodwill (Notes 3 and 5) | 65,953 | 63,134 |
| Intangible assets, net (Notes 3 and 5) | 15,630 | 16,165 |
| Deposits and other | 810 | 691 |
| Restricted cash and cash equivalents | 224 | 216 |
| Total Assets | \$ 100,601 | \$ 100,542 |
| LIABILITIES AND STOCKHOLDERS EQUITY | | |
| Current liabilities | | |
| Accounts payable | \$ 4,959 | \$ 12,467 |
| Accrued expenses | 3,208 | 2,523 |
| Accrued salaries and other compensation | 3,713 | 3,521 |
| Current maturities of long-term debt | 6,915 | 10,746 |
| Current maturities of subordinated notes, net of debt discount of \$60,000 in 2007 | | 1,480 |
| Dividends payable | 34 | 34 |
| Minority interest in net income of consolidated joint venture, currently payable | 1,526 | 1,221 |
| Total current liabilities | 20,355 | 31,992 |
| Long-term debt (Notes 3 and 6) | 49,099 | 36,499 |
| Deferred income taxes | 7,284 | 6,462 |
| Total long-term liabilities | 56,383 | 42,961 |
| Commitments and contingencies (Note 15) | | |

Stockholders equity (Notes 9 and 10)

Preferred stock (aggregate liquidation preference \$2,330,000, \$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

44,828,384 and 38,325,414 shares issued

Stock subscription

Additional paid-in capital

Accumulated deficit

Accumulated other comprehensive income

Treasury stock, at cost: 523,662 common shares

Total Stockholders Equity

Total Liabilities and Stockholders Equity

| | | |
|--|-----------|-----------|
| | 4,483 | 3,833 |
| | | (412) |
| | 137,032 | 133,261 |
| | (116,416) | (113,076) |
| | 1,249 | 4,468 |
| | (2,485) | (2,485) |

23,863 **25,589**

\$ 100,601 **\$ 100,542**

See accompanying notes to consolidated financial statements

HearUSA, Inc.
Consolidated Statements of Operations

| | December 27, 2008 | Year Ended December 29, 2007 | December 30, 2006 |
|--|--|---|------------------------------|
| | (Dollars and shares in thousands, except per share amounts) | | |
| Net revenues | | | |
| Hearing aids and other products | \$ 104,392 | \$ 95,936 | \$ 82,820 |
| Services | 7,596 | 6,868 | 5,966 |
| Total net revenues | 111,988 | 102,804 | 88,786 |
| Operating costs and expenses | | | |
| Hearing aids and other products | 30,171 | 26,017 | 24,942 |
| Services | 2,311 | 2,088 | 1,761 |
| Total cost of products sold and services excluding depreciation and amortization | 32,482 | 28,105 | 26,703 |
| Center operating expenses | 57,450 | 50,401 | 42,281 |
| General and administrative expenses (including approximately \$849,000, \$606,000 and \$976,000 in 2008, 2007 and 2006 of non-cash employee stock-based compensation expense Notes 1 and 10) | 15,176 | 15,227 | 14,005 |
| Depreciation and amortization | 2,963 | 2,248 | 1,988 |
| Total operating costs and expenses | 108,071 | 95,981 | 84,977 |
| Income from operations | 3,917 | 6,823 | 3,809 |
| Non-operating income (expense): | | | |
| Gain from insurance settlement | | | 203 |
| Gain on restructuring of contract (Note 13) | 981 | | |
| Interest income | 42 | 164 | 152 |
| Interest expense (including approximately \$763,000 of non-cash interest expense on a long-term contractual commitment in 2008 (Note 13), \$421,000 and \$117,000 of non-cash interest expense on discounted notes payable in 2008 and 2007 (Note 6) and \$192,000, \$3.5 million and \$2.7 million of non-cash debt discount amortization in 2008, 2007 and 2006 (Note 7) and a non-cash reduction of approximately \$319,000 for the decrease in the fair value of the warrant liability in 2006 Note 8) | (5,755) | (8,022) | (5,964) |
| Loss before income tax expense and minority interest in income of consolidated Joint Venture | (815) | (1,035) | (1,800) |

| | | | | | | |
|---|----|---------|----|---------|----|---------|
| Income tax expense (Note 14) | | (1,126) | | (769) | | (741) |
| Minority interest in income of consolidated Joint Venture | | (1,260) | | (1,478) | | (633) |
| Net loss | | (3,201) | | (3,282) | | (3,174) |
| Dividends on preferred stock (Notes 9C) | | (139) | | (137) | | (138) |
| Net loss applicable to common stockholders | \$ | (3,340) | \$ | (3,419) | \$ | (3,312) |
| Net loss applicable to common stockholders per common share basic and diluted (Note 1) | \$ | (0.09) | \$ | (0.09) | \$ | (0.10) |
| Weighted average number of shares of common stock outstanding (Notes 1, 9 and 10) | | 38,635 | | 36,453 | | 32,225 |

See accompanying notes to consolidated financial statements

HearUSA, Inc.
Consolidated Statements of Changes in Stockholders' Equity

| | December 27, 2008 | | Year Ended December 29, 2007 | | December 30, 2006 | |
|--|-------------------|------------|---------------------------------|------------|-------------------|------------|
| | Shares | Amount | Shares | Amount | Shares | Amount |
| (Dollars and shares in thousands) | | | | | | |
| Preferred stock | | | | | | |
| Balance beginning and end of year | | \$ | | \$ | | \$ |
| Common stock | | | | | | |
| Balance, beginning of year | 38,325 | \$ 3,833 | 32,030 | \$ 3,203 | 31,893 | \$ 3,189 |
| Exercise of employee stock options | 210 | 21 | 473 | 47 | 7 | 1 |
| Issuance of common stock for exchangeable shares | 93 | 9 | 164 | 17 | 30 | 3 |
| Issuance of restricted stock | | | | | 100 | 10 |
| Cancellation of stock subscription | (200) | (20) | | | | |
| Issuance of common stock for convertible debt | | | 3,158 | 316 | | |
| Issuance of common stock for repayment of debt | 6,400 | 640 | | | | |
| Warrant exercise | | | 2,500 | 250 | | |
| Balance, end of year | 44,828 | \$ 4,483 | 38,325 | \$ 3,833 | 32,030 | \$ 3,203 |
| Treasury stock | | | | | | |
| Balance beginning and end of year | 524 | \$ (2,485) | 524 | \$ (2,485) | 524 | \$ (2,485) |
| Stock subscription | | | | | | |
| Balance, beginning of year | | \$ (412) | | \$ (412) | | \$ (412) |
| Cancellation of stock subscription | | 412 | | | | |
| Balance, end of year | | \$ | | \$ (412) | | \$ (412) |
| Additional paid-in capital: | | | | | | |
| Balance, beginning of year | | \$ 133,261 | | \$ 123,972 | | \$ 121,935 |
| Cumulative effect of adjustment (Note 8) | | | | 246 | | |
| Employee stock-based compensation expense | | 849 | | 606 | | 976 |
| Cancellation of stock subscription | | (392) | | | | |
| Value of warrants issued with debt | | | | | | 917 |
| Exercise of employee stock options | | 125 | | 399 | | 4 |

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| | | | |
|--|------------|------------|------------|
| Issuance of common stock for exchangeable shares | (11) | (16) | (3) |
| Exercise of warrants | | 2,871 | |
| Consulting expense | | 32 | 143 |
| Issuance of common stock for convertible debt | | 5,151 | |
| Issuance of common stock for repayment of debt | 3,200 | | |
| Balance, end of year | \$ 137,032 | \$ 133,261 | \$ 123,972 |

See accompanying notes to consolidated financial statements

HearUSA, Inc.
Consolidated Statements of Changes in Stockholders' Equity

| | December 27, 2008 Amount | Year Ended December 29, 2007 Amount (Dollars in thousands) | December 30, 2006 Amount |
|--|---|---|---|
| Accumulated deficit: | | | |
| Balance, beginning of year | \$ (113,076) | \$ (109,521) | \$ (106,209) |
| Cumulative effect adjustment (Note 8) | | (136) | |
| Net loss | (3,201) | (3,282) | (3,174) |
| Dividends on preferred stock | (139) | (137) | (138) |
| Balance, end of year | \$ (116,416) | \$ (113,076) | \$ (109,521) |
| Accumulated other comprehensive income: | | | |
| Balance, beginning of year | \$ 4,468 | \$ 2,163 | \$ 2,214 |
| Foreign currency translation adjustment | (3,219) | 2,305 | (51) |
| Balance, end of year | \$ 1,249 | \$ 4,468 | \$ 2,163 |
| Comprehensive income (loss): | | | |
| Net loss | \$ (3,201) | \$ (3,282) | \$ (3,174) |
| Foreign currency translation adjustment | (3,219) | 2,305 | (51) |
| Comprehensive loss | \$ (6,420) | \$ (977) | \$ (3,225) |

See accompanying notes to consolidated financial statements

HearUSA, Inc.
Consolidated Statements of Cash Flows

| | December 27, 2008 | Year Ended December 29, 2007 | December 30, 2006 |
|---|----------------------------------|---|----------------------------------|
| | (Dollars in thousands) | | |
| Cash flows from operating activities | | | |
| Net loss | \$ (3,201) | \$ (3,282) | \$ (3,174) |
| Adjustments to reconcile net loss to net cash provided by operating activities: | | | |
| Debt discount amortization | 192 | 2,122 | 2,694 |
| Depreciation and amortization | 2,963 | 2,248 | 1,988 |
| Interest on Siemens Tranche C and Tranche D | | | 1,130 |
| Employee stock-based compensation | 849 | 606 | 976 |
| Interest on reduction of warrant exercise price | | 1,371 | |
| Minority interest in income of consolidated subsidiary | 1,260 | 1,478 | 633 |
| Deferred tax expense | 1,068 | 769 | 870 |
| Interest on long-term contractual commitment | 763 | | |
| Provision for doubtful accounts | 424 | 478 | 379 |
| Interest on discounted notes payable | 421 | 117 | |
| Consulting stock-based compensation | | 32 | 28 |
| Principal payments on long-term debt made through rebate credits | (3,783) | (4,491) | (3,112) |
| Gain on restructuring of contract | (981) | | |
| Decrease in fair value of warrant liability | | | (319) |
| Other | (102) | (8) | 7 |
| (Increase) decrease in: | | | |
| Accounts and notes receivable | 569 | (1,209) | (1,233) |
| Inventories | 755 | (281) | (767) |
| Prepaid expenses and other | 679 | 287 | 218 |
| Increase in: | | | |
| Accounts payable and accrued expenses | 6,595 | 1,171 | 4,348 |
| Accrued salaries and other compensation | 245 | 666 | 233 |
| Net cash provided by operating activities | 8,716 | 2,074 | 4,899 |
| Cash flows from investing activities | | | |
| Purchase of property and equipment | (1,501) | (736) | (1,200) |
| Proceeds from redemption of certificates of deposit | | | 226 |
| Business acquisitions | (4,157) | (6,963) | (9,601) |
| Net cash used in investing activities | (5,658) | (7,699) | (10,575) |
| Cash flows from financing activities | | | |
| Proceeds from issuance of long-term debt | 4,271 | 11,806 | 7,539 |

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| | | | |
|--|---------|---------|---------|
| Payments on long-term debt | (4,444) | (3,803) | (3,039) |
| Payments on subordinated notes | (1,540) | (1,760) | (1,760) |
| Payments on convertible subordinated notes | | (784) | (1,250) |
| Proceeds from exercise of employee stock options | 146 | 447 | 5 |
| Proceeds from the exercise of warrants | | 1,750 | |
| Distributions paid to minority interest | (956) | (890) | |
| Dividends on preferred stock | (139) | (137) | (138) |
| Net cash provided by financing activities | (2,662) | 6,629 | 1,357 |

See accompanying notes to consolidated financial statements

HearUSA, Inc.
Consolidated Statements of Cash Flows

| | December 27, 2008 | Year Ended December 29, 2007 | December 30, 2006 |
|--|----------------------------------|---|----------------------------------|
| Effects of exchange rate changes on cash | (212) | 39 | (62) |
| Net increase (decrease) in cash and cash equivalents | 184 | 1,043 | (4,381) |
| Cash and cash equivalents at beginning of year | 3,369 | 2,326 | 6,707 |
| Cash and cash equivalents at end of year | \$ 3,553 | \$ 3,369 | \$ 2,326 |
| Supplemental disclosure of cash flow information: | | | |
| Cash paid for interest | \$ 1,567 | \$ 1,659 | \$ 1,200 |
| Supplemental schedule of non-cash investing and financing activities: | | | |
| Principal payments on long-term debt through rebate credits | \$ 3,783 | \$ 4,491 | \$ 3,112 |
| Interest payments on long-term debt through rebate credits | \$ 2,832 | \$ 2,696 | \$ 626 |
| Issuance of note payable in exchange for business acquisitions | \$ 3,227 | \$ 6,445 | \$ 6,711 |
| Issuance of capital leases in exchange for property and equipment | \$ 445 | \$ 416 | \$ 172 |
| Conversion of accounts payable to notes payable | \$ 8,985 | \$ | \$ 2,200 |
| Conversion of debt to common stock | \$ 3,840 | \$ | \$ |
| Acquisition of intangible asset | \$ 19,273 | \$ | \$ |
| Issuance of contractual liability | \$ 19,273 | \$ | \$ |
| Restructuring of contractual obligation written off (AARP) | \$ 20,036 | | |
| Intangible asset written off (AARP) | \$ 19,055 | \$ | \$ |
| Purchase of equipment with volume discount credit | \$ 200 | \$ | \$ |
| <i>See accompanying notes to consolidated financial statements</i> | | | |

HearUSA, Inc.

Notes to Consolidated Financial Statements

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

The Company

HearUSA Inc. (HearUSA or the Company), a Delaware corporation, was established in 1986. As of December 27, 2008, the Company has a network of 202 company-owned hearing care centers in ten states and the Province of Ontario, Canada. The Company also sponsors a network of approximately 1,900 credentialed audiology providers that participate in selected hearing benefit programs contracted by the Company with employer groups, health insurers and benefit sponsors in 49 states. The centers and the network providers provide audiological products and services for the hearing impaired.

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 2008 and 2007 the Company's fifty percent owned Joint Venture, HEARx West, Inc, generated net income of approximately \$2.5 million and \$3.0 million, respectively. Since the Company is the general manager of Hearx West and it's 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.

According to the Company's agreement with its joint venture partner, The Permanente Federation, the Company had included in its statement of operations 100% of the losses incurred by the joint venture since its inception and then received 100% of the net income of the joint venture until the accumulated deficit was eliminated which was completely eliminated at the end of the second quarter of 2006. The Company now records 50% of the venture's net income as minority interest in income of consolidated subsidiary in the Company's consolidated statements of operations with a corresponding liability on its consolidated balance sheets.

