FORM 10−Q

HANGER ORTHOPEDIC GROUP INC − HGR

Filed: May 14, 2003 (period: March 31, 2003)

Quarterly report which provides a continuing view of a company's financial position

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SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)

[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15 (d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended March 31, 2003

OR

[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from ____________ to ____________

Commission file number 1-10670

HANGER ORTHOPEDIC GROUP, INC.
(Exact name of registrant as specified in its charter)

Delaware	84-0904275
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)

Two Bethesda Metro Center, Suite 1200, Bethesda, MD 20814
(Address of principal executive offices) (Zip Code)

Registrant's telephone number, including area code:
(301) 986-0701

Former name, former address and former fiscal year, if changed since last report.

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

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

As of May 9, 2003, 20,685,268 shares of common stock, $.01 par value per share were outstanding.

HANGER ORTHOPEDIC GROUP, INC.

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HANGER ORTHOPEDIC GROUP, INC.
CONSOLIDATED BALANCE SHEETS
(Dollars in thousands, except share and per share amounts)

	March 31, 2003	December 31, 2002
	(unaudited)	
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	$ 13,679	$ 6,566
Accounts receivable, less allowances for doubtful accounts of $7,955 and $8,649 in 2003 and 2002, respectively	105,505	107,604
Inventories	55,283	56,454
Prepaid expenses, other assets, and income taxes receivable	6,236	15,432
Deferred income taxes	6,586	6,586
Total current assets	187,289	192,642
PROPERTY, PLANT AND EQUIPMENT		
Land	3,743	3,743
Buildings	6,726	6,715
Machinery and equipment	17,480	17,110
Computer and software	19,608	17,990
Furniture and fixtures	10,479	10,353
Leasehold improvements	19,799	18,671
Property, plant, and equipment, gross	77,835	74,582
Less accumulated depreciation and amortization	41,255	39,036
Property, plant, and equipment, net	36,580	35,546
INTANGIBLE ASSETS		
Excess cost over net assets acquired	454,289	453,988
Patents and other intangible assets, $10,232 and $10,232 less accumulated amortization of $4,629 and $4,404 in 2003 and 2002, respectively	5,604	5,828
Total intangible assets	459,893	459,816
OTHER ASSETS		
Debt issuance costs, net	13,146	13,741
Other assets	9,454	10,481
Total other assets	22,600	24,222
TOTAL ASSETS	$ 706,362	$ 712,226

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

HANGER ORTHOPEDIC GROUP, INC.
CONSOLIDATED BALANCE SHEETS
(Dollars in thousands, except share and per share amounts)

	March 31, 2003	December 31, 2002
	(unaudited)	
LIABILITIES, REDEEMABLE PREFERRED STOCK AND SHAREHOLDERS' EQUITY		
CURRENT LIABILITIES		
Current portion of long-term debt	$ 3,536	$ 5,181
Accounts payable	11,559	14,876
Accrued expenses and income taxes payable	5,720	5,460
Accrued interest payable	7,253	7,507
Accrued compensation related cost	19,639	32,950
Total current liabilities	47,707	65,974
LONG-TERM LIABILITES		
Long-term debt, less current portion	384,894	378,101
Deferred income taxes	22,965	22,965
Other liabilities	1,331	1,578
Total long-term liabilities	409,190	402,644
Total liabilities	456,897	468,618
PREFERRED STOCK		
7% Redeemable Convertible Preferred Stock, liquidation preference $1,000 per share	77,298	75,941
COMMITMENTS AND CONTINGENCIES		
SHAREHOLDERS' EQUITY		
Common stock, $.01 par value; 60,000,000 shares authorized, 20,549,435 shares and 20,277,180 shares issued and outstanding in 2003 and 2002, respectively	205	203
Additional paid-in capital	150,664	150,287
Retained earnings (accumulated deficit)	21,954	17,833
	172,823	168,323
Treasury stock, cost (133,495 shares)	(656)	(656)
Total shareholders' equity	172,167	167,667
TOTAL LIABILITIES, REDEEMABLE PREFERRED STOCK AND SHAREHOLDERS' EQUITY	$ 706,362	$ 712,226

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

HANGER ORTHOPEDIC GROUP, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS
For the Three Months Ended March 31,
(Dollars in thousands, except share and per share amounts)

	2003	2002
	(unaudited)	
Net sales	$ 126,128	$ 123,510
Cost of goods sold (exclusive of depreciation and amortization)	60,690	59,537
Gross profit	65,438	63,973
Selling, general and administrative	44,766	44,777
Depreciation and amortization	2,453	2,784
Income from operations	18,219	16,412
Interest expense, net	9,096	9,079
Extinguishment of debt	-	4,686
Income before taxes	9,123	2,647
Provision for income taxes	3,645	1,125
Net income	5,478	1,522
Preferred stock dividend and accretion	1,357	1,266
Net income applicable to common stock	$ 4,121	$ 256
Basic Per Common Share Data		
Net income applicable to common stock	$ 0.20	$ 0.01
Shares used to compute basic per common share amounts	20,408,262	19,137,586
Diluted Per Common Share Data		
Net income applicable to common stock	$ 0.19	$ 0.01
Shares used to compute diluted per common share amounts	21,990,343	21,642,231