Revenue Recognition

HearUSA has company-owned centers in its core markets and a network of affiliated providers who provide products and services to customers that are located outside its core markets. HearUSA enters into provider agreements with benefit providers (third party payors such as insurance companies, managed care companies, employer groups, etc.) under (a) a discount arrangement on products and service; (b) a fee for service arrangement; and (c) a per capita basis or capitation arrangements, which is a fixed per member per month fee received from the benefit providers.

All contracts are for one calendar year and are and cancelable with ninety days notice by either party.

Under the discount arrangements, the Company provides the products and services to the eligible members of a benefit provider at a pre-determined discount or customary price and the member pays the Company directly for the products and services. Under the fee for service arrangements, the Company provides the products and services to the eligible members at its customary price less the benefit they are allowed (a specific dollar amount), which the member pays directly to the Company. The Company then bills the benefit provider the agreed upon benefit for the service.

Under the capitation agreements, the Company agrees with the benefit provider to provide their eligible members with a pre-determined discount. Revenue under capitation agreements is derived from the sales of products and services to members of the plan and from a capitation fee paid to the Company by the benefit provider at the beginning of each month. The members that are purchasing products and services pay the customary price less the pre-determined discount. This revenue from the sales of products to these members is recorded at the customary price less applicable discount in the period that the product is delivered. The direct expenses consisting primarily of the cost of goods sold and commissions on sales are recorded in the same period. Other indirect operating expenses are recorded in the period which they are incurred.

HearUSA, Inc.

Notes to Consolidated Financial Statements

The capitation fee revenue is calculated based on the total members in the benefit provider's plan at the beginning of each month and is non-refundable. Only a small percentage of these members may ever purchase product or services from the Company. The capitation fee revenue is earned as a result of agreeing to provide services to members without regard to the actual amount of service provided. That revenue is recorded monthly in the period that the Company has agreed to see any eligible members.

The Company records each transaction at its customary price for the three types of arrangements, less any applicable discounts from the arrangements in the center business segment. The products sold are recorded under the hearing aids and other products line item and the services are recorded under the service line item on the consolidated statement of operations. Revenue and expense are recorded when the product has been delivered, net of an estimate for return allowances. Revenue and expense from services and repairs are recorded when the services or repairs have been performed. Capitation revenue is recorded as revenue from hearing aids since it relates to the discount given to the members.

Revenues are considered earned by the Company at the time delivery of product or services have been provided to its customers (when the Company is entitled to the benefits of the revenues).

When the arrangements are related to members of benefit providers that are located outside the Company-owned centers' territories, the revenues generated under these arrangements are included under the network business segment. The Company records a receivable for the amounts due from the benefit providers and a payable for the amounts owed to the affiliated providers. The Company only pays the affiliated provider when the funds are received from the benefit provider. The Company records revenue equal to the minimal fee for processing and administrative fees. The costs associated with these services are operating costs, mostly for the labor of the network support staff and are recorded when incurred.

No contract costs are capitalized by the Company.

Foreign Currency Translation

The consolidated financial statements for the Company's Canadian subsidiaries are translated into U.S. dollars at current exchange rates. For assets and liabilities, the year-end rate is used. For revenues, expenses, gains and losses the average rate for the period is used. Unrealized currency adjustments in the Consolidated Balance Sheet are accumulated in stockholders' equity as a component of accumulated other comprehensive income.

Intercompany foreign currency transactions are considered of a long term-investment nature (that is, settlement is not planned or anticipated in the foreseeable future). Translation adjustments on the intercompany foreign currency transactions are included in other comprehensive income.

Comprehensive Income (Loss)

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 foreign currency translation adjustment.

Fiscal year

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. 2008 and 2007 include 52 weeks. The next year with 53 weeks will be 2011.

Concentration of credit risk

The Company maintains its cash deposits at commercial banks. We place our cash and cash equivalents with high quality financial institutions. At times, our account balances may exceed federally insured limits. The maximum potential loss that would result from this excess is approximately \$4.1 million. Management believes the Company is not exposed to any significant risk on its cash accounts.

HearUSA, Inc.
Notes to Consolidated Financial Statements

Allowance for doubtful accounts

The Company provides an allowance for doubtful accounts equal to the estimated uncollectible amounts. That estimate is based on historical collection experience, current economic and market conditions and a review of the current status of each customer's trade accounts receivable.

Inventories

Inventory of hearing aids consists of finished product directly purchased from the manufacturers. The cost of the inventory corresponds to the amount directly charged by the manufacturers, which includes freight. The Company does not incur charges for buying or inspection costs.

Inventories of batteries, special hearing devices and related items, are priced at the lower of cost (first-in, first-out) or market.

Property and equipment

Property and equipment is stated at cost. Depreciation is provided on the straight-line method over the estimated useful lives of the depreciable assets. Leasehold improvements are amortized over the shorter of the term of the lease or the useful life of the asset.

Business acquisitions and goodwill and other intangible assets

We account for business acquisitions using the purchase method of accounting. As of January 1, 2009 we adopted the provisions of SFAS 141(R) and will account for acquisitions completed after December 31, 2008 in accordance with SFAS 141(R). SFAS 141(R) revises the manner in which companies account for business combinations and is described more fully elsewhere in this annual report. We determine the purchase price of an acquisition based on the fair value of the consideration given or the fair value of the net assets acquired, whichever is more clearly evident. The total purchase price of an acquisition is allocated to the underlying net assets based on their respective estimated fair values. As part of this allocation process, management must identify and attribute values and estimated lives to intangible assets acquired. Such determinations involve considerable judgment, and often involve the use of significant estimates and assumptions, including those with respect to future cash inflows and outflows, discount rates and asset lives. These determinations will affect the amount of amortization expense recognized in future periods. Assets acquired in a business combination that will be re-sold are valued at fair value less cost to sell. Results of operating these assets are recognized currently in the period in which those operations occur.

The Company evaluates goodwill and certain intangible assets with indefinite lives not being amortized in accordance with SFAS No. 142, Goodwill and Other Intangible Assets. Under SFAS No. 142, goodwill and certain intangible assets are reviewed for impairment annually or more frequently if impairment indicators arise. Indicators at the Company includes, but are not limited to: sustained operating losses or a trend of poor operating performance, a decrease in the company's market capitalization below its book value and an expectation that a reporting unit will be sold or otherwise disposed of. If one or more indicators of impairment exist, the Company performs an evaluation to identify potential impairments. If an impairment is identified, the Company measures and records the amount of impairment losses. The Company performs its annual analysis on the first day of its fourth quarter.

A two-step impairment test is performed on goodwill. In order to do this, management applies judgment in determining its reporting units, which represent distinct parts of the Company's business. The reporting units determined by management are the centers, the network and e-commerce. The definition of the reporting units affects the Company's goodwill impairment assessments. In the first step, the Company compares the fair value of each reporting unit to its carrying value. Calculating the fair value of the reporting units requires significant estimates and long-term assumptions. The Company tests goodwill for impairment annually on the first day of the Company's fourth quarter, and each of these tests indicated no impairment. The Company estimates the fair value of its reporting units by applying a weighted average of two methods: quoted market prices and discounted cash flows. The weighting is 40% exchange market price and 60% discounted cash flows.

If the carrying value of the reporting unit exceeds its fair value, additional steps are required to calculate an impairment charge. The second step of the goodwill impairment test compares the implied fair value of the reporting unit's goodwill with the carrying value of the goodwill. If the carrying amount of the reporting unit's goodwill exceeds

the implied fair value of that goodwill, an impairment loss is recognized in an amount equal to that excess. The implied fair value of goodwill is the fair value of the reporting unit allocated to all of the assets and liabilities of that unit as if the reporting unit had been acquired in a business combination and the fair value of the reporting unit was the purchase price paid to acquire the reporting unit. Significant changes in key assumptions about the business and its prospects, or changes in market conditions, stock price, interest rates or other externalities, could result in an impairment charge.

The market capitalization of the Company's stock temporarily declined to approximately \$17.3 million on December 11, 2008, which was substantially lower than the Company's estimated combined fair values of its three reporting units. The Company completed a reconciliation of the sum of the estimated fair values of its reporting units to its market value (based upon its stock price at December 11, 2008). We believe one of the primary reconciling differences between fair value and our market capitalization is due to a control premium. We believe the value of a control premium is the value a market participant could extract as savings and / or synergies by obtaining control, and thereby eliminating duplicative overhead costs and obtaining discounts on volume purchasing from suppliers. The Company also considers the following qualitative items that cannot be accurately quantified and are based upon the beliefs of management, but provide additional support for the explanation of the remaining difference between the estimated fair value of the Company's reporting units and its market capitalization:

- The Company's stock is thinly traded;
- The decline in the Company's stock price during 2008 is not directly correlated to a change in the overall operating performance of the Company; and
- Previously unseen pressures are in place given the global financial and economic crisis.

At December 27, 2008 the Company's market capitalization of \$26.2 million exceeded the book value of its three reporting units. We will continue to monitor market trends in our business, the related expected cash flows and our calculation of market capitalization for purposes of identifying possible indicators of impairment. Should our market capitalization again decline below our book value or we have other indicators of impairment, as previously discussed, we will be required to perform an interim step one impairment analysis, which may lead to a step two analysis resulting in a goodwill impairment. Additionally, we would then be required to review our remaining long-lived assets for impairment.

Judgments regarding the existence of impairment indicators are based on legal factors, market conditions and operational performance of the acquired businesses. Future events could cause us to conclude that impairment indicators exist and that goodwill associated with the acquired businesses is impaired. Additionally, as the valuation of identifiable goodwill requires significant estimates and judgment about future performance, cash flows and fair value, our future results could be affected if these current estimates of future performance and fair value change. Any resulting impairment loss could have a material adverse impact on our financial condition and results of operations.

HearUSA, Inc.

Notes to Consolidated Financial Statements

Other intangible assets include finite lived intangible assets, such as patient files and customer lists, which are amortized over the estimated useful life of the assets of 15 to 25 years, generally based upon estimated undiscounted future cash flows resulting from use of the asset. Indefinite lived assets include trademarks and trade-names, which are not amortized.

Pre-opening costs

The costs associated with the opening of new centers are expensed as incurred.

Long-lived assets impairments and disposals

The Company reviews the carrying values of its long-lived and identifiable intangible assets for possible impairment whenever events or changes in circumstances indicate that the carrying amounts of the assets may not be recoverable through the estimated undiscounted future cash flows resulting from the use of these assets. At December 27, 2008 no long-lived assets were held for disposal. No impairment losses were recorded in the consolidated statement of operations for the three years ended December 27, 2008.

Deferred Financing Costs and Debt Discounts

Costs associated with arranging financing and note discounts are deferred and expensed over the term of the related financing arrangement using the effective interest method. Should we repay an obligation earlier than its contractual maturity, any remaining deferred financing costs are charged to earnings.

Vendor rebates

The Company receives various pricing rebates from Siemens recorded based on the earning of such rebates by meeting the compliance levels of the Supply Agreement. Those levels relate to quarterly sales of hearing aid products net of returns. These rebates are recorded monthly on a systematic basis based on supporting historical information that the Company has met these compliance levels and reduce the outstanding Siemens loan balance and accrued interest and reduce the cost of products sold for the respective quarter.

Marketing allowances

The Company receives a monthly marketing allowance from Siemens to reimburse the Company for marketing and advertising expenses for promoting its business and Siemens products. The Company's advertising rebates, which represent a reimbursement of specific incremental, identifiable advertising costs, are recorded as an offset to advertising expense.

Advertising costs

Costs of newspaper, television, and other media advertising are expensed as incurred and were approximately \$7.6 million, \$7.4 million and \$6.2 million in 2008, 2007, and 2006, respectively.

Sales return policy

The Company provides to all patients purchasing hearing aids a specific return period of at least 30 days, or as mandated by state guidelines. 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. classes. The Company calculates its allowance for returns using estimates based upon actual historical returns. The cost of a returned hearing aid is reimbursed to the Company by the manufacturer.

HearUSA, Inc.
Notes to Consolidated Financial Statements

Warranties

The Company provides its patients with warranties on hearing aids varying from one to three years. The first year of the warranty is always covered by the manufacturer's warranty. The warranties provided for the second and third year require a co-payment from the patients, usually covering the cost of the repair or replacement to the Company. When the cost of repair or replacement to the Company is estimated to exceed the patient co-pay, the Company provides an allowance in accrued expenses to cover the future excess cost. Historically such amounts have been minimal.

Income taxes

Deferred taxes are provided for temporary differences arising from the differences between financial statement and income tax bases of assets and liabilities. Deferred tax assets and liabilities are measured using enacted tax rates. Valuation allowances are established when necessary to reduce deferred tax assets and liabilities to amounts considered more likely than not to be realized.

Net loss per common share

The Company calculates net income per share in accordance with SFAS No. 128, Earnings Per Share. Basic earnings per share (EPS) is computed by dividing net income or loss attributable to 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 (convertible preferred stock, warrants to purchase common stock and common stock options using the treasury stock method) 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 convertible debt, mandatorily redeemable convertible preferred stock, outstanding options and warrants to purchase common stock, of approximately 2.0 million, 8.3 million, and 12.3 million, respectively, were excluded from the computation of net loss per common share diluted at December 27, 2008, December 29, 2007 and December 30, 2006 because they were anti-dilutive. For purposes of computing net (loss) applicable to common stockholders per common share basic and diluted, for the years ended December 27, 2008, December 29, 2007 and December 30, 2006, the weighted average number of shares of common stock outstanding includes the effect of 503,061, 596,161 and 760,461, respectively, exchangeable shares of HEARx Canada, Inc., as if they were outstanding common stock of the Company.

Stock-based compensation

Effective January 1, 2006, we adopted the fair value recognition provisions of Financial Accounting Standards No. 123(R), Share-Based Payment, (SFAS 123(R)), using the modified-prospective transition method. Under this transition method, compensation expense recognized includes the estimated fair value of stock options and restricted stock units (RSU) granted on and subsequent to January 1, 2006, based on the grant date fair value estimated in accordance with the provisions of SFAS 123R, and the estimated fair value of the portion vesting in the period for options granted prior to, but not vested as of January 1, 2006, based on the grant date fair value estimated in accordance with the original provisions of FASB Statement No. 123, Accounting for Stock-Based Compensation, (SFAS 123).

The fair value for stock awards was estimated at the date of grant using a Black-Scholes option valuation model. Options and RSU s-service based granted are valued using the single option valuation approach and compensation expense is recognized using a straight-line method. Restricted stock units with performance based vesting provisions are expensed based on our estimate of achieving the specific performance criteria over the requisite service period. We perform periodic reviews of the progress of actual achievement against the performance criteria in order to reassess the likely vesting scenario and, when applicable, realign the expense associated with that outcome. Total stock-based compensation expense recognized in the consolidated statement of operations for the years ended December 27, 2008, December 29, 2007 and December 30, 2006, was approximately \$849,000, \$606,000 and \$976,000, respectively. This additional expense is non-cash and therefore has no effect on the Company's cash flows.

HearUSA, Inc.**Notes to Consolidated Financial Statements**

The fair value for stock awards was estimated using a Black-Scholes option valuation model with the following weighted average assumptions.

| | Year Ended | | |
|---------------------------------|----------------------|----------------------|----------------------|
| | December 27, 2008 | December 29, 2007 | December 30, 2006 |
| Risk free interest rate | 3.79% | 4.63% | 4.69% |
| Expected life in years | 10 | 10 | 10 |
| Expected volatility | 86% | 84% | 86% |
| Weighted average exercise price | \$ 0.76 | \$ 1.28 | \$ 1.30 |

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 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.

SFAS 123 (R) requires the estimation of forfeitures when recognizing compensation expense and that this estimate of forfeitures be adjusted over the requisite service period should actual forfeitures differ from such estimates. Changes in estimated forfeitures are recognized through a cumulative adjustment, which is recognized in the period of change and which impacts the amount of unamortized compensation expense to be recognized in future periods.

Cash and Cash Equivalents

Temporary cash investments which are not restricted as to their use and have an original maturity of ninety days or less are considered cash equivalents.

Estimates

The preparation of the financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

2. Restricted Cash and Cash Equivalents

Restricted cash deposited with clearing organizations and cash equivalents at December 27, 2008 and December 29, 2007 consist of certificates of deposit with contractual maturities of one year or less of approximately \$224,000 and \$216,000 pledged as collateral for automated clearing house exposure.

3. Business Acquisitions

In 2008, the Company continued to pursue a strategy of its acquiring hearing care centers located in the Company's core and target markets. The Company often can benefit from the synergies of combined staffing and can use advertising more efficiently.

The Company acquired the assets of twenty hearing care centers in New York, Michigan, Florida, North Carolina, California and the Province of Ontario in thirteen separate transactions during 2008. Consideration was cash of approximately \$3.6 million and notes payable of approximately \$3.2 million. The acquisitions resulted in additions to goodwill of approximately \$5.4 million, fixed assets of approximately \$126,000, customer lists and non-compete agreements of approximately \$1.2 million. The notes payable bear interest varying from 5% to 7% and are payable in quarterly installments varying from \$3,000 to \$83,000, plus accrued interest, through October 2012. In accordance with SFAS 141 Business Combinations these notes have been recorded at their fair value on the date of issuance using an imputed interest rate of 10%. The Company drew approximately \$3.6 million on its acquisition line of credit with Siemens to fund these acquisitions (see Note 6 Long-term Debt).

HearUSA, Inc.**Notes to Consolidated Financial Statements**

During 2007, the Company acquired the assets of twenty-four hearing care centers in New York, Missouri, Michigan, Florida, North Carolina, California and the Province of Ontario in seventeen separate transactions. Consideration was cash of approximately \$6.8 million and notes payable of approximately \$6.8 million. The acquisitions resulted in additions to goodwill of approximately \$10.4 million, fixed assets of approximately \$379,000, customer lists and non-compete agreements of approximately \$2.9 million and deferred tax liabilities of approximately \$387,000. The notes payable bear interest varying from 5% to 7% and are payable in quarterly installments varying from \$8,000 to \$255,000, plus accrued interest, through September 2011. Interest was imputed at market rates ranging from 7.3% to 9.5% in 2007. The Company drew approximately \$6.8 million on its acquisition line of credit with Siemens to fund these acquisitions (see Note 6 Long-term Debt).

During 2006, the Company, in 21 separate transactions acquired the assets of 31 hearing care centers in New Jersey, New York, California, Michigan, Florida and the Province of Ontario. Consideration paid was approximately \$9.5 million of cash and notes payable of approximately \$6.7 million. The acquisitions resulted in additions to goodwill of approximately \$13.4 million, fixed assets of approximately \$229,000, customer lists and non-compete agreements of approximately \$2.9 million. All additions to intangibles are amortizable for income tax purposes. The notes payable bear interest at rates varying from 5% to 7.0% and are payable in quarterly installments varying from \$8,000 to \$84,000 plus accrued interest through October 2011. In connection with these acquisitions, the Company utilized approximately \$7.8 million of its revolver with Siemens.

The following unaudited pro forma information represents the results of operations of the Company for the years ended December 27, 2008, December 29, 2007 and December 30, 2006, as if the acquisitions occurred on December 30, 2007, December 31, 2006 and January 1, 2006. This pro forma information may not be indicative of future operations:

| | December 27, 2008 | December 29, 2007 | December 30, 2006 |
|--|----------------------|----------------------|----------------------|
| Total revenue | \$ 115,000 | \$ 118,000 | \$ 109,000 |
| Net loss | \$ (3,011) | \$ (1,650) | \$ (1,037) |
| Net loss applicable to common stockholder per share basic and diluted | \$ (0.08) | \$ (0.05) | \$ (0.03) |

The allocated value of the customer lists, non-compete agreements and contracts were recorded as intangible assets on the consolidated balance sheets.

Goodwill recorded as a result of an asset-based acquisition in the United States is generally deducted over a 15 year period for tax purposes. Seventy-five percent of goodwill recorded in an asset-based Canadian acquisition is deducted based on a 7% declining balance.

HearUSA, Inc.**Notes to Consolidated Financial Statements****4. Property and Equipment and Leases**

Property and equipment consists of the following:

| | Range of Useful Lives | December 27, 2008 | December 29, 2007 |
|--|---|----------------------------------|----------------------------------|
| Equipment, furniture and fixtures | 5 -10 years | \$ 13,776 | \$ 12,900 |
| Leasehold Improvements | Lesser of life of lease or asset life | 7,930 | 8,629 |
| Computer systems | 3 years | 3,686 | 3,648 |
| Construction in progress | N/A | 555 | 63 |
| | | 25,947 | 25,240 |
| Less accumulated depreciation and amortization | | 21,071 | 20,884 |
| | | \$ 4,876 | \$ 4,356 |

Equipment on capital leases totaled \$2.2 million and \$1.8 million in 2008 and 2007, respectively. Accumulated depreciation on equipment on capital leases was \$1.6 million and \$1.4 million in 2008 and 2007, respectively. Included in depreciation and amortization is approximately \$250,000 in amortization expense related to equipment under capital lease obligations.

Total estimated future depreciation expense for the Company's current property and equipment are as follows:

| | |
|------------|----------|
| 2009 | \$ 1,486 |
| 2010 | 990 |
| 2011 | 602 |
| 2012 | 418 |
| 2013 | 235 |
| Thereafter | 1,145 |

The Company leases facilities primarily for hearing centers. These are located in retail shopping areas and have terms expiring through 2016. The Company recognizes rent expense on a straight-line basis over the lease term. The leases have renewal clauses of 1 to 10 years at the option of the Company. The difference between the straight-line and actual payments is due to escalating rents in the lease contracts and is included in accrued expenses in the accompanying consolidated balance sheets. Equipment and building rent expense under operating leases in 2008, 2007 and 2006 was approximately \$8.9 million, \$7.8 million and \$6.7 million, respectively.

Approximate future minimum rental commitments under operating leases are as follows:

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| | | |
|------------|----|-------|
| 2009 | \$ | 6,450 |
| 2010 | | 5,495 |
| 2011 | | 3,223 |
| 2012 | | 1,858 |
| 2013 | | 1,019 |
| Thereafter | | 991 |

HearUSA, Inc.
Notes to Consolidated Financial Statements

5. Goodwill and Intangible Assets

A summary of changes in the Company's goodwill during the years ended December 27, 2008 and December 29, 2007, by business segment are as follows:

| | December 29, 2007 | Additions/ Adjustments | Currency Translation | December 27, 2008 |
|---------|----------------------------------|-----------------------------------|---------------------------------|----------------------------------|
| Centers | \$ 62,254 | \$ 5,229 | \$ (2,410) | \$ 65,073 |
| Network | 880 | | | 880 |
| | \$ 63,134 | \$ 5,229 | \$ (2,410) | \$ 65,953 |

| | December 30, 2006 | Additions/ Adjustments | Currency Translation | December 29, 2007 |
|---------|----------------------------------|-----------------------------------|---------------------------------|----------------------------------|
| Centers | \$ 50,090 | \$ 10,434 | \$ 1,730 | \$ 62,254 |
| Network | 880 | | | 880 |
| | \$ 50,970 | \$ 10,434 | \$ 1,730 | \$ 63,134 |

Business acquisitions and goodwill impairment

We account for business acquisitions using the purchase method of accounting. As of January 1, 2009 we adopted the provisions of SFAS 141(R) and will account for acquisitions completed after December 31, 2008 in accordance with SFAS 141(R). SFAS 141(R) revises the manner in which companies account for business combinations and is described more fully elsewhere in this annual report. We determine the purchase price of an acquisition based on the fair value of the consideration given or the fair value of the net assets acquired, whichever is more clearly evident. The total purchase price of an acquisition is allocated to the underlying net assets based on their respective estimated fair values. As part of this allocation process, management must identify and attribute values and estimated lives to intangible assets acquired. Such determinations involve considerable judgment, and often involve the use of significant estimates and assumptions, including those with respect to future cash inflows and outflows, discount rates and asset lives. These determinations will affect the amount of amortization expense recognized in future periods. Assets acquired in a business combination that will be re-sold are valued at fair value less cost to sell. Results of operating these assets are recognized currently in the period in which those operations occur.

The Company evaluates goodwill and certain intangible assets with indefinite lives not being amortized in accordance with SFAS No. 142, Goodwill and Other Intangible Assets. Under SFAS No. 142, goodwill and certain intangible assets are reviewed for impairment annually or more frequently if impairment indicators arise. Indicators at the Company include, but are not limited to: sustained operating losses or a trend of poor operating performance, a decrease in the company's market capitalization below its book value and an expectation that a reporting unit will be sold or otherwise disposed of. If one or more indicators of impairment exist, the Company performs an evaluation to identify potential impairments. If an impairment is identified, the Company measures and records the amount of

impairment losses. The Company performs its annual analysis on the first day of its fourth quarter. A two-step impairment test is performed on goodwill. In order to do this, management applies judgment in determining its reporting units, which represent distinct parts of the Company's business. The reporting units determined by management are the centers, the network and e-commerce. The definition of the reporting units affects the Company's goodwill impairment assessments. In the first step, the Company compares the fair value of each reporting unit to its carrying value. Calculating the fair value of the reporting units requires significant estimates and long-term assumptions. The Company tests goodwill for impairment annually on the first day of the Company's fourth quarter, and each of these tests indicated no impairment. The Company estimates the fair value of its reporting units by applying a weighted average of two methods: quoted exchange market prices and discounted cash flows. The weighting is 40% exchange market price and 60% discounted cash flows.

If the carrying value of the reporting unit exceeds its fair value, additional steps are required to calculate an impairment charge. The second step of the goodwill impairment test compares the implied fair value of the reporting units goodwill with the carrying value of the goodwill. If the carrying amount of the reporting unit's goodwill exceeds the implied fair value of that goodwill, an impairment loss is recognized in an amount equal to that excess. The implied fair value of goodwill is the fair value of the reporting unit allocated to all of the assets and liabilities of that unit as if the reporting unit had been acquired in a business combinations and the fair value of the reporting unit was the purchase price paid to acquire the reporting unit. Significant changes in key assumptions about the business and its prospects, or changes in market conditions, stock price, interest rates or other externalities, could result in an impairment charge.

During the fourth quarter of 2008, the Company's market capitalization was approximately \$17.3 million, which is substantially lower than the Company's estimated combined fair values of its three reporting units. The Company has completed a reconciliation of the sum of the estimated fair values of its reporting units to its market value (based upon its stock price at December 11, 2008). We believe one of the primary reconciling differences between fair value and our market capitalization is due to a control premium. We believe the value of a control premium is the value a market participant could extract as savings and / or synergies by obtaining control, and thereby eliminating duplicative overhead costs and obtaining discounts on volume purchasing from suppliers. The Company also considers the following qualitative items that cannot be accurately quantified and are based upon the beliefs of management, but provide additional support for the explanation of the remaining difference between the estimated fair value of the Company's reporting units and its market capitalization:

The Company's stock is thinly traded;

The decline in the Company's stock price during 2008 is not directly correlated to a change in the overall operating performance of the Company; and

Previously unseen pressures are in place given the global financial and economic crisis.

We will continue to monitor market trends in our business, the related expected cash flows and our calculation of market capitalization for purposes of identifying possible indicators of impairment. Should our book value per share continue to exceed our market share price or we have other indicators of impairment, as previously discussed, we will be required to perform an interim step one impairment analysis, which may lead to a step two analysis resulting in goodwill impairment. Additionally, we would then be required to review our remaining long-lived assets for impairment.

Judgments regarding the existence of impairment indicators are based on legal factors, market conditions and operational performance of the acquired businesses. Future events could cause us to conclude that impairment indicators exist and that goodwill associated with the acquired businesses is impaired. Additionally, as the valuation of identifiable goodwill requires significant estimates and judgment about future performance, cash flows and fair value, our future results could be affected if these current estimates of future performance and fair value change. Any resulting impairment loss could have a material adverse impact on our financial condition and results of operations. As of December 27, 2008 and December 29, 2007, intangible assets consisted of the following:

| December 27, 2008 | December 29, 2007 |
|------------------------------|------------------------------|
|------------------------------|------------------------------|

Amortizable intangible assets:

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| | | | | | |
|------------------------------------|-------------------|----|---------|----|---------|
| Customer lists | | \$ | 11,532 | \$ | 11,268 |
| Non-Compete agreements | | | 1,259 | | 1,268 |
| Computer Software | | | 1,581 | | 1,584 |
| Accumulated amortization | customer list | | (4,102) | | (3,935) |
| Accumulated amortization | non-compete | | (475) | | (255) |
| Accumulated amortization | computer software | | (1,534) | | (1,487) |
| Amortizable intangible assets, net | | | 8,261 | | 8,443 |
| Trademark and trade names | | | 7,347 | | 7,700 |
| Intellectual property | | | 22 | | 22 |
| | | \$ | 15,630 | \$ | 16,165 |

HearUSA, Inc.**Notes to Consolidated Financial Statements**

The aggregate amortization expense was \$1.4 million in 2008, \$896,000 in 2007 and \$815,000 in 2006. Annual estimated future amortization expense for intangible assets is as follows:

| | | |
|------------|----|-------|
| 2009 | \$ | 1,051 |
| 2010 | | 949 |
| 2011 | | 868 |
| 2012 | | 757 |
| 2013 | | 702 |
| Thereafter | | 3,934 |

6. Long-term Debt (also see Notes 3, 7 and 8)

Long-term debt consists of the following:

| | December 27, 2008 | December 29, 2007 |
|--|------------------------------|------------------------------|
| Notes payable to a Siemens | | |
| Tranche B | \$ 5,552 | \$ 5,403 |
| Tranche C | 41,109 | 23,670 |
| Tranche D | | 7,895 |
| Total notes payable to Siemens | 46,661 | 36,968 |
| Notes payable from business acquisitions and other | 9,353 | 10,277 |
| | 56,014 | 47,245 |
| Less current maturities | 6,915 | 10,746 |
| | \$ 49,099 | \$ 36,499 |

The approximate aggregate maturities on long-term debt obligations in years following 2008 are as follows:

| | | |
|------------|----|--------|
| 2009 | \$ | 6,915 |
| 2010 | | 5,515 |
| 2011 | | 4,499 |
| 2012 | | 2,972 |
| 2013 | | 2,523 |
| Thereafter | | 33,590 |

Notes payable from business acquisitions and other includes capital lease obligations. The approximate aggregate maturities on capital lease obligations in years following 2008 are, \$327,000 in 2009, \$190,000 in 2010, \$111,000 in 2011, \$55,000 in 2012 and \$41,000 in 2013.