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

HANGER ORTHOPEDIC GROUP, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
For the Three Months Ended March 31,
(Dollars in thousands)

	2003	2002
	(unaudited)	
Cash flows from operating activities:		
Net income	$ 5,478	$ 1,522
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Extinguishment of debt	-	4,686
Loss on disposal of assets	-	413
Provision for bad debts	4,763	5,158
Depreciation and amortization	2,453	2,784
Amortization of debt issuance costs	595	513
Changes in assets and liabilities, net of effects of acquired companies:		
Accounts receivable	(2,664)	(5,495)
Inventories	1,171	1,632
Prepaid expenses, other assets, and income taxes receivable	10,558	(1,603)
Other assets	73	(181)
Accounts payable	(3,317)	(6,080)
Accrued expenses, interest, and income taxes payable	(1,355)	5,734
Accrued compensation related costs	(13,311)	(11,329)
Other liabilities	(247)	(765)
Net cash provided by (used in) operating activities	4,197	(3,011)
Cash flows from investing activities:		
Purchase of property, plant and equipment	(3,303)	(1,626)
Acquisitions and earouts	(301)	(1,226)
Proceeds from sale of certain assets	41	1,492
Net cash used in investing activities	(3,563)	(1,360)
Cash flows from financing activities:		
Borrowings under revolving credit agreement	16,000	-
Repayments under revolving credit agreement	(8,000)	(34,300)
Proceeds from sale of Senior Notes	-	200,000
Repayment and termination of bank loans	-	(153,587)
Scheduled repayment of long-term debt	(1,900)	(3,132)
Increase in financing costs	-	(8,480)
Proceeds from issuance of Common Stock	379	729
Net cash provided by financing activities	6,479	1,230
Increase (decrease) in cash and cash equivalents	7,113	(3,141)
Cash and cash equivalents at beginning of year	6,566	10,043
Cash and cash equivalents at end of year	$ 13,679	$ 6,902

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

NOTE A − BASIS OF PRESENTATION

The accompanying unaudited financial statements have been prepared in accordance with Rule 10−01 of Regulation S−X. They do not include all of the information and notes required by generally accepted accounting principles ("GAAP") for complete financial statements. In the opinion of management, all adjustments considered necessary (consisting solely of normal recurring adjustments) for a fair presentation of the financial statements have been included. Certain reclassifications of the prior year's data have been made to improve comparability.

These financial statements should be read in conjunction with the financial statements of Hanger Orthopedic Group, Inc. (the "Company") and notes thereto included in the Annual Report on Form 10−K for the year ended December 31, 2002, filed by the Company with the Securities and Exchange Commission.

NOTE B − SIGNIFICANT ACCOUNTING PRINCIPLES

Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Inventories

Inventories, which consist principally of purchased parts and work in process, are stated at the lower of cost or market using the first−in, first−out (FIFO) method. The Company calculates cost of goods sold in accordance with the gross profit method. The Company bases the estimates used in applying the gross profit method on the actual results of the most recently completed fiscal year and other factors affecting cost of goods sold during the current reporting periods. Estimated cost of goods sold during the period is adjusted when the annual physical inventory is taken. The Company treats these adjustments as changes in accounting estimates in accordance with the provisions of Accounting Principles Board Opinion ("APB") 20.

Stock Based Compensation

At March 31, 2003, the Company has multiple stock−based employee compensation plans and has outstanding non−qualified options held by employees. Stock−based compensation is accounted for using the intrinsic−value−based method in accordance with APB 25, Accounting for Stock Issued to Employees, and related Interpretations. No stock−based employee compensation expense is reflected in net income (loss) as all options granted under these plans and the non−qualified options

NOTE B - SIGNIFICANT ACCOUNTING PRINCIPLES (CONTINUED)

Stock Based Compensation (continued)

granted to employees had an exercise price equal to the market value of the underlying common stock on the date of grant. The following table illustrates the effect on net income and earnings per share if the Company had applied the fair value recognition provisions of Statement of Financial Accounting Standards ("SFAS") 123, Accounting for Stock-Based Compensation, to stock-based employee compensation:

	Three Months Ended March 31,	
	2003	2002
(In thousands, except per share amounts)		
Net income applicable to common stock, as reported	$ 4,121	$ 256
Deduct: total stock-based employee compensation expense determined under fair value method for all awards, net of related tax effects	(638)	(628)
Pro forma net income (loss) applicable to common stock	$ 3,483	$ (372)
Earnings (loss) per share:		
Basic - as reported	$ 0.20	$ 0.01
Basic - pro forma	$ 0.17	$ (0.02)
Diluted - as reported	$ 0.19	$ 0.01
Diluted - pro forma	$ 0.16	$ (0.02)

The fair value for these options was estimated at the date of grant using a Black-Scholes option pricing model with the following weighted average assumptions:

	Three Months Ended March 31,	
	2003	2002
Expected term	5	5
Volatility factor	74%	71%
Risk free interest rate	2.9%	5.8%
Dividend yield	0.00%	0.00%

For the quarters ended March 31, 2003 and 2002, the Company granted aggregate options to purchase 110,332 and 405,000 shares of the Company's common stock, respectively. The weighted average fair value of each option granted was $7.40 per share for 2003 and $6.80 per share for 2002.