Notes payable to Siemens

On December 23, 2008, the Company entered into a Third Amendment to Credit Agreement (Credit Agreement Amendment), Second Amendment to Supply Agreement (Supply Agreement Amendment), Amendment No. 2 to Amended and Restated Security Agreement, a Second Amendment to Investor Rights Agreement (Investor Rights Amendment) (collectively the Amendments) and a Purchase Agreement with Siemens Hearing Instruments, Inc. (Siemens). The Company and Siemens are parties to a Second Amended and Restated Credit Agreement dated December 30, 2006, as amended by a First Amendment to Credit Agreement dated as of June 27, 2007 and a Second Amendment to Credit Agreement and First Amendment to Investor Rights Agreement and Supply Agreement dated

September 28, 2007 (the 2007 Amendments) (as amended, the Credit Agreement), an Amended and Restated Supply Agreement dated December 30, 2006, as amended by the 2007 Amendments (as amended, the Supply Agreement) and an Investor Rights Agreement dated December 30, 2006, as amended by the 2007 Amendments (as amended, the Investor Rights Agreement).

HearUSA, Inc.

Notes to Consolidated Financial Statements

Pursuant to these agreements, Siemens has extended to the Company a \$50 million credit facility and the Company purchases from Siemens most of the Company's requirements for hearing aids. The December 2006 agreements represented amendments to agreements that had been in place between the parties since 2001. In 2006 when the Credit Agreement was amended, the Company granted to Siemens the right to convert a portion of the debt into common stock at certain times and upon certain conditions. Pursuant to the Supply Agreement, the Company has agreed to purchase at least 90% of its hearing aid purchases in the United States from Siemens and its affiliates. If the minimum purchase requirement of the Supply Agreement is met, the Company earns rebates which are then applied to certain payments due under the Credit Agreement to liquidate those payments. The Investor Rights Agreement provided Siemens with certain rights, including the right to have the shares of common stock underlying the debt be registered for resale and a right of first refusal on equity securities sold by the Company. In 2007 when the 2007 Amendments were made, Siemens agreed to provide the Company with an additional \$3 million revolving line of credit for working capital purposes in the form of Tranche E which would be due on December 29, 2008. In addition, in the 2007 amendments Siemens agreed that the \$4.2 million principal of Tranche D in the Credit Agreement would be due on December 19, 2008.

In the Amendments and the Purchase Agreement the parties agreed to the following:

The previous amendment of the Credit Agreement called for cash payments of \$7.2 million in December 2008 on Tranches D and E and quarterly principal payments of \$500,000 on Tranche C. The Amendment transferred the amounts due under Tranches D and E to Tranche C. Providing the Company meets the purchase requirements in the Supply Agreement, all repayments on both Tranches can now be self-liquidating.

The balances of Tranche D and E were transferred to Tranche C. Going forward the credit agreement will have only Tranches B and C.

Approximately \$3.8 million of outstanding debt under the supply agreement was converted into 6.4 million shares of the Company's Common Stock at a conversion price of \$0.60 per share. The conversion provisions of the credit agreement were eliminated from the Credit Agreement.

An additional \$6.2 million of debt under the supply agreement was converted into long-term indebtedness under Tranche C.

The maturity date of the credit and supply agreement was extended an additional two years, to February, 2015.

Siemens was granted a right of first refusal for all new issuances of equity (except issuances pursuant to employee compensation plans and pursuant to warrants outstanding on the date of the amendments) for a period of 18 months and thereafter a more limited right of first refusal and preemptive rights for the life of the investor rights agreement.

The Company will invite a representative of Siemens to attend meetings of the Board in a nonvoting observer capacity.

Financing and rebate arrangement

The revolving credit facility is a line of credit of \$50 million that bears interest of 9.5% and is secured by substantially all of the Company assets. Approximately \$46.7 million was outstanding at December 27, 2008. Approximately, \$5.6 million has been borrowed under Tranche B for acquisitions and \$41.1 million has been borrowed under Tranche C. Borrowing for acquisitions under Tranche B is generally based upon a formula equal to 1/3 of 70% of the acquisition's trailing 12 months revenues and any amount greater than that may be borrowed from Tranche C with Siemens' approval. Amounts borrowed under Tranche B are repaid quarterly through rebates at a rate of \$65 per Siemens' units sold by the acquisition plus interest. Amounts borrowed under Tranche C are repaid quarterly at \$500,000 plus interest. The required payments are subject to the rebate credits described below.

The credit facility also requires the Company reduce the principal balance by making annual payments in an amount equal to 20% of Excess Cash Flow (as defined in the Amended Credit Agreement), and by paying Siemens 25% of proceeds from any equity offerings the Company may complete. The Company did not have any Excess Cash Flow

(as defined) in 2008, 2007 or 2006.

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Rebate credits on product sales

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 sold by the Company are Siemens products. Amounts rebated are accounted for as a reduction of cost of products sold. If the Company does not maintain the 90% sales requirement, those amounts are not rebated and must be paid quarterly. The 90% requirement is computed on a cumulative twelve month calculation. Approximately \$32.2 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 and interest on Tranches B and C and are recorded as a reduction in products sold. Volume rebates of \$1.1 million, \$1.3 million and \$1.3 million were recorded in 2008, 2007 and 2006, respectively.

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

| (Dollars in thousands) | 2008 | 2007 | 2006 |
|--|----------|----------|----------|
| Portion applied against quarterly principal payments | \$ 3,783 | \$ 4,491 | \$ 3,112 |
| Portion applied against quarterly interest payments | 2,832 | 2,696 | 626 |
| | \$ 6,615 | \$ 7,187 | \$ 3,738 |

Conversion of debt for equity

Prior to the December 23, 2008 amendment to the credit agreement, the Company was required to make a payment on December 23, 2008 of \$4.2 million on Tranche D and \$3 million on Tranche E by December 23, 2008 or be declared in default of the agreement. In addition, the Company was required to pay all trade payables within 90 days of the invoice date or be in default of the credit agreement. If there was an event of default, Siemens had the right to convert debt for 6.4 million shares of the Company's common stock at current market price. Rather than paying the \$7.2 million on the two Tranches and the trade payables over 90 days, Siemens agreed to convert into the 6.4 million shares at the default terms and allow conversion of the balance of the amounts currently payable into the line of credit. These terms under which Siemens converted the debt into common stock at the current market price were the terms of the original contract for an event of default.

When the Company evaluated the original contract for a beneficial conversion feature, the Company determined that assuming there were no changes to the current circumstances except for the passage of time, the most favorable conversion price would occur if the Company did not repay the \$4.2 million due under the Tranche D. That calculation did not result in a beneficial conversion feature. Since the conversion occurred under the terms that were originally agreed to for the conversion, there is no additional charge.

Investor and other rights arrangement

Pursuant to the amended Investor Rights Agreement, the Company granted Siemens resale registration rights for the common stock acquired under the Purchase Agreement. The Company is not liable for liquidating damages or penalties.

In addition, for a period of 18 months following the December 23, 2008 amendment, the Company has granted to Siemens certain rights of first refusal in the event the Company chooses issue capital or if there is a change of control transaction involving a person in the hearing aid industry. Thereafter, Siemens will have a more limited right of first refusal and preemptive rights for the life of the agreement.

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 incurrence of indebtedness, merger or sale of assets, the modification of material agreements, changes in capital structure and making certain payments. 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. In addition, a material breach of the supply agreement or a willful breach of certain of the Company's obligations under the Investor Rights Agreement may be declared 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. Any non-compliance with the supply agreement could have a material adverse effect on the Company's financial condition and continued operations. At December 27, 2008 the Company was in compliance with the Siemens loan covenants.

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 totaling approximately \$8.6 million at December 27, 2008 (payable in monthly or quarterly installments of principal and interest varying from \$3,000 to \$83,000 over periods varying from 2 to 5 years and bear interest varying from 5% to 7%) and approximately \$9.8 million at December 29, 2007 (payable in monthly or quarterly installments varying from \$8,000 to \$255,000 over periods varying from 2 to 5 years and bear interest at rates varying from 5.0% to 7.0%). The notes have been discounted to market rates ranging from 9.5 to 10%. Other notes relates mostly to capital leases totaling approximately \$724,000 at December 27, 2008 and approximately \$489,000 at December 29, 2007, are payable in monthly or quarterly installment varying from \$1,000 to \$10,000 over periods varying from 1 to 3 years and bear interest at rates varying from 4.6% to 16.3%.

HearUSA, Inc.

Notes to Consolidated Financial Statements

7. Convertible Subordinated Notes

On April 9, 2007, the Company entered into a transaction with the holders of 14 of 15 outstanding notes originally issued in December 2003 through a private placement of \$7.5 million of subordinated notes and related warrants. These holders converted the balance of their notes into approximately 3.1 million common shares, after a prepayment of approximately \$409,000 by the Company, and exercised approximately 2.5 million warrants for a consideration of approximately \$1.7 million, or \$0.70 per share. The Company also paid down \$375,000 of the approximately \$417,000 outstanding balance to the non-participating note holder on the closing date. This transaction resulted in a non-cash charge of approximately \$2.6 million that was recorded in the second quarter of 2007. The charge was due to the acceleration of the remaining balance of the debt discount amortization (approximately \$1.2 million) and the reduction in the price of the warrants (approximately \$1.4 million). The remaining principal balance of approximately \$42,000 owed to the non-participating note holder was converted to common stock in June 2007.

These convertible subordinated notes were originally convertible at \$1.75 per share and the warrants could be exercised at \$1.75 per share. The quoted closing market price of the Company's common stock on December 11, 2003, the commitment date, was \$2.37 per share. The notes bore interest at 11% annually for the first two years and then at 8% for the remainder of their term. The Company recorded a debt discount of approximately \$7.5 million consisting of the intrinsic value of the beneficial conversion feature of approximately \$4.5 million and the portion of the proceeds allocated to the warrants issued to the investors of approximately \$3.0 million, using a Black-Scholes option pricing model, based on the relative fair values of the investor warrants and the notes. The debt discount was being amortized as interest expense over the five-year term of the note using the effective interest method. The notes were subordinated to the Siemens notes payable.

During 2007 and 2006, approximately \$3.5 million and \$2.6 million, respectively of interest expense was recorded related to this financing, including non-cash prepaid finder fees, a debt discount amortization charge and charges related to the reduction in the price of the warrants of approximately \$3.1 million (including the \$1.2 million charge due to the acceleration of the remaining balance of the debt discount) in 2007 and \$1.8 million in 2006.

In addition to the 2.6 million investor warrants issued to the investors in the financing, the Company also issued 117,143 common stock purchase warrants with the same terms as the investor warrants and paid cash of approximately \$206,000 to third parties as finder fees and financing costs. These warrants were valued at approximately \$220,000 using a Black-Scholes option pricing model. The total of such costs of approximately \$426,000 were being amortized as interest expense using the effective interest method over the five-year term of the notes.

8. Subordinated Notes and Warrant

On August 22, 2005, the Company completed a private placement of \$5.5 million three-year subordinated notes (Subordinated Notes) with warrants (Note Warrants) to purchase approximately 1.5 million shares of the Company's common stock at \$2.00 per share expiring on August 2010. The Note Warrants were exercisable. The quoted closing market price of the Company's common stock on the commitment date for this transaction was \$1.63 per share. The notes bore interest at 7% per annum. Proceeds were used to redeem all of the Company's 1998-E Series Convertible Preferred Stock. A debt discount of approximately \$1.9 million based on the portion of the proceeds allocated to the fair value of the Note Warrants, using a Black-Scholes option pricing model. The debt discount was amortized as interest expense over the three-year term of the notes. In addition, the Company also issued 55,000 common stock purchase warrants with the same terms as the Note Warrants and paid cash of approximately \$330,000 as finder fees and financing costs. These warrants were valued at approximately \$66,000. The total of costs of approximately \$396,000 was amortized as interest expense over the three-year term.

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At issuance, the Company agreed to register the common shares underlying the warrant shares and to maintain such registration during the three-year period ending September 2008 so that the warrant holders could sell their shares if the Note Warrants were exercised. The liability created by the Company's agreement to register and keep the underlying shares registered during the three-year period was recorded as a warrant liability of \$1.9 million based on the fair value. Any gains or losses resulting from changes in fair value from period to period were recorded in interest expense. During the third quarter of 2006 the Company renegotiated its registration obligations with the Note Warrant holders to eliminate the penalty provisions of the registration rights agreement for failure to keep the registration active. Holders of eighty-six percent of the Note Warrants agreed to the changes. For those who agreed to the changes, the value of the Note Warrant was calculated at the date the amended registration rights agreement was signed and approximately \$918,000 was reclassified from warrant liability to additional paid in capital.

Effective December 31, 2006, the Company adopted FSP EITF 00-19-2, *Accounting for Registration Payment Arrangements*, which specifies that the contingent obligation to make future payments or otherwise transfer consideration under a registration payment arrangement, whether issued as a separate agreement or included as a provision of a financial instrument or other agreement, should be separately recognized and measured in accordance with FASB Statement No. 5, *Accounting for Contingencies*. The transition adjustment to reclassify the warrant liability to equity at the amount that would have been recognized as of the date it would have originally met the criteria for equity classification under other GAAP without regard to the contingent obligation to transfer consideration under the registration payment arrangement was to increase additional paid in capital \$246,000, increase accumulated deficit \$136,000 and decrease warrant liability as cumulative effect adjustment at January 1, 2007.

During 2008, 2007 and 2006, approximately \$247,000, \$825,000 and \$1.1 million, respectively, in interest expense was recorded related to this financing, including non-cash prepaid finder fees and debt discount amortization charges of approximately \$122,000, \$496,000 and \$850,000, respectively. The balances of these notes were repaid in August 2008.

9. Stockholders' Equity

A. Common Stock

During 2008, employee stock options for approximately 210,000 shares of common stock were exercised, at a weighted average exercise price of \$0.69 and 6.4 million shares of common stock were issued in connection with the conversion of \$3.8 million in outstanding trade payables, at a conversion price equal to \$0.60. During 2007, approximately 2.5 million warrants were exercised at an exercise price of \$0.70, approximately 3.2 million shares of common stock were issued in connection with the conversion of the 2003 Convertible Subordinated Notes and employee stock options for 472,500 shares of common stock were exercised. No employee stock options or warrants were exercised in 2006.