Segment Information

SFAS 131, Disclosures about Segments of an Enterprise and Related Information, applies a "management" approach to disclosure of segment information. The management approach designates the internal organization that is used by management for making operating decisions and assessing performance as the basis of the Company's reportable segments. SFAS 131 also requires disclosure about products and services, geographic areas and major customers. The description of the Company's reportable segments and the disclosure of segment information pursuant to SFAS 131 are presented in Note I.

New Accounting Standards

In April 2002, the Financial Accounting Standard Board ("FASB") issued Statement of Financial Accounting Standards 145, Rescission of FASB Statements 4, 44, and 64, Amendment of FASB Statement 13, and Technical Corrections ("SFAS 145"). Under SFAS 145, gains and losses from the early extinguishment of debt are no longer classified as extraordinary items, unless they satisfied the criteria in Accounting Principles Board Opinion 30 ("APB 30") where extraordinary items are stated to be distinguishable by their unusual nature and by the infrequency of their occurrence. Any gain or loss on extinguishment of debt that was classified as an extraordinary item in prior periods presented that does not meet the criteria in APB 30 for classification as an extraordinary item has been reclassified. In addition, under SFAS 145, certain lease modifications that have economic effects similar to sale−leaseback transactions are to be accounted for in the same manner as sale−leaseback transactions. SFAS 145 was effective for fiscal years beginning after May 15, 2002. SFAS 145 was adopted by the Company on January 1, 2003 and resulted in a reclassification of existing extraordinary losses on the early extinguishment of debt from an extraordinary item to a non−operating item.

In July 2002, the FASB issued Statement of Financial Accounting Standards 146, Accounting for Costs Associated with Exit or Disposal Activities ("SFAS 146"). Under SFAS 146, costs associated with exit or disposal activities are to be recognized when they are incurred rather than at the date of a commitment to an exit or disposal plan. Such costs include lease termination costs and certain employee severance costs that are associated with a restructuring, discontinued operation, plant closing, or other exit or disposal activity. SFAS 146 is to be applied prospectively to exit or disposal activities initiated after December 31, 2002. SFAS 146 has not had a material effect on the Company's financial statements.

In December 2002, the FASB issued Statement of Financial Accounting Standards 148, Accounting for Stock−Based Compensation − Transition and Disclosure, an amendment of SFAS Statement 123 ("SFAS 148"). SFAS 148 amends SFAS 123, Accounting for Stock−Based Compensation, to provide alternative methods of transition for a voluntary change to the fair value based method of

New Accounting Standards (continued)

accounting for stock−based compensation. The Company continues to use the intrinsic−value−based method of accounting for stock−based employee compensation as prescribed by APB Opinion 25. In addition, SFAS 148 amends the disclosure requirements of SFAS 123 to require prominent disclosures in both annual and interim financial statements about the method of accounting for stock−based employee compensation and the effect of the method used on reported results. The Company adopted the disclosure provisions of SFAS 148 as of December 31, 2002. The adoption had no material impact on the Company's financial statements.

In November 2002, the FASB issued FASB Interpretation 45, Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others ("FIN 45"). FIN 45 requires that upon issuance of a guarantee, a guarantor must recognize a liability for the fair value of an obligation assumed under a guarantee. FIN 45 also requires additional disclosures by a guarantor in its interim and annual financial statements about the obligations associated with guarantees issued. The recognition provisions of FIN 45 are effective for any guarantees that are issued or modified after December 31, 2002. The disclosure requirements are effective for the Company's quarter ended March 31, 2003. The adoption of this statement had no material effect on the Company's financial statements.

NOTE C − SUPPLEMENTAL CASH FLOW FINANCIAL INFORMATION

The following are the supplemental disclosure requirements for the statements of cash flows:

(In thousands)	Three Months Ended March 31, 2003	Three Months Ended March 31, 2002
Cash paid (received) during the period for:		
Interest	$ 8,778	$ 11,286
Income taxes	$ (8,122)	$ 632
Non−cash financing and investing activities:		
Preferred stock dividends declared and accretion	$ 1,357	$ 1,266

NOTE D − ACQUISITIONS

The Company did not acquire any companies during the three months ended March 31, 2003 or 2002. In April 2003, the Company acquired one orthotic and prosthetic company.

In connection with the acquisition of NovaCare Orthotics & Prosthetics, Inc. ("NovaCare O&P") in July 1999, the Company assumed responsibility for payments of earnouts and working capital provisions related to acquisitions made by NovaCare O&P prior to July 1, 1999. In connection with these agreements and the Company's acquisitions prior to 2001, the Company paid $0.3

million and $1.2 million in the three month periods ended March 31, 2003 and 2002, respectively. The Company has accounted for these amounts as additional purchase price, resulting in an increase in excess cost over net assets acquired. The Company estimates that it may pay an additional $1.1 million related to earn-out provisions in future periods.

NOTE E - NET INCOME PER COMMON SHARE

Basic per common share amounts are computed using the weighted average number of common shares outstanding during the period. Diluted per common share amounts are computed using the weighted average number of common shares outstanding during the period and dilutive potential common shares. Dilutive potential common shares consist of stock options, stock warrants, and redeemable convertible preferred stock and are calculated using the treasury stock method.