B. Stock Subscription

The Company sold 200,000 shares of the Company's common stock to an investment banker for \$2.0625 per share, and received a secured, nonrecourse promissory note receivable for the principal amount of \$412,500 on April 1, 2001. The note receivable was collateralized by the common stock purchased which was held in escrow. The principal amount of the note and accrued interest were payable on April 1, 2006. The note bore interest at the prime rate published by the Wall Street Journal adjusted annually. The interest rate at December 29, 2007 of the note was 7.5%. A cancellation agreement was signed and the stock was returned to the Company and cancelled in June 2008. The note receivable under the caption Stock Subscription is part of stockholders' equity in the accompanying consolidated balance sheets.

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C. Series J Preferred Stock

The Series J Preferred Stock has a stated value of \$10,000 per share and is non-convertible and non-voting. The holder of the Series J Preferred Stock is entitled to receive cumulative dividends, in cash, at a rate of 6% per year. Dividends earned but not paid on the applicable dividend payment date will bear interest at a rate of 18% per year payable in cash unless the holders and the Company agree that such amounts may be paid in shares of common stock.

The Company has the right to redeem all or a portion of the Series J Preferred Stock for a redemption price equal to the stated value plus accrued and unpaid dividends at any time. The holder of the Series J Preferred Stock has the right to require the Company to redeem the Series J Preferred Stock at a price of 120% of the stated value plus any accrued and unpaid dividends upon approval by the Company's Board of Directors after a change of control.

In the event of liquidation, dissolution or winding up of the Company prior to the redemption of the Series J Preferred Stock, the holder of the Series J Preferred Stock will be entitled to receive the stated value per share plus any accrued and unpaid dividends before any distribution or payment is made to the holders of any junior securities but after payment is made to the holders of the 1998 Convertible Preferred Stock, if any. In the event that the assets of the Company are insufficient to pay the full amount due the holder of the Series J Preferred Stock and any holders of securities equal in ranking, such holders will be entitled to share ratably in all assets available for distribution.

During 2008, 2007 and 2006, approximately \$139,000, \$137,000 and \$138,000, respectively, of the 6% dividend on the Series J Preferred Stock is included in the caption Dividends on Preferred Stock in the accompanying Consolidated Statements of Operations.

D. Shareholder Rights Plan

On December 14, 1999, the Board of Directors approved the adoption of a Shareholder Rights Plan, in which a dividend of one preferred share purchase right (a Right) for each outstanding share of common stock was declared, and payable to the stockholders of record on December 31, 1999.

The Shareholder Rights Plan as amended and restated on July 11, 2002, in connection with the combination with Helix to, among other things, give effect to the issuance of the exchangeable shares as voting stock of the Company, and to otherwise take into account the effects of the combination. The Rights will be exercisable only if a person or group acquires 15% or more of the Company's common stock or announces a tender offer which would result in ownership of 15% or more of the common stock. The Rights entitle the holder to purchase one one-hundredth of a share of Series H Junior Participating Preferred Stock at an exercise price of \$28.00 and will expire on December 31, 2009 (See Note 9E).

Following the acquisition of 15% or more of the Company's common stock by a person or group without the prior approval of the Board of Directors, the holders of the Rights (other than the acquiring person) would be entitled to purchase shares of common stock (or common stock equivalents) at one-half the then current market price of the common stock, or at the election of the Board of Directors, to exchange each Right for one share of the Company's common stock (or common stock equivalent). In the event of a merger or other acquisition of the Company without the prior approval of the Board of Directors, each Right will entitle the holder (other than the acquiring person), to buy shares of common stock of the acquiring entity at one-half of the market price of those shares. The Company would be able to redeem the Rights at \$0.01 per Right at any time until a person or group acquires 15% or more of the Company's common stock.

E. Series H Junior Participating Preferred Stock

See Shareholder Rights Plan, above, and Exchangeable Right Plan, below. The Series H Junior Participating Preferred Stock is subject to the rights of the holders of any shares of any series of preferred stock of the Company ranking prior and superior to the Series H Junior participating Preferred Stock with respect to dividends. The holders of shares of Series H Junior Participating Preferred, in preference to the holders of shares of common stock, and any other junior stock, shall be entitled to receive dividends, when, as and if declared by the Board of Directors out of funds legally available therefore.

HearUSA, Inc.
Notes to Consolidated Financial Statements

F. Exchangeable Rights Plan

On July 11, 2002, in connection with the combination with Helix, HEARx Canada, Inc., an indirect subsidiary of the Company, adopted a Rights Agreement (the Exchangeable Rights Plan) substantially equivalent to the Company's Shareholder Rights Plan (See Note 9D). Under the Exchangeable Rights Plan, each exchangeable share (See Note 9I) issued has an associated right (an Exchangeable Share Right) entitling the holder of such Exchangeable Share Right to acquire additional exchangeable shares on terms and conditions substantially the same as the terms and conditions upon which a holder of shares of common stock is entitled to acquire either one one-hundredth of a share of the Company's Series H Junior Participating Preferred Stock or, in certain circumstances, shares of common stock under the Company's Shareholder Rights Plan. The definitions of beneficial ownership, the calculation of percentage ownership and the number of shares outstanding and related provisions of the Company's Shareholder Rights Plan and the Exchangeable Rights Plan apply, as appropriate, to shares of common stock and exchangeable shares as though they were the same security. The Exchangeable Share Rights are intended to have characteristics essentially equivalent in economic effect to the Rights granted under the Company's Shareholder Rights Plan.

G. Warrants

During 2008 approximately 260,000 warrants expired and no warrants were issued or exercised. In 2007 approximately 100,000 warrants were issued at an exercise price of \$1.56 and approximately 2.5 million warrants were exercised at an exercise price of \$0.70. No warrants were issued or exercised during 2006.

The aggregate number of common shares reserved for issuance upon the exercise of warrants was approximately 2.5 million as of December 27, 2008.

The expiration date and exercise prices of the outstanding warrants are as follows:

| Outstanding Warrants | Expiration Date | Exercise Price |
|-------------------------|--------------------|-------------------|
| 240 | 2010 | 1.25 |
| 560 | 2010 | 1.31 |
| 1,555 | 2010 | 2.00 |
| 100 | 2010 | 1.56 |
| 2,455 | | |

H. Aggregate and Per Share Cumulative Preferred Dividends

As of December 27, 2008 there were no arrearages in cumulative preferred dividends/premiums.

I. Exchangeable Shares

Immediately following the effective combination of the Company and Helix, each outstanding Helix common share, other than shares held by dissenting Helix Stockholders who were paid the fair value of their shares and shares held by the Company, were automatically exchanged for, at the election of the holder, 0.3537 fully-paid and non-assessable exchangeable shares (Exchangeable Shares) of HEARx Canada, Inc., or 0.3537 shares of HearUSA, Inc. common stock. The Exchangeable Shares are the economic equivalent of HearUSA, Inc. common stock. Each Exchangeable Share will be exchanged at any time at the option of the holder, for one share of HearUSA, Inc. common stock, subject to any anti-dilution adjustments. Until exchanged for HearUSA, Inc. common stock; (i) each Exchangeable Share outstanding will entitle the holder to one vote per share at all meetings of HearUSA, Inc. common stockholders; (ii) if any dividends are declared on HearUSA, Inc. common stock, an equivalent dividend must be declared on such exchangeable shares and (iii) in the event of the liquidation, dissolution or winding-up of HEARx Canada, Inc., such exchangeable shares will be exchanged for an equivalent number of shares of HearUSA, Inc. common stock.

HearUSA, Inc.
Notes to Consolidated Financial Statements

10. Stock-based Benefit Plans

A. Stock Options and Awards

On June 11, 2007, the stockholders of HearUSA approved the 2007 Employee Incentive Compensation Plan (2007 Plan). The 2007 Plan is administered by the Board of Directors and permits the grant of stock options (incentive and non-qualified), stock appreciation rights, restricted shares, performance shares and other stock-based awards to officers, employees and certain non-employees for up to 2.5 million shares of common stock. Under the 2007 Plan, 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. All options have a term of not greater than 10 years from the date of grant. Options issued generally vest 25% on each anniversary of the date of the grant over 4 years. A restricted stock unit is an award covering a number of shares of HearUSA common stock that may be settled in cash or by issuance of those shares, which may consist of restricted stock. Restricted stock units generally vest in three installments with 33.3% of the shares vesting on each anniversary of the date of grant over 3 years. For financial reporting purposes, stock-based compensation expense is included in general and administrative expenses.

Stock options and awards were granted to employees under the 1987 Stock Option Plan, the 1995 Flexible Stock Plan and the 2002 Flexible Stock Plan. The 1987 Stock Option and the 1995 Flexible Stock Plans expired and no further option grants can be made under these plans. The expiration of these plans did not affect the outstanding options still outstanding. Options granted under the 2002 Flexible Stock Plan generally vest over 4 years and expire after 10 years. The 2002 Flexible Stock Plan was approved by the stockholders, is administered by the Board of Directors and permits the grant of stock options (incentive and non-qualified), stock appreciation rights, restricted shares, performance shares and other stock-based awards to officers, employees and certain non-employees for up to 5 million shares of common stock.

As of December 27, 2008, employees of the Company held options permitting them to purchase an aggregate of approximately 5.4 million shares of common stock at prices ranging from \$0.35 to \$5.75 per share. Options are exercisable for periods ranging from five to ten years commencing one year following the date of grant and are generally exercisable in cumulative annual installments of 25 percent per year.

As of December 27, 2008, under the terms of our Non-Employee Director Plan, which terminated in accordance with its terms in 2003, directors held options permitting them to purchase an aggregate of 9,000 shares of common stock at prices ranging from \$4.00 to \$5.00 per share.

Impact of the Adoption of SFAS 123(R)

Under the terms of the company s stock option 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. For financial reporting purposes 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 \$849,000, \$606,000 and \$976,000 in 2008, 2007 and 2006, respectively. As of December 27, 2008, there was approximately \$1.9 million of unrecognized compensation cost related to share-based compensation under our stock award plans. That cost is expected to be recognized over a straight-line period of four years from the date of grant.

HearUSA, Inc.**Notes to Consolidated Financial Statements**

During 2008, the Company extended the exercise period relating to 400,000 fully vested options held by Dr. Paul Brown as part of his retirement agreement. As a result of this modification, the Company recognized additional stock-based compensation of approximately \$91,000, which is included in general and administrative expense.

Stock-based Payment Award Activity

The following table summarizes activity under our equity incentive plans:

| (Options in thousands) | Shares | Weighted Average Exercise | Weighted Average Remaining Contractual Term (in years) | Aggregate Intrinsic Value |
|----------------------------------|--------|---------------------------------|---|---------------------------------|
| Outstanding at December 29, 2007 | 5,158 | \$ 1.28 | | |
| Granted | 1,055 | \$ 1.65 | | |
| Exercised | (210) | \$ 0.69 | | \$ 143 |
| Forfeited/expired/cancelled | (647) | \$ 1.92 | | |
| Outstanding at December 27, 2008 | 5,356 | \$ 1.30 | 6.02 | \$ 207 |
| Exercisable at December 27, 2008 | 3,804 | \$ 1.18 | 4.73 | \$ 207 |

The following table summarizes outstanding and exercisable options under our equity incentive plans as of December 27, 2008:

(options in thousands)

| Range of Exercise Price | Number Outstanding | Options Outstanding Average Remaining Contractual Life | Weighted Average Exercise Price | Options Exercisable Number Exercisable | Weighted Average Exercise Price |
|----------------------------|-----------------------|--|--|--|--|
| \$.35 \$.77 | 1,193 | 3.90 | \$ 0.43 | 1,193 | \$ 0.43 |
| \$.78 \$2.00 | 3,928 | 6.88 | \$ 1.46 | 2,376 | \$ 1.37 |
| \$2.01 \$5.75 | 235 | 2.44 | \$ 3.12 | 235 | \$ 3.12 |
| | 5,356 | | | 3,804 | |

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 December 27, 2008. That cost is expected to be recognized over a straight-line period of four years. At December 27, 2008 the aggregate intrinsic value of the employee and non-employee director options outstanding and exercisable was approximately \$207,000, of which \$23,000 is non-employee director aggregate intrinsic value.

B. Restricted Stock Units

In 2008, the Company granted restricted stock units pursuant to its stockholder approved plans as part of its regular annual employee equity compensation review program. Restricted stock units are share awards that, upon vesting, will

deliver to the holder shares of the Company's common stock. Restricted stock units granted during 2008 have graded vesting of one-third each year for three years. Some restricted stock units are performance based and therefore subject to forfeiture if certain performance criteria are not met.

HearUSA, Inc.**Notes to Consolidated Financial Statements**

In the first quarter of 2008, we granted to our executive officers 136,500 restricted stock units with service based vesting provisions that may vest in three equal tranches over each of the next three years. The fair value of the service based restricted stock units is the quoted market price of the Company's common stock on the date of the grant.

We also granted to our executive officers 345,500 restricted stock units with performance based vesting provisions that may vest in three equal tranches over each of the next three years. These performance based awards are contingent on the achievement of specific annual performance criteria related to increased revenue, net income and institutional investors. As of December 27, 2008, the performance criteria for 2008 were not met and no performance shares vested in February 2009. Accordingly, we have not recorded any compensation expense at December 31, 2008 related to the restricted stock units that will not vest in February 2009 due to 2008 performance criteria not being met.

A summary of the Company's restricted stock unit activity and related information as of December 27, 2008 is as follows:

| | Service-Based Restricted Stock Units (1) | Performance-Based Restricted Stock Units (1) |
|----------------------------------|--|--|
| Outstanding at December 29, 2007 | | |
| Awarded | 136,500 | 345,500 |
| Vested | | |
| Cancelled | | (115,167) |
| Outstanding at December 27, 2008 | 136,500 | 230,333 |

(1) Each stock unit represents one share of common stock.

The weighted average grant-date fair value per share for the restricted stock units was \$1.40 at December 27, 2008 with a weighted average remaining contractual term of 1.25 years.

Based on the closing price of the Company's common stock of \$0.58 on December 27, 2008, the total pretax value of all outstanding restricted stock units on that date was approximately \$213,000.

C. Non-Employee Director Non-Plan Grant

At December 27, 2008 options to purchase 100,000 shares of common stock at an exercise price of \$0.35, which was equal to the quoted closing price of the common stock on April 1, 2003 (the grant date) were outstanding to members of the Board of Directors. The options vested after one year and have a ten-year life.

11. Major Customers and Suppliers

During 2008, 2007 and 2006 no customer accounted for more than 10% or more of net revenues.