Income per share is computed as follows:

	Three Months Ended March 31,	
(In thousands, except share amounts)	2003	2002
Net income	$ 5,478	$ 1,522
Less preferred stock dividends declared and accretion	(1,357)	(1,266)
Net income available to common stockholders used to compute basic and diluted per common share amounts	$ 4,121	$ 256
Shares of common stock outstanding used to compute basic per common share amounts	20,408,262	19,137,586
Effect of dilutive options	1,582,081	2,361,525
Effect of dilutive warrants	-	143,120
Shares used to compute dilutive per common share amounts (1)	21,990,343	21,642,231

(1) Excludes the effect of the conversion of the 7% Redeemable Convertible Preferred Stock into common stock as it is considered anti-dilutive.

Options to purchase 1,385,498 and 1,207,212 shares of common stock were outstanding at March 31, 2003 and 2002, respectively, and are not included in the computation of diluted income per share for the three months ended March 31, 2003 and 2002, as these options are anti-dilutive.

NOTE F − INVENTORY

Inventories consist of the following:

(In thousands)	March 31, 2003	December 31, 2002
Raw materials	$ 25,628	$ 26,905
Work in process	19,719	19,719
Finished goods	9,936	9,830
	$ 55,283	$ 56,454

NOTE G − LONG TERM DEBT

Long−term debt consists of the following:

(In thousands)	March 31, 2003	December 31, 2002
Revolving Credit Facility	$ 23,000	$ 15,000
10 3/8% Senior Notes due 2009 (1)	207,445	208,398
11 1/4% Senior Subordinated Notes due 2009	150,000	150,000
Subordinated seller notes, non−collateralized net of unamortized discount of $ 0.1 million with principal and interest payable in either monthly, quarterly or annual installments at effective interest rates ranging from 6% to 12.287%, maturing through January 2009	7,985	9,884
	388,430	383,282
Less current portion	(3,536)	(5,181)
Total long−term debt	$ 384,894	$ 378,101

(1) Includes $7.4 million and $8.4 million adjustments for March 31, 2003 and December 31, 2002, respectively, related to the interest rate swaps.

The previously existing Revolving Credit Facility, Tranche A Term Loan Commitment, and Tranche B Term Commitment outstanding as of December 31, 2001 were subsequently prepaid in full and the agreements were terminated on February 15, 2002.

As a result of retiring the previously existing indebtedness, the Company wrote off $4.7 million in unamortized debt issuance costs that had previously been included in Other Assets. These costs are included in Extinguishment of Debt for the three months ended March 31, 2002. As discussed in Note B, under "New Accounting Standards", this amount was previously reported as an extraordinary item, net of a tax benefit of $1.8 million. The gross amount has been reclassified to a non−operating item and the tax benefit has been reclassified into the provision for income taxes as a result of the Company's adoption of SFAS 145.

On February 15, 2002, the Company sold $200.0 million principal amount of its 10 3/8% Senior Notes due 2009 (the "Senior Notes") and established a new $75.0 million senior secured revolving line of credit (the "New Revolving Credit Facility"). The Senior Notes were issued under an indenture, dated as of February 15, 2002, with Wilmington Trust Company, as trustee. The Company used the $194.0 million net proceeds from the sale of the Senior Notes, along with approximately $36.9 million from the New Revolving Credit Facility, to retire approximately $228.4 million of indebtedness outstanding under the Company's previously existing revolving credit and term loan facilities, plus related fees and expenses.

As of March 31, 2003, the Company had available borrowings of $52.0 million under the New Revolving Credit Facility.

On April 30, 2003, the total available borrowings under the New Revolving Credit Facility were increased from $75.0 million to $100.0 million and the administrative agent was changed from BNP Paribas to GE Capital Corporation.

NOTE H - COMMITMENTS AND CONTINGENT LIABILITIES

Commitments

In October 2001, the Company entered into a Supply Agreement with United States Manufacturing Company ("USMC"), under which it agreed to purchase certain products and components for use solely by the Company's patient-care centers during a five-year period following the date of the agreement. The Company satisfied its obligation to purchase from USMC at least $7.5 million of products and components during the first year following the date of the agreement. Accordingly, on November 1, 2002, the escrow agent released $1.0 million in escrowed funds to the Company for the satisfaction of such first-year purchase obligations.

In addition, the Company is obligated to purchase from USMC at least $8.5 million and $9.5 million of products and components during the second and third years following the agreement, respectively, subject to certain adjustments. However, in the event purchases during each of the fourth and fifth years are less than approximately $8.7 million, the Company shall pay USMC an amount equal to $0.1 million multiplied by the number of $1.0 million units by which actual purchases during each of the fourth and fifth years are less than approximately $8.7 million.

Contingencies

The Company is subject to legal proceedings and claims which arise in the ordinary course of its business, including claims related to alleged contingent additional payments under business purchase agreements. In the opinion of management, the amount of ultimate liability, if any, with respect to these actions, will not have a materially adverse effect on the financial position, liquidity or results of operations of the Company.

Contingencies (Continued)

On November 28, 2000, a class action complaint (Norman Ottmann v. Hanger Orthopedic Group, Inc., Ivan R. Sabel and Richard A. Stein; Civil Action No. 00CV3508) was filed against the Company in the United States District Court for the District of Maryland on behalf of all purchasers of our common stock from November 8, 1999 through and including January 6, 2000. The complaint also names as defendants Ivan R. Sabel, the Company's Chairman of the Board and Chief Executive Officer (and then President), and Richard A. Stein, the Company's former Chief Financial Officer, Secretary and Treasurer (the "Class Action Lawsuit").