During 2008, 2007 and 2006, the Company purchased approximately 93.0% 90.1% and 90.6%, respectively, of all hearing aids sold by the Company from Siemens. As described in Note 6, the Company is a party to a supply agreement with Siemens whereby the Company has agreed to purchase minimum levels from Siemens. Although there are a limited number of manufacturers of hearing aids, management believes that other suppliers could provide similar hearing aids on comparable terms. In the event of a disruption of supply from Siemens, the Company could obtain comparable products from other manufacturers. The Company has not experienced any significant disruptions in supply in the past.

12. Related Party Transactions

The Company is party to a capitation contract with an affiliate of its minority owner, the Permanente Federation LLC (the Kaiser Plan) a member of its consolidated joint venture, HEARx West, LLC. Under the terms of the contract, HEARx West is paid an amount per enrollee of the Kaiser Plan, to provide a once every three years benefit on certain hearing products and services. During 2008, 2007 and 2006 approximately \$8.4 million, \$8.9 million and \$7.7 million, respectively, of capitation revenue from this contract is included in net revenue in the accompanying consolidated statements of operations.

HearUSA, Inc.**Notes to Consolidated Financial Statements****13. Gain on Restructuring of Contract**

On August 8, 2008, HearUSA, Inc. (the Company) entered into a Hearing Care Program Services Agreement with American Association of Retired Persons (AARP), Inc. and AARP Services, Inc. (the Services Agreement), and an AARP License Agreement with AARP, Inc. (the License Agreement), pursuant to which the Company will provide an AARP-branded discount hearing care program to AARP members. Under the Services Agreement, the Company has agreed to provide to AARP members discounts on hearing aids and related services, through the Company's company-owned centers and independent network of hearing care providers. The Company will allocate \$4.4 million annually to promote the AARP program to AARP members and the general public, and will contribute 9.25% of that amount to AARP's marketing cooperative. The Company will also contribute \$500,000 annually to fund an AARP sponsored education campaign to educate and promote hearing loss awareness and prevention to AARP members and the general public. The Company has also committed, in cooperation with AARP, to donate a number of hearing aids annually to be distributed free of charge to economically disadvantaged individuals who have experienced hearing loss. The Company was to begin the program with AARP, December 1, 2008. The Services Agreement has an initial term of three years ending in December 1, 2011. At the end of the initial three year term, the Company has an option to extend the term of the Services Agreement for an additional two year period.

Pursuant to the License Agreement, AARP granted the Company a limited license to use the AARP name and related trade and service marks in connection with the operation and administration of the AARP program, including the advertising and promotion of the program. The Company originally agreed to pay AARP a fixed annual royalty of \$7.6 million for each year of the initial three year term of the AARP license for an option to extend for two years. This provision was eliminated in the December 2008 amendment.

In accordance with SFAS 142 "Goodwill and Other Intangibles", the intangible was recorded at approximately \$19.3 million based on the fair value of the payments on the date of issuance using an imputed interest rate of 10%.

In 2008, the Company recorded non-cash interest expense of approximately \$763,000 and amortization expense of approximately \$391,000 related to the long-term contractual commitment to AARP and corresponding intangible asset.

On December 22, 2008, AARP and the Company amended the License Agreement to restructure the payment terms of the agreement and eliminated the required annual royalty payment. The Company is no longer contractually committed to pay the \$7.6 million annual royalty payments. Accordingly, the Company wrote off the remaining contractual liability of approximately \$20.0 million and the balance of intangible asset of approximately \$19.1 million and recorded a corresponding gain on the restructuring of the AARP agreement of approximately \$981,000. The Company is currently in negotiations with AARP for restructuring the royalty compensation provision.

14. Income Taxes

The Company accounts for income taxes under FASB Statement No. 109, Accounting for Income Taxes (FASB 109). Deferred income tax assets and liabilities are determined based upon differences between financial reporting and tax bases of assets and liabilities and are measured using the enacted tax rates and laws that will be in effect when the differences are expected to reverse. The components of the income tax provision (benefit) for the years ended December 27, 2008, December 29, 2007 and December 30, 2006 are as follows:

| | 2008 | 2007 | 2006 |
|--|-------|------|----------|
| Current: | | | |
| Federal | \$ | \$ | \$ |
| State | | | (129) |
| Foreign | 58 | | |
| Current income tax provision (benefit) | \$ 58 | \$ | \$ (129) |

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| | | | | |
|------------------------------------|----|-------|----|-----|
| Deferred: | | | | |
| Federal and state deferred | \$ | 831 | \$ | 595 |
| Foreign deferred | | 220 | | 155 |
| | | | | 415 |
| Deferred income tax provision | \$ | 1,051 | \$ | 750 |
| | | | | 852 |
| Benefit applied to reduce goodwill | | 17 | | 19 |
| foreign | | | | 18 |
| Total income tax provision | \$ | 1,126 | \$ | 769 |
| | | | | 741 |

HearUSA, Inc.
Notes to Consolidated Financial Statements

The components of loss from operations, before income tax expense and minority interest in income of consolidated joint venture are as follows:

| | 2008 | 2007 | 2006 |
|---|-------------|-------------|-------------|
| Domestic | \$ (1,708) | \$ (1,570) | \$ (2,962) |
| Foreign | 893 | 535 | 1,162 |
| Total loss from operations, before income tax expense and minority interest in income of consolidated joint venture | \$ (815) | \$ (1,035) | \$ (1,800) |

The Company has accounted for certain items (principally depreciation, intangibles and the allowance for doubtful accounts) for financial reporting purposes in periods different from those for tax reporting purposes.

Effective January 1, 2007, we adopted the provisions of FIN 48, which clarifies the accounting for income tax positions by prescribing a minimum recognition threshold that a tax position is required to meet before being recognized in the financial statements. FIN 48 also provides guidance on derecognition of previously recognized deferred tax items, measurement, classification, interest and penalties, accounting in interim periods, disclosure and transition. Under FIN 48, we recognize the tax benefit from an uncertain tax position only if it is more likely than not that the tax position will be sustained upon examination by the taxing authorities, based on the technical merits of the tax position. The tax benefits recognized in our consolidated financial statements from such a position are measured based on the largest benefit that has a greater than 50% likelihood of being realized upon ultimate resolution.

As of December 27, 2008 and December 29, 2007, we had approximately \$13.8 million and \$14.8 million, respectively, of total gross unrecognized tax benefits.

| | |
|---|---------|
| Balance as of December 29, 2007 | \$ 14.8 |
| Additions to tax provisions related to the current year | |
| Additions to tax provision related to prior years | |
| Reduction for tax provisions of prior years | (1.0) |
| Balance as of December 27, 2008 | \$ 13.8 |

In accordance with our accounting policy, the Company recognizes accrued interest related to unrecognized tax benefits as a component of income tax expense.

The tax years 2004-2007 remain open to examination by the major taxing jurisdictions to which we are subject in the United States.

The tax years 2002-2007 remain open to examination by the major taxing jurisdictions to which we are subject in the Province of Canada.

HearUSA, Inc.**Notes to Consolidated Financial Statements**

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amount of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Significant components of the Company's net deferred income taxes United States operations are as follows:

| | 2008 | 2007 |
|---|-------------|-------------|
| Deferred income tax assets: | | |
| Fixed assets depreciation | \$ 1,082 | \$ 1,254 |
| Employee stock-based compensation-non-qualified | 128 | 27 |
| Accrued severance | 223 | 79 |
| Inventory costs | 20 | 41 |
| Joint venture | 283 | 287 |
| Accrued vacation | 415 | 358 |
| Bad debts | 172 | 173 |
| Charitable contributions | 11 | 15 |
| Net operating loss carryforwards | 22,089 | 21,583 |
| Total deferred tax assets | 24,423 | 23,817 |
| Less valuation allowance | (24,018) | (23,302) |
| Net deferred tax assets | \$ 405 | \$ 515 |
| Deferred income tax liabilities: | | |
| Amortization of definite lived intangibles | (405) | (515) |
| Amortization of indefinite lived intangibles | (2,200) | (2,200) |
| Amortization of goodwill for tax purposes | (4,203) | (3,423) |
| Total deferred tax liabilities | (6,808) | (6,138) |
| Net deferred income tax liability | \$ (6,403) | \$ (5,623) |

Deferred income tax assets (liabilities) Canadian operations are comprised of the following:

| | 2008 | 2007 |
|-----------------------------|-------------|-------------|
| Deferred income tax assets: | | |
| Fixed assets depreciation | \$ 135 | \$ 420 |
| Net loss carryforwards | | 62 |
| Other | 29 | 35 |
| Capital loss carryforwards | 4,695 | 5,838 |
| Total deferred tax assets | 4,859 | 6,355 |
| Less: valuation allowance | (4,695) | (5,838) |
| Net deferred tax assets | \$ 164 | \$ 517 |

| | | |
|--|----------|----------|
| Deferred income tax liabilities: | | |
| Amortizable intangible assets | \$ (176) | \$ (267) |
| Indefinite lived intangibles and goodwill for tax purposes | (869) | (1,027) |
| Total deferred income tax liability | (1,045) | (1,294) |
| Net deferred income tax liability | \$ (881) | \$ (777) |

HearUSA, Inc.**Notes to Consolidated Financial Statements**

SFAS 109 requires a valuation allowance to reduce the deferred tax assets reported if, based on the weight of the evidence, it is more likely than not that some portion or all of the deferred tax assets will not be realized. After consideration of all the evidence, both positive and negative, management has determined that a \$24.0 million valuation allowance at December 27, 2008 is necessary related to the United States operations to reduce the deferred tax assets to the amount that will more likely than not be realized. The change in the valuation allowance for the current year is approximately \$716,000. At December 27, 2008 the Company has available federal net operating loss carryforwards of approximately \$59.1 million, which will expire in the year 2021.

In addition for Canadian purposes, the Company has capital loss carryforward of approximately \$17.3 million which can only be utilized against gains from sales on capital assets. Since the Company does not anticipate any gains on sales of capital assets in the foreseeable future, a valuation allowance has been recorded at December 27, 2008 to offset the deferred tax asset from the capital loss carryforward.

The provision for income taxes on loss before income taxes (including minority interests) differ from the amount computed using the Federal statutory income tax rate as follows:

| | 2008 | 2007 | 2006 |
|--|----------|----------|----------|
| Benefit at Federal statutory rate | \$ (706) | \$ (855) | \$ (827) |
| State income taxes, net of Federal income tax effect | (87) | (37) | (88) |
| Nondeductible expenses | 196 | 687 | (82) |
| Effect of foreign earnings | (42) | (25) | (36) |
| Change in valuation allowance | 1,249 | 965 | 1,128 |
| Deferred tax liability recorded to goodwill | 622 | (80) | 512 |
| Other | (106) | 114 | 134 |
| Income tax expense | \$ 1,126 | \$ 769 | \$ 741 |

Provision has not been made for U.S. or additional foreign taxes on undistributed earnings of the Company's Canadian subsidiaries. Such earnings have been and will continue to be reinvested but could become subject to additional tax if they are remitted as dividends, or are loaned to the Company, or if the Company should sell its stock in the foreign subsidiaries. Such undistributed earnings were \$3.1 million, \$1.7 million and \$1.2 million, in 2008, 2007 and 2006, respectively.

15. Commitments and Contingencies

The Company established the HearUSA Inc. 401(k) plan in October 1998. All employees who have attained age 21 with at least three months of service are eligible to participate in the plan. The Company's contribution to the plan is determined from year to year by the Board of Directors. The Company's contributions to the plan were approximately \$90,000, \$73,000 and \$73,000 for the years 2008, 2007 and 2006, in 2008, 2007 and 2006 respectively.

In February 2008, the Company entered into employment agreements with two of its executive officers that provide for annual salaries, severance payments, and accelerated vesting of stock options upon termination of employment under certain circumstances or a change in control, as defined.

The Company also entered into change of control agreements with several of its other officers which provide for severance payments and acceleration of stock option vesting upon termination of employment after a change in control, as defined.

HearUSA, Inc.**Notes to Consolidated Financial Statements****16. Quarterly Financial Data (Unaudited)**

| Year Ended | First | Second | Third | Fourth |
|---|----------------|----------------|----------------|----------------|
| December 27, 2008 | Quarter | Quarter | Quarter | Quarter |
| Net revenues | \$ 28,688 | \$ 30,125 | \$ 28,717 | \$ 24,458 |
| Operating costs and expenses | 27,577 | 27,922 | 26,420 | 26,152 |
| Income (loss) from operations | 1,111 | 2,203 | 2,297 | (1,694) |
| Net income (loss) applicable to common stockholders | \$ (685) | \$ 245 | \$ (75) | \$ (2,825) |
| Net income (loss) including dividends on preferred stock, applicable to common stockholders basic and diluted | \$ (0.02) | \$ 0.01 | \$ (0.00) | \$ (0.08) |
| Year Ended | First | Second | Third | Fourth |
| December 29, 2007 | Quarter | Quarter | Quarter | Quarter |
| Net revenues | \$ 23,586 | \$ 24,920 | \$ 26,862 | \$ 27,436 |
| Operating costs and expenses | 21,944 | 24,110 | 24,353 | 25,574 |
| Income from operations | 1,642 | 810 | 2,509 | 1,862 |
| Net income (loss) applicable to common stockholders | \$ (595) | \$ (3,351) | \$ 488 | \$ 39 |
| Net income (loss) including dividends on preferred stock, applicable to common stockholders basic and diluted | \$ (0.02) | \$ (0.08) | \$ 0.01 | \$ 0.00 |

17. Fair Value of Financial Instruments

Statement of Financial Accounting Standards (SFAS) No. 157, Fair Value Measurements, defines and establishes a framework for measuring fair value and expands related disclosures. This Statement does not require any new fair value measurements. SFAS No. 157 was effective for the Company's financial assets and financial liabilities beginning in 2008. In February 2008, FASB Staff Position 157-2, Effective Date of Statement 157, deferred the effective date of SFAS No. 157 for all nonfinancial assets and nonfinancial liabilities to fiscal years beginning after November 15, 2008.

On January 1, 2008, we adopted the provisions of SFAS 157, except as it applies to those nonfinancial assets and nonfinancial liabilities for which the effective date has been delayed by one year. The full adoption of SFAS 157 will not have a material effect on our financial position or results of operations. The book values of cash, restricted cash and cash equivalents (Note 2), 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.

SFAS No. 157 prioritizes the inputs used in measuring fair value into the following hierarchy:

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

As of December 27, 2008 and December 29, 2007 the fair value of the Company's long-term debt is estimated at approximately \$56.0 million and \$48.2 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.

On January 1, 2008, we adopted the provisions of SFAS No. 159, *The Fair Value Option for Financial Assets or Financial Liabilities* including an amendment of FASB Statement No. 115 (*SFAS 159*), which provides companies with an option to report selected financial assets and liabilities at fair value. Unrealized gains and losses on items for which the fair value option has been elected are reported in earnings at each subsequent reporting date. The fair value options: (i) may be applied instrument by instrument, with a few exceptions, such as investments accounted for by the equity method; (ii) is irrevocable (unless a new election date occurs); and (iii) is applied only to entire instruments and not to portions of instruments. We did not elect to report any additional assets or liabilities at fair value and accordingly, the adoption of SFAS 159 did not have a material effect on our financial position or results of operations. The fair value of a financial instrument represents the amount at which the instrument could be exchanged in a current transaction between willing parties, other than in a forced sale or liquidation. Fair value estimates are made at a specific point in time, based on relevant market information about the financial instrument. These estimates are subjective in nature and involve uncertainties and matters of significant judgment, and therefore cannot be determined with precision. The assumptions used have a significant effect on the estimated amounts reported.

18. Restructuring

Paul A. Brown, M.D., the founder and chairman of the board of directors of HearUSA, Inc. (the "Company"), retired as chairman of the Company effective February 4, 2008. In honor of Dr. Brown's service to the Company and in recognition of his industry knowledge and expertise, the Board designated Dr. Brown as chairman emeritus of the board of directors and will pay him \$30,000 annually in such role. The Company and Dr. Brown entered into a retirement agreement pursuant to which the parties set forth the terms of Dr. Brown's retirement from the Company. The retirement agreement provides for the termination of his employment agreement dated August 31, 2005 and the payment of a sum equal to \$720,000 over three years, provision of continuing health and life insurance benefits for three years and extension of the post-termination exercise period for his options. The total amount included in general and administrative expenses related to Dr. Brown's severance costs was approximately \$811,000 in 2008.

The Company implemented an expense reduction plan intended to save approximately \$5 million in annual expenses on November 10, 2008. This plan was initiated to increase profitability and to respond to the current economic downturn. The expense reduction plan includes a restructuring of center operations, a reduction in the number of marketing programs and other cost control measures. The Company eliminated approximately 65 positions, all previously held by active employees. Included in center operating expenses is approximately \$235,000 of severance and other costs incurred in the fourth quarter of 2008 as a result of implementing the plan.

19. Recent Accounting Pronouncements

In December 2007, the FASB issued SFAS No 160 (*SFAS 160*), *Non-controlling Interests in Consolidated Financial Statements*, an amendment of Accounting Research Bulletin No. 51, which requires all entities to report minority interests in subsidiaries as equity in the consolidated financial statements, and requires that transactions between entities and non-controlling interests be treated as equity transactions. SFAS 160 is effective for fiscal years beginning on or after December 15, 2008, and will be applied prospectively. The Company expects SFAS 160 to impact the accounting for HEARx West's minority interest.

In December 2007, the FASB issued SFAS No. 141(R) (*SFAS 141R*), *Business Combinations*, which will significantly change how business acquisitions are accounted for and will impact financial statements both on the acquisition date and in subsequent periods. Some of the changes, such as the accounting for contingent consideration,

will introduce more volatility into earnings, and may impact a company's acquisition strategy. SFAS 141R is effective for fiscal years beginning on or after December 15, 2008, and will be applied prospectively. The Company does not expect this standard will have a significant impact on its financial position and results of operations.

In March 2008, the FASB issued SFAS No. 161, Disclosures about Derivative Instruments and Hedging Activities, an amendment of FASB Statement No. 133 (SFAS No. 161). SFAS No. 161 amends and expands the disclosure requirements of SFAS No. 133 with the intent to provide users of financial statements with an enhanced understanding of: (i) how and why an entity uses derivative instruments; (ii) how derivative instruments and related hedged items are accounted for under SFAS No. 133 and its related interpretations and (iii) how derivative instruments and related hedged items affect an entity's financial position, financial performance and cash flows. This statement is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008, with early application encouraged. The Company does not expect this standard will have a significant impact on its disclosures.

HearUSA, Inc.

Notes to Consolidated Financial Statements

In April 2008, the FASB issued FSP FAS 142-3, *Determination of the Useful Life of Intangible Assets* (FSP FAS 142-3). FSP FAS 142-3 amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset under SFAS No. 142, *Goodwill and Other Intangible Assets* (SFAS 142). The intent of FSP FAS 142-3 is to improve the consistency between the useful life of a recognized intangible asset under SFAS 142 and the period of expected cash flows used to measure the fair value of the asset under SFAS 141(R) and other applicable accounting literature. FSP FAS 142-3 is effective for financial statements issued for fiscal years beginning after December 15, 2008. The Company does not anticipate that the adoption of FSP FAS 142-3 will have a significant impact on its financial position and results of operations.

In May 2008, the FASB issued SFAS No. 162, *The Hierarchy of Generally Accepted Accounting Principles*, (SFAS 162). SFAS 162 identifies the sources of accounting principles and the framework for selecting the principles used in the preparation of financial statements. SFAS 162 is effective 60 days following the SEC's approval of the Public Company Accounting Oversight Board amendments to AU Section 411, *The Meaning of Present Fairly in Conformity with Generally Accepted Accounting Principles*. The Company does not expect this standard will have a material impact on its results of operations, financial position and results of operations.

In May 2008, the FASB issued Staff Position No. APB 14-1, *Accounting for Convertible Debt Instruments That May Be Settled in Cash upon Conversion (Including Partial Cash Settlement)*, or FSP APB 14-1. FSP APB 14-1 specifies that issuers of convertible debt instruments that may be settled in cash upon conversion should separately account for the liability and equity components in a manner that will reflect the entity's nonconvertible debt borrowing rate when interest cost is recognized in subsequent periods. We are required to adopt FSP APB 14-1 at the beginning of 2009 and apply FSP APB 14-1 retrospectively to all periods presented. The Company does not expect this standard will have a material impact on its results of operations, financial position and results of operations.

20. 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; the establishment, maintenance and support of an affiliated network; and the operation of an e-commerce business. The centers offer people afflicted with hearing loss a complete range of services and products, including diagnostic audiological testing, the latest technology in hearing aids and listening devices to improve their quality of life. The network, unlike the Company-owned centers, is comprised of hearing care practices owned by independent audiologists. The network revenues are mainly derived from administrative fees paid by employer groups, health insurers and benefit sponsors to administer their benefit programs as well as maintaining an affiliated provider network. E-commerce offers on-line product sales of hearing aid related products, such as batteries, hearing aid accessories and assistive listening devices. The Company's business units are located in the United States and Canada.

HearUSA, Inc.
Notes to Consolidated Financial Statements

The following is the Company's segment information:

| | Centers | E-commerce | Network | Corporate | Total |
|---|------------|------------|----------|-------------|------------|
| For the years ended: | | | | | |
| Hearing aids and other products revenues | | | | | |
| December 27, 2008 | \$ 104,291 | \$ 101 | \$ | \$ | \$ 104,392 |
| December 29, 2007 | \$ 95,861 | \$ 75 | \$ | \$ | \$ 95,936 |
| December 30, 2006 | \$ 82,769 | \$ 51 | \$ | \$ | \$ 82,820 |
| Service revenues | | | | | |
| December 27, 2008 | \$ 5,710 | \$ | \$ 1,886 | \$ | \$ 7,596 |
| December 29, 2007 | \$ 5,306 | \$ | \$ 1,562 | \$ | \$ 6,868 |
| December 30, 2006 | \$ 4,371 | \$ | \$ 1,596 | \$ | \$ 5,967 |
| Income (loss) from operations | | | | | |
| December 27, 2008 | \$ 18,854 | \$ (141) | \$ 830 | \$ (15,626) | \$ 3,917 |
| December 29, 2007 | \$ 21,417 | \$ (66) | \$ 1,081 | \$ (15,609) | \$ 6,823 |
| December 30, 2006 | \$ 17,233 | \$ (188) | \$ 966 | \$ (14,202) | \$ 3,809 |
| As of and for years ended: | | | | | |
| December 27, 2008 | | | | | |
| Depreciation and amortization | \$ 2,510 | \$ | \$ 3 | \$ 450 | \$ 2,963 |
| Total assets | \$ 84,144 | \$ | \$ 920 | \$ 15,537 | \$ 100,601 |
| Capital expenditures | \$ 1,111 | \$ | \$ | \$ 390 | \$ 1,501 |
| December 29, 2007 | | | | | |
| Depreciation and amortization | \$ 1,863 | \$ | \$ 3 | \$ 382 | \$ 2,248 |
| Total assets | \$ 81,797 | \$ | \$ 934 | \$ 17,811 | \$ 100,542 |
| Capital expenditures | \$ 199 | \$ | \$ | \$ 537 | \$ 736 |
| December 30, 2006 | | | | | |
| Depreciation and amortization | \$ 1,788 | \$ | \$ 3 | \$ 197 | \$ 1,988 |
| Total assets | \$ 66,362 | \$ | \$ 971 | \$ 15,943 | \$ 83,276 |
| Capital expenditures | \$ 667 | \$ | \$ | \$ 533 | \$ 1,200 |

Hearing aids and other products revenues consisted of the following:

| | 2008 | 2007 | 2006 |
|-------------------------|-------|-------|-------|
| Hearing aid revenues | 95.4% | 95.3% | 95.9% |
| Other products revenues | 4.6% | 4.7% | 4.1% |

Services revenues consisted of the following:

| | 2008 | 2007 | 2006 |
|--------------------------|-------|-------|-------|
| Hearing aid repairs | 48.1% | 49.8% | 51.7% |
| Testing and other income | 51.9% | 50.2% | 48.3% |

HearUSA, Inc.**Notes to Consolidated Financial Statements**

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:

| | 2008 | 2007 | 2006 |
|------------------------------------|-----------|-----------|-----------|
| General and administrative expense | \$ 15,176 | \$ 15,227 | \$ 14,005 |
| Depreciation and amortization | \$ 450 | \$ 382 | \$ 197 |
| Corporate loss from operations | \$ 15,626 | \$ 15,609 | \$ 14,202 |

Information concerning geographic areas:

As of and for the Years Ended December 27, 2008, December 29, 2007 and December 30, 2006

| | United States 2008 \$ | Canada 2008 \$ | United States 2007 \$ | Canada 2007 \$ | United States 2006 \$ | Canada 2006 \$ |
|--|--------------------------------|----------------------|--------------------------------|----------------------|--------------------------------|----------------------|
| Hearing aid and other product revenues | 88,306 | 16,086 | 82,789 | 13,147 | 73,542 | 9,278 |
| Service revenues | 6,991 | 605 | 6,305 | 563 | 5,539 | 428 |
| Long-lived assets | 73,866 | 13,626 | 68,728 | 15,834 | 58,071 | 11,451 |
| Total assets | 84,559 | 16,042 | 81,013 | 19,529 | 69,995 | 13,281 |

Net revenues by geographic area are allocated based on the location of the subsidiary operations.

21. Liquidity

The working capital deficit decreased \$8.8 million to \$7.2 million at December 27, 2008 from \$16.0 million at December 29, 2007. The decrease in the deficit is mostly attributable to a decrease in trade payables and current maturities of long-term debt which arose from the conversion of approximately \$6.2 million in trade payables to long-term indebtedness under Siemens Tranche C, conversion of approximately \$3.8 million in trade payables to 6.4 million shares of the Company's Common Stock and the elimination of the current maturities of subordinated notes of approximately \$1.5 million following the repayment of these notes in August 2008 (see Note 8 Subordinated Notes and Warrant Liability, Notes to Consolidated Financial Statements included herein).

The working capital deficit of \$7.2 million includes approximately \$2.7 million of the current maturities of the long-term debt to Siemens which may be repaid through rebate credits. In 2008, the Company generated income from operations of approximately \$3.9 million (including approximately \$849,000 of non-cash employee stock-based compensation expense and approximately \$1.4 million of amortization of intangible assets) compared to \$6.8 million (including approximately \$606,000 of non-cash employee stock-based compensation and approximately \$896,000 of amortization of intangible assets) in 2007. Cash and cash equivalents as of December 27, 2008 were approximately \$3.6 million.

The Company believes that current cash and cash equivalents and cash flow from operations, at current net revenue levels, will be sufficient to support the Company's operational needs through the next twelve months. However, 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 cash flow from operations will not be sufficient. In the event of a shortfall in cash, 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 sales and gross margin improvements.

HearUSA Inc.
Schedule II Valuation and Qualifying Accounts

| | Balance at Beginning Of Period | Additions | Deductions | Balance at End Of Period |
|---------------------------------|---|------------------|-------------------|---|
| December 27, 2008 | | | | |
| Allowance for doubtful accounts | \$ 498 | \$ 424 | \$ (416) | \$ 506 |
| Allowance for sales returns (1) | \$ 385 | \$ 455 | \$ (163) | \$ 677 |
| Valuation allowance US | \$ 23,302 | \$ 716 | \$ | \$ 24,018 |
| Valuation allowance foreign | \$ 5,838 | \$ | \$ (1,143) | \$ 4,695 |
| December 29, 2007 | | | | |
| Allowance for doubtful accounts | \$ 434 | \$ 478 | \$ (414) | \$ 498 |
| Allowance for sales returns (1) | \$ 443 | \$ 132 | \$ (190) | \$ 385 |
| Valuation allowance | \$ 29,639 | \$ | \$ (6,337) | \$ 23,302 |
| Valuation allowance foreign | \$ 4,901 | \$ 937 | \$ | \$ 5,838 |
| December 30, 2006 | | | | |
| Allowance for doubtful accounts | \$ 413 | \$ 379 | \$ (358) | \$ 434 |
| Allowance for sales returns (1) | \$ 440 | \$ 97 | \$ (94) | \$ 443 |
| Valuation allowance | \$ 27,764 | \$ 1,875 | \$ | \$ 29,639 |
| Valuation allowance foreign | \$ 5,648 | \$ | \$ (747) | \$ 4,901 |

(1) Allowance for sales returns is included in accounts payable on the Consolidated Balance Sheets.

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

Not applicable.

Item 9A (T). Controls and Procedures

a. Evaluation of Disclosure Controls and Procedures

In connection with the preparation and filing of the Company's annual report on Form 10-K, the Company's management, with the participation of the Company's chief executive officer and chief financial officer, evaluated the effectiveness of the Company's disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended) as of December 27, 2008. The Company's chief executive officer and chief financial officer concluded that, as of December 27, 2008, the Company's disclosure controls and procedures were effective.

b. Management's Report on Internal Control over Financial Reporting Our management is responsible for establishing and maintaining adequate internal control over financial reporting as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act. Under the supervision and with the participation of our management, including our chief executive officer and chief financial officer, we conducted an evaluation of the effectiveness of our internal control over financial reporting as of December 27, 2008 using the criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Based on our evaluation under the COSO framework, management determined that, as of December 27, 2008, our internal control over financial reporting was effective.

This annual report does not include an attestation report of the Company's registered public accounting firm regarding internal control over financial reporting. Management's report was not subject to attestation by the Company's registered public accounting firm pursuant to temporary rules of the Securities and Exchange Commission that permit the Company to provide only management's report in this annual report.

c. Changes in Internal Control over Financial Reporting

No change in the Company's internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) occurred during the fiscal quarter ended December 27, 2008 that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

Item 9B. Other Information

None.