The complaint alleges that during the above period of time, the defendants violated Section 10(b) and 20(a) of the Securities Exchange Act of 1934 by, among other things, knowingly or recklessly making material misrepresentations concerning the Company's financial results for the quarter ended September 30, 1999, and the progress of the Company's efforts to integrate the recently−acquired operations of NovaCare O&P. The complaint further alleges that by making those material misrepresentations, the defendants artificially inflated the price of the Company's common stock. The plaintiff seeks to recover damages on behalf of all of the class members. The Class Action Lawsuit has been dismissed by the District Court for failure to comply with statutory requirements. On November 5, 2002, plaintiffs filed a notice of appeal to the United States Court of Appeals for the Fourth Circuit.

The Company believes that the allegations have no merit and is vigorously defending the Class Action Lawsuit. Additionally, the Company believes that it is remote that any claims would result from this action and therefore, no related liabilities have been recorded.

Guarantees and Indemnifications

In the ordinary course of its business, the Company may enter into service agreements with service providers in which it agrees to indemnify or limit the service provider against certain losses and liabilities arising from the service provider's performance of the agreement. In connection with the provisions of FASB Interpretation 45, Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others, the Company has reviewed its existing contracts containing indemnification or clauses of guarantees. The Company does not believe that its obligation under such agreements will result in any material liability.

NOTE I − SEGMENT AND RELATED INFORMATION

The Company has identified two reportable segments in which it operates based on the products and services it provides. The Company evaluates segment performance and allocates resources based on the segments' EBITDA. EBITDA is defined as net income (loss) before extraordinary item, interest, taxes, depreciation and amortization and unusual charges. EBITDA, as used by management to evaluate segment performance, is not a measure of performance under GAAP. Other EBITDA not directly attributable to reportable segments is primarily related to corporate general and administrative expenses.

The two reportable segments are: (i) patient−care centers and (ii) distribution. The reportable segments are described further below:

Patient−care centers − This segment consists of the Company's owned and operated O&P patient−care centers, fabrication centers of O&P components and OPNET. The patient−care centers provide services to design and fit orthotic and prosthetic devices to patients. These centers also instruct patients in the use, care and maintenance of the devices. Fabrication centers are involved in the fabrication of O&P components for both the O&P industry and the Company's own patient−care practices. OPNET is a national managed care agent for O&P services and a patient referral clearing house.

Distribution − This segment distributes O&P products and components to both the O&P industry and the Company's own patient−care practices.

The accounting principles of the segments are the same as those described in the summary of "Significant Accounting Principles."

Summarized financial information concerning the Company's reportable segments is shown in the following table. Intersegment sales mainly include sales of O&P components from the distribution segment to the patient−care centers segment and were made at prices which approximate market values.

NOTE I - SEGMENT AND RELATED INFORMATION (CONTINUED)

(In thousands)	Patient-Care Centers	Distribution	Other and Eliminations	Total
Three Months Ended March 31, 2003				
Net sales				
Customers	$ 118,110	$ 8,018	$ -	$ 126,128
Intersegment	-	13,941	(13,941)	-
EBITDA	23,236	2,563	(5,127)	20,672
Three Months Ended March 31, 2002				
Net sales				
Customers	$ 116,947	$ 6,563	$ -	$ 123,510
Intersegment	-	12,399	(12,399)	-
EBITDA	22,603	1,146	(4,553)	19,196

"Other" EBITDA presented in the preceding table consists of corporate general and administrative expenses.

The following table reconciles EBITDA to consolidated net income:

	Three Months Ended March 31,	
(In thousands)	2003	2002
EBITDA	$ 20,672	$ 19,196
Depreciation and amortization	2,453	2,784
Interest expense, net	9,096	9,079
Extinguishment of debt	-	4,686
Provision for income taxes	3,645	1,125
Net income	$ 5,478	$ 1,522

NOTE J - CONSOLIDATING FINANCIAL INFORMATION

The Company's Senior Notes and Senior Subordinated Notes are guaranteed fully, jointly and severally, and unconditionally by all of the Company's current and future domestic subsidiaries. The following is summarized condensed consolidating financial information, as of March 31, 2003 and December 31, 2002, and for the three month periods ended March 31, 2003 and 2002 of the Company, segregating the parent company (Hanger Orthopedic Group, Inc.) and its guarantor subsidiaries, as each of the Company's subsidiaries is wholly-owned.

BALANCE SHEET - March 31, 2003 (In thousands)	Hanger Orthopedic Group (Parent Company)	Guarantor Subsidiaries	Consolidating Adjustments	Consolidated Totals
ASSETS				
Cash and cash equivalents	$ 7,722	$ 5,957	$ -	$ 13,679
Accounts receivable	-	105,505	-	105,505
Inventories	-	55,283	-	55,283
Prepaid expenses, other assets, and income taxes receivable	841	5,395	-	6,236
Intercompany receivable	506,921	-	(506,921)	-
Deferred income taxes	6,586	-	-	6,586
Total current assets	522,070	172,140	(506,921)	187,289
Property, plant and equipment, net	4,666	31,914	-	36,580
Intangible assets, net	-	459,893	-	459,893
Investment in subsidiaries	121,820	-	(121,820)	-
Other assets	20,836	1,764	-	22,600
Total assets	$ 669,392	$ 665,711	$ (628,741)	$ 706,362
LIABILITIES, REDEEMABLE PREFERRED STOCK, AND SHAREHOLDERS' EQUITY				
Current portion of long-term debt	$ -	$ 3,536	$ -	$ 3,536
Accounts payable	623	10,936	-	11,559
Accrued expenses and income taxes payable	7,611	(1,891)	-	5,720
Accrued interest payable	7,055	198	-	7,253
Accrued compensation related cost	1,202	18,437	-	19,639
Total current liabilities	16,491	31,216	-	47,707
Long-term debt, less current portion	380,445	4,449	-	384,894
Deferred income taxes	22,965	-	-	22,965
Intercompany Payable	-	506,921	(506,921)	-
Other liabilities	26	1,305	-	1,331
Total long-term liabilities	403,436	512,675	(506,921)	409,190
Total liabilities	419,927	543,891	(506,921)	456,897
Redeemable preferred stock	77,298	-	-	77,298
Common stock	205	35	(35)	205
Additional paid-in capital	150,664	7,462	(7,462)	150,664
Retained earnings	21,954	114,863	(114,863)	21,954
Treasury stock	(656)	(540)	540	(656)
Total shareholders' equity	172,167	121,820	(121,820)	172,167
Total liabilities, redeemable preferred stock, and shareholders' equity	$ 669,392	$ 665,711	$ (628,741)	$ 706,362

BALANCE SHEET - December 31, 2002 (In thousands)	Hanger Orthopedic Group (Parent Company)	Guarantor Subsidiaries	Consolidating Adjustments	Consolidated Totals
ASSETS				
Cash and cash equivalents	$ 570	$ 5,996	$ -	$ 6,566
Accounts receivable	-	107,604	-	107,604
Inventories	-	56,454	-	56,454
Prepaid expenses, other assets, and income taxes receivable	8,865	6,567	-	15,432
Intercompany receivable	513,802	-	(513,802)	-
Deferred income taxes	6,586	-	-	6,586
Total current assets	529,823	176,621	(513,802)	192,642
Property, plant and equipment, net	4,633	30,913	-	35,546
Intangible assets, net	-	459,816	-	459,816
Investment in subsidiaries	98,258	-	(98,258)	-
Other assets	22,465	1,757	-	24,222
Total assets	$ 655,179	$ 669,107	$ (612,060)	$ 712,226
LIABILITIES, REDEEMABLE PREFERRED STOCK, AND SHAREHOLDERS' EQUITY				
Current portion of long-term debt	$ -	$ 5,181	$ -	$ 5,181
Accounts payable	334	14,542	-	14,876
Accrued expenses	4,446	1,014	-	5,460
Accrued interest payable	7,340	167	-	7,507
Accrued compensation related cost	3,062	29,888	-	32,950
Total current liabilities	15,182	50,792	-	65,974
Long-term debt, less current portion	373,398	4,703	-	378,101
Deferred income taxes	22,965	-	-	22,965
Intercompany payable	-	513,802	(513,802)	-
Other liabilities	26	1,552	-	1,578
Total long-term liabilities	396,389	520,057	(513,802)	402,644
Total liabilities	411,571	570,849	(513,802)	468,618
Redeemable preferred stock	75,941	-	-	75,941
Common stock	203	35	(35)	203
Additional paid-in capital	150,287	7,460	(7,460)	150,287
Retained earnings (accumulated deficit)	17,833	91,303	(91,303)	17,833
Treasury stock	(656)	(540)	540	(656)
Total shareholders' equity	167,667	98,258	(98,258)	167,667
Total liabilities, redeemable preferred stock, and shareholders' equity	$ 655,179	$ 669,107	$ (612,060)	$ 712,226

NOTE J - CONSOLIDATING FINANCIAL INFORMATION (CONTINUED)

STATEMENT OF OPERATIONS Three Months Ended March 31, 2003 (In thousands)	Hanger Orthopedic Group (Parent Company)	Guarantor Subsidiaries	Consolidating Adjustments	Consolidated Totals
Net sales	$ -	$ 126,128	$ -	$ 126,128
Cost of goods sold (exclusive of depreciation and amortization)	-	60,690	-	60,690
Gross profit	-	65,438	-	65,438
Selling, general and administrative	5,127	39,639	-	44,766
Depreciation and amortization	357	2,096	-	2,453
Income from operations	(5,484)	23,703	-	18,219
Interest expense, net	8,953	143	-	9,096
Equity in earnings of subsidiaries	23,560	-	(23,560)	-
Income before taxes	9,123	23,560	(23,560)	9,123
Provision for income taxes	3,645	-	-	3,645
Net income	$ 5,478	$ 23,560	$ (23,560)	$ 5,478

STATEMENT OF CASH FLOWS
Three Months Ended March 31, 2003
(In thousands)