PART III

Item 10. Directors, Executive Officers and Corporate Governance

Information regarding executive officers may be found in the section captioned Executive Officers of the Registrant (Part I) of this Annual Report on Form 10-K. Information regarding our directors, compliance with Section 16(a) of the Securities Exchange Act of 1934 and certain other corporate governance matters may be found in the Company's 2009 definitive Proxy Statement under the headings Election of Directors, Audit Committee, and Section 16 Beneficial Ownership Reporting Compliance and is incorporated herein by reference.

We have adopted a code of ethics that applies to our principal executive officer, principal financial officer and other senior accounting officers. The Code of Ethics for the Chief Executive Officer and Senior Financial Officers is located on our Web site (www.hearusa.com).

Item 11. Executive Compensation

The information required by this Item is set forth in the Company's 2009 Proxy Statement under the headings Compensation of Directors, Compensation Discussion and Analysis, Report of the Compensation Committee, Executive Compensation, Employment Agreements, Compensation Committee Interlocks and Insider Participation and the following tables, 2008 Grants of Plan-Based Awards, Outstanding Equity Awards at 2008 Fiscal Year End and 2008 Option Exercises and is incorporated herein by this reference as if set forth in full.

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

The information required by this Item is set forth in the Company's 2009 Proxy Statement under the heading Security Ownership of Certain Beneficial Owners and Management and is incorporated herein by this reference as if set forth in full.

The following table sets forth certain information regarding the Company's equity compensation plans as of December 27, 2008:

Equity Compensation Plan Information

| Plan Category | Number of Securities to be issued upon exercise of outstanding options, warrants and rights (a) | Weighted-average exercise price of outstanding options, warrants and rights (b) | Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a)) (a) |
|---|--|--|--|
| Equity compensation plans approved by security holders | 5,255,955 | \$ 1.32 | 1,303,000 |
| Equity compensation plans not approved by security holders | 100,000(1) | \$ 0.35 | |
| Total equity compensation plans approved and not approved by security holders | 5,355,955 | \$ 1.30 | 1,303,000 |

(1) Consists of non-employee director options granted on April 1, 2003 outside of the Non-Employee Director Plan at an exercise price of \$0.35, which was equal to the closing price of the Common Stock as reported on the NYSE Amex (formerly known as the American Stock Exchange) the grant date. The

options vested
after one year
and have a
ten-year life.

Item 13. Certain Relationships and Related Transactions and Director Independence

The information required by this item is set forth in the Company's 2009 Proxy Statement under the heading "Certain Relationships and Related Transactions" and is incorporated herein by this reference as if set forth in full.

Item 14. Principal Accountant Fees and Services

The information required by this Item will appear under the heading "Independent Registered Public Accounting Firm Services and Fees" in our Proxy Statement, which section is incorporated herein by reference.

PART IV

Item 15. Exhibits and Financial Statement Schedules

(a) The following documents are filed as part of this report:

(1) Financial Statements

- (i) Consolidated Balance Sheets as of December 27, 2008 and December 29, 2007. Consolidated Statements of Operations for the years ended December 27, 2008, December 29, 2007 and December 30, 2006.
- (ii) Consolidated Statements of Changes in Stockholders' Equity for the years ended December 27, 2008, December 29, 2007 and December 30, 2006.
- (iii) Consolidated Statements of Cash Flows for the years ended December 27, 2008, December 29, 2007 and December 30, 2006.

(iv) Notes to Consolidated Financial Statements

(2) Financial statement schedule:

Schedule II Valuation and Qualifying Accounts

Exhibits:

- 2.1 Plan of Arrangement, including exchangeable share provisions (incorporated herein by reference to 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 to 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 to 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 to 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 to 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 1999 Series H Junior Participating Preferred Stock (incorporated herein by reference to Exhibit 4 to the Company's Current Report on Form 8-K, filed December 17, 1999 (File No. 001-11655)).
- 3.6 Certificate of Designations, Preferences and Rights of the Company's Special Voting Preferred Stock (incorporated herein by reference to Exhibit 3.2 to the Company's Current Report on Form 8-K, filed July 19, 2002 (File No. 001-11655)).
- 3.7 Amendment to Certificate of Designations, Preferences and Rights of the Company's 1999 Series H Junior Participating Preferred Stock (incorporated herein by reference to Exhibit 4 to the Company's Current Report on Form 8-K, filed July 17, 2002 (File No. 001-11655)).
- 3.8 Certificate of Designations, Preferences and Rights of the Company's 1998-E Convertible Preferred Stock (incorporated herein by reference to Exhibit 4.1 to the Company's Current Report on Form 8-K, filed August 28, 2003 (File No. 001-11655)).
- 3.9 Amendment of Restated Certificate of Incorporation (increasing authorized capital) (incorporated herein by reference to Exhibit 3.9 to the Company's Quarterly Report on Form 10-Q for the quarter ended June 26, 2004).
- 3.10 Amended and Restated By-Laws of HearUSA, Inc. (effective May 9, 2005) (incorporated herein by reference to Exhibit 3.1 to the Company's Current Report on Form 8-K, filed May 13, 2005).

- 4.1 Amended and Restated Rights Agreement, dated July 11, 2002 between HEARx 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 to Exhibit 4.9.1 to the Company's Joint Proxy/Prospectus on Form S-4 (Reg. No. 333-73022)).

Exhibits:

- 4.2 Form of Support Agreement among HEARx Ltd., HEARx Canada, Inc. and HEARx Acquisition ULC (incorporated herein by reference to Annex D in the Company's Joint Proxy Statement/Prospectus on Form S-4/A, filed May 28, 2002 (Reg. No. 333-73022)).
- 9.1 Form of Voting and Exchange Trust Agreement among HearUSA, Inc., HEARx Canada, Inc and HEARx Acquisition ULC and ComputerShare Trust Company of Canada (incorporated herein by reference to Annex C in the Company's Joint Proxy Statement/Prospectus on Form S-4/A, filed May 28, 2002 (Reg. No. 333-73022)).
- 10.1 HEARx Ltd. 1987 Stock Option Plan (incorporated herein by reference to Exhibit 10.11 to the Company's Registration Statement on Form S-18 (Reg. No. 33-17041-NY))#
- 10.2 HEARx Ltd. Stock Option Plan for Non-Employee Directors and Form of Option Agreement (incorporated herein by reference to Exhibits 10.35 and 10.48 to Post-Effective Amendment No. 1 to the Company's Registration Statement on Form S-18 (Reg. No. 33-17041-NY))#
- 10.3 1995 Flexible Employee Stock Plan (incorporated herein by reference to Exhibit 4 to the Company's 1995 Proxy Statement)#
- 10.4 Form of Change in Control Agreement (incorporated herein by reference to Exhibit 10.5 to the Company's Quarterly Report on Form 10-Q for the quarter ended October 1, 2005.)#
- 10.5 HearUSA 2002 Flexible Stock Plan (incorporated herein by reference to Exhibit 10.9 to the Company's Joint Proxy Statement/Prospectus on Form S-4 (Reg. No. 333-73022))#
- 10.6 Amended and Restated Security Agreement, dated February 10, 2006 between HearUSA, Inc. and Siemens Hearing Instruments, Inc. (incorporated herein by reference to Exhibit 10.2 to the Company's Form 10-Q for the period ended April 1, 2006).
- 10.7 Amended and Restated Supply Agreement, dated December 30, 2006 between HearUSA, Inc. and Siemens Hearing Instruments, Inc. (incorporated herein by reference to Exhibit 10.23 to the Company's Form 10-K for the period ended December 30, 2006).*
- 10.8 Second Amended and Restated Credit Agreement, dated December 30, 2006 between HearUSA, Inc. and Siemens Hearing Instruments, Inc. (incorporated herein by reference to Exhibit 10.22 to the Company's Form 10-K for the period ended December 30, 2006).
- 10.9 Investor Rights Agreement by and among HearUSA, Inc. and Siemens Hearing Instruments, Inc., dated December 30, 2006 (incorporated herein by reference to Exhibit 10.24 to the Company's Form 10-K for the period ended December 30, 2006).
- 10.10 First Amendment to the Second Amended and Restated Credit Agreement, dated June 27, 2007 between HearUSA, Inc. and Siemens Hearing Instruments, Inc. (incorporated herein by reference to Exhibit 10.5 to the Company's Form S-3/A, filed August 3, 2007).

- 10.11 Second Amendment to the Second Amended and Restated Credit Agreement dated September 24, 2007 between HearUSA, Inc. and Siemens Hearing Instruments, Inc. (incorporated herein by reference to Exhibit 10.1 to the Company's Current Report of Form 8-K, filed October 4, 2007).

Exhibits:

- 10.12 First Amendment to the Amended and Restated Supply Agreement, dated September 24, 2007 between HearUSA, Inc. and Siemens Hearing Instruments, Inc. (incorporated herein by reference to Exhibit 10.1 to the Company's Current Report of Form 8-K, filed October 4, 2007).
- 10.13 First Amendment to the Investor Rights Agreement by and among HearUSA, Inc. and Siemens Hearing Instruments, Inc. dated September 24, 2007 (incorporated herein by reference to Exhibit 10.1 to the Company's Current Report of Form 8-K, filed October 4, 2007).
- 10.14 Third Amendment to Credit Agreement dated December 23, 2008, by and between the Company and Siemens Hearing Instruments, Inc. (incorporated herein by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K, filed December 23, 2008).
- 10.15 Second Amendment to Supply Agreement dated December 23, 2008 by and between the Company and Siemens Hearing Instruments, Inc. (incorporated herein by reference to Exhibit 10.2 to the Company's Current Report on Form 8-K, filed December 23, 2008).*
- 10.16 Second Amendment to Investor Rights Agreement dated December 23, 2008 by and between the Company and Siemens Hearing Instruments, Inc. (incorporated herein by reference to Exhibit 10.3 to the Company's Current Report on Form 8-K, filed December 23, 2008).
- 10.17 Amendment No. 2 to Amended and Restated Security Agreement dated December 23, 2008 by and between the Company and Siemens Hearing Instruments, Inc. (incorporated herein by reference to Exhibit 10.4 to the Company's Current Report on Form 8-K, filed December 23, 2008).
- 10.18 Stock Purchase Agreement dated December 23, 2008 by and between the Company and Siemens Hearing Instruments, Inc. (incorporated herein by reference to Exhibit 10.5 to the Company's Current Report on Form 8-K, filed December 23, 2008).
- 10.19 Hearing Care Program Services Agreement by and among HearUSA, Inc., AARP, Inc. and AARP Services, Inc. dated August 8, 2008 (incorporated herein by reference to Exhibit 10.1 to the Company's Form 10-Q for the period ended September 27, 2008).
- 10.20 AARP License Agreement by and between HearUSA, Inc. and AARP, Inc. dated August 8, 2008 (incorporated herein by reference to Exhibit 10.2 to the Company's Form 10-Q for the period ended September 27, 2008).
- 10.21 Amendment No. 1 to the AARP License Agreement dated as of December 22, 2008, by and between the Company and AARP, Inc. (incorporated herein by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K, filed December 29, 2008).
- 10.22 Separation Agreement and Release by and between the Company and Kenneth Schofield dated October 12, 2007 (incorporated herein by reference to Exhibit 10.24 to the

Company's Form 10-K for the period ended December 29, 2007).#

10.23

Amended and Restated HearUSA 2007 Equity Incentive Compensation Plan (incorporated herein by reference to Exhibit 10.25 to the Company's Form 10-K for the period ended December 29, 2007).#

Exhibits:

- 10.24 Form of option grant agreement pursuant to 2007 Equity Incentive Compensation Plan (incorporated herein by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K, filed September 18, 2007).#
- 10.25 Form of time-vesting restricted stock unit grant agreement pursuant to 2007 Equity Incentive Compensation Plan (incorporated herein by reference to Exhibit 10.27 to the Company's Form 10-K for the period ended December 29, 2007).#
- 10.26 Form of performance-based restricted stock unit grant agreement pursuant to 2007 Equity Incentive Compensation Plan (incorporated herein by reference to Exhibit 10.28 to the Company's Form 10-K for the period ended December 29, 2007).#
- 10.27 Form of time-vesting restricted stock unit grant agreement pursuant to 2002 Flexible Stock Plan (incorporated herein by reference to Exhibit 10.29 to the Company's Form 10-K for the period ended December 29, 2007).#
- 10.28 Retirement Agreement entered into by and between Paul A. Brown, M.D. and the Company dated February 4, 2008 (incorporated herein by reference to Exhibit 10.30 to the Company's Form 10-K for the period ended December 29, 2007).#
- 10.29 Amended and Restated Executive Employment Agreement entered into by and between the Company and Stephen J. Hansbrough as of February 25, 2008 (incorporated herein by reference to Exhibit 10.31 to the Company's Form 10-K for the period ended December 29, 2007).#
- 10.30 Amended and Restated Executive Employment Agreement entered into by and between the Company and Gino Chouinard as of February 25, 2008 (incorporated herein by reference to Exhibit 10.32 to the Company's Form 10-K for the period ended December 29, 2007).#
- 21 List of Subsidiaries
- 23 Consent of the Independent Registered Public Accountants
- 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

Denotes
compensatory
plan or
arrangement for
Company

officer or
director.

- * Confidential treatment has been requested or granted for portions of this agreement

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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: March 27, 2009

/s/ Stephen J. Hansbrough
Stephen J. Hansbrough
Chairman and Chief Executive Officer
HearUSA, Inc.

/s/ Francisco Puñal
Francisco Puñal
Senior Vice President and
Chief Financial Officer
HearUSA, Inc.

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Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated.

| Signature | Title | Date |
|--|--|----------------|
| /s/ Stephen J. Hansbrough Stephen J. Hansbrough | Chairman of the Board Chief Executive Officer and Director | March 27, 2009 |
| /s/ Gino Chouinard Gino Chouinard | President Chief Operating Officer | March 27, 2009 |
| /s/ Francisco Puñal Francisco Puñal | Senior Vice President Chief Financial Officer (Chief Accounting Officer) | March 27, 2009 |
| /s/ Paul A Brown Paul A. Brown, M.D. | Director | March 27, 2009 |
| /s/ David J. McLachlan David J. McLachlan | Director | March 27, 2009 |
| /s/ Thomas W. Archibald Thomas W. Archibald | Director | March 27, 2009 |
| /s/ Joseph L. Gitterman III Joseph L. Gitterman III | Director | March 27, 2009 |
| /s/ Michel Labadie Michel Labadie | Director | March 27, 2009 |
| /s/ Bruce Bagni Bruce Bagni | Director | March 27, 2009 |
| /s/ Stephen W. Webster Stephen W. Webster | Director | March 27, 2009 |

EXHIBIT INDEX

| Exhibit Number | Description |
|---------------------------|--|
| 21 | List of Subsidiaries |
| 23 | Consent of the Independent Registered Public Accountants |
| 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 |