Cash flows provided by (used in) operating activities	$ 22,723	$ 5,034	$ (23,560)	$ 4,197
Cash flows used in investing activities				
Purchase of property, plant and equipment	(390)	(2,913)	−	(3,303)
Acquisitions and earnouts	−	(301)	−	(301)
Investment in subsidiaries	(23,560)	−	23,560	−
Proceeds from sale of certain assets	−	41	−	41
Net cash provided by (used in) investing activities	(23,950)	(3,173)	23,560	(3,563)
Cash flows provided by (used in) financing activities				
Borrowings under revolving credit agreement	16,000	−	−	16,000
Repayments under revolving credit agreement	(8,000)	−	−	(8,000)
Scheduled repayment of long−term debt	−	(1,900)	−	(1,900)
Proceeds from issuance of common stock	379	−	−	379
Net cash provided by (used in) financing activities	8,379	(1,900)	−	6,479
Net increase (decrease) in cash and cash equivalents	7,152	(39)	−	7,113
Cash and cash equivalents, beginning of period	570	5,996	−	6,566
Cash and cash equivalents, end of period	$ 7,722	$ 5,957	$ −	$ 13,679

NOTE J - CONSOLIDATING FINANCIAL INFORMATION (CONTINUED)

STATEMENT OF OPERATIONS Three Months Ended March 31, 2002 (In thousands)	Hanger Orthopedic Group (Parent Company)	Guarantor Subsidiaries	Consolidating Adjustments	Consolidated Totals
Net sales	$ -	$ 123,510	$ -	$ 123,510
Cost of goods sold (exclusive of depreciation and amortization)	-	59,537	-	59,537
Gross profit	-	63,973	-	63,973
Selling, general and administrative	4,553	40,224	-	44,777
Depreciation and amortization	335	2,449	-	2,784
Income from operations	(4,888)	21,300	-	16,412
Interest expense (income), net	(3,396)	12,475	-	9,079
Extinguishment of debt	4,686	-	-	4,686
Equity in earnings of subsidiaries	8,825	-	(8,825)	-
Income before taxes	2,647	8,825	(8,825)	2,647
Provision for income taxes	1,125	-	-	1,125
Net income	$ 1,522	$ 8,825	$ (8,825)	$ 1,522

STATEMENT OF CASH FLOWS
Three Months Ended March 31, 2002
(In thousands)

Cash flows provided by (used in) operating activities	$ 3,631	$ 2,183	$ (8,825)	$ (3,011)
Cash flows used in investing activities				
Purchase of property, plant and equipment	(116)	(1,510)	-	(1,626)
Acquisitions and earnouts	-	(1,226)	-	(1,226)
Investment in subsidiaries	(8,825)	-	8,825	-
Proceeds from sale of certain assets	-	1,492	-	1,492
Net cash provided by (used in) investing activities	(8,941)	(1,244)	8,825	(1,360)
Cash flows provided by (used in) financing activities				
Repayments under revolving credit agreement	(34,300)	-	-	(34,300)
Proceeds from sale of senior notes	200,000	-	-	200,000
Repayment and termination of bank loans	(153,587)	-	-	(153,587)
Scheduled repayment of long-term debt	-	(3,132)	-	(3,132)
Increase in financing costs	(8,480)	-	-	(8,480)
Proceeds from issuance of common stock	729	-	-	729
Net cash provided by (used in) financing activities	4,362	(3,132)	-	1,230
Net increase (decrease) in cash and cash equivalents	(948)	(2,193)	-	(3,141)
Cash and cash equivalents, beginning of period	(212)	10,255	-	10,043
Cash and cash equivalents, end of period	$(1,160)	$ 8,062	$ -	$ 6,902

ITEM 2: Management's Discussion and Analysis of Financial Condition and Results of Operations

Results of Operations

The following table sets forth for the periods indicated certain items of the Company's Statements of Operations and their percentage of the Company's net sales:

	Three Months Ended March 31, 2003	Three Months Ended March 31, 2002
Net sales	100.0 %	100.0 %
Cost of goods sold	48.1	48.2
Gross profit	51.9	51.8
Selling, general and administrative	35.6	36.2
Depreciation and amortization	1.9	2.3
Income from operations	14.4	13.3
Interest expense, net	7.2	7.4
Extinguishment of debt	-	3.8
Income before taxes	7.2	2.1
Provision for income taxes	2.9	0.9
Net income	4.3	1.2

Three Months Ended March 31, 2003 Compared to the Three Months Ended March 31, 2002

Net Sales. Net sales for the quarter ended March 31, 2003 were $126.1 million, an increase of $2.6 million, or 2.1%, versus net sales of $123.5 million for the quarter ended March 31, 2002. The sales growth was primarily the result of a 1.0% increase in sales in the Company's O&P patient-care practices and a 22.2% increase in outside sales of the distribution segment.

Gross Profit. Gross profit for the quarter ended March 31, 2003 was $65.4 million, an increase of approximately $1.4 million, or 2.3%, versus $64.0 million for the quarter ended March 31, 2002. Gross profit as a percentage of net sales for the first quarter of 2003 increased slightly to 51.9% from 51.8% for the first quarter of 2002. The improvement in gross profit, in both dollars and as a percentage of net sales, was due to a reduction in material costs.

Selling, General and Administrative. Selling, general and administrative expenses in the quarter ended March 31, 2003 remained relatively constant compared to the same quarter in 2002. However, due to the increased net sales, these expenses as a percentage of net sales dropped by 0.6 percentage points.

Depreciation and Amortization. Depreciation and amortization for the three months ended March 31, 2003 was $2.5 million versus $2.8 million for the three months ended March 31, 2002.

Income from Operations. Principally as a result of the above, income from operations for the quarter ended March 31, 2003 was $18.2 million, an increase of $1.8 million, or 11.0%, compared to the quarter ended March 31, 2002. Income from operations, as a percentage of net sales, increased by 1.1 percentage points to 14.4% of net sales in the first quarter of 2003 versus 13.3% for the prior year's comparable period.

Interest Expense, Net. Interest expense in the first quarter of 2003 remained constant compared to the same quarter in 2002.

Extinguishment of Debt. There were no charges for the extinguishment of debt in the three months ended March 31, 2003. Extinguishment of debt was $4.7 million in the three months ended March 31, 2002. In 2002, the extinguishment of debt was reported as an extraordinary item, net of a tax benefit of $1.8 million. The gross amount of this charge has been reclassified to a non-operating item as a result of our adoption of Statement of Financial Accounting Standards 145, Rescission of FASB Statements 4, 44, and 64, Amendment of FASB Statement 13, and Technical Corrections which is explained further under "New Accounting Pronouncements" below.

Income Taxes. The provision for income taxes for the three months ended March 31, 2003 was $3.6 million compared to $1.1 million for the three months March 31, 2002. The change in the income tax provision was due to the Company's increased profitability and increased income before taxes because there was no benefit related to the extinguishment of debt in the three months ended March 31, 2003.

Net Income. As a result of the above, we recorded net income of $5.5 million for the three months ended March 31, 2003, an improvement of $4.0 million over the three months ended March 31, 2002.

Financial Condition, Liquidity, and Capital Resources

Our working capital at March 31, 2003 was $139.6 million compared to $126.7 million at December 31, 2002. While current assets decreased by $5.4 million, current liabilities decreased by a larger amount, $18.3 million. The decline in current liabilities was due principally to decreased obligations related to accrued compensation costs. Our cash and cash equivalents amounted to $13.7 million at March 31, 2003, and $6.6 million at December 31, 2002. The ratio of current assets to current liabilities increased to 3.9 to 1 at March 31, 2003, compared to 2.9 to 1 at December 31, 2002. Available cash under our Revolving Credit Facility decreased to $52.0 million at March 31, 2003 compared to $60.0 million at December 31, 2002 as the Company drew an additional $8 million, net of expenses, to help fund the year−end practitioner bonus payout in March 2003.

Net cash provided by operating activities for the three months ended March 31, 2003 was $4.2 million, compared to net cash used in operating activities of $3.0 million in the three months ended March 31, 2002. The increase was primarily due to the receipt of an $8.4 million income tax receivable which was outstanding at December 31, 2002.

Net cash used in investing activities was $3.6 million for the three months ended March 31, 2003, versus $1.4 million for the same period in the prior year. The increase in net cash used was primarily due to capitalization of internal use software and continuing leasehold improvements.

Net cash provided by financing activities was $6.5 million for the three months ended March 31, 2003 compared to $1.2 million for the three months ended March 31, 2003. The increase in cash provided by financing activities was primarily due to the net increase in borrowings under the Revolving Credit Facility of $8.0 million.

On February 15, 2002, we received $200.0 million in proceeds from the sale of 10 3/8% Senior Notes due 2009 ("Senior Notes") in a private placement exempt from registration under the Securities Act of 1933, as amended. The Senior Notes were issued under an indenture, dated as of February 15, 2002, with Wilmington Trust Company, as trustee. We also closed, concurrent with the sale of Senior Notes, a new $75.0 million senior secured revolving line of credit ("New Revolving Credit Facility"). The proceeds from the sale of Senior Notes and the New Revolving Credit Facility were offset by (i) principal payments of $153.6 million to retire our Tranche A & B Term Facilities, (ii) a net paydown of $38.3 million of our prior revolving line of credit, and (iii) payment of $8.1 million in financing costs related to the issuance of the Senior Notes and the establishment of the New Revolving Credit Facility.

On April 30, 2003, the total available borrowings under the New Revolving Credit Facility were increased from $75.0 million to $100.0 million and the administrative agent was changed from BNP Paribas to GE Capital Corporation.

We believe that, based on current levels of operations and anticipated growth, cash generated from operations, together with other available sources of liquidity, including borrowings available under the New Revolving Credit Facility, will be sufficient for the foreseeable future to fund anticipated capital expenditures and make required payments of principal and interest on our debt, including payments due on the Senior Notes and obligations under the New Revolving Credit Facility. In addition, we continually evaluate potential acquisitions and expect to fund such acquisitions from our available sources of liquidity, as discussed above.

Market Risk

We are exposed to the market risk that is associated with changes in interest rates. To manage that risk, in March 2002, we entered into interest rate swaps to modify our exposure to interest rate movements and reduce borrowing costs. We entered into $100.0 million fixed-to-floating interest rate swaps, consisting of floating rate instruments benchmarked to LIBOR. We are exposed to potential losses in the event of nonperformance by the counterparties to the swap agreements.

New Accounting Pronouncements

In April 2002, the FASB issued Statement of Financial Accounting Standards 145, Rescission of FASB Statements 4, 44, and 64, Amendment of FASB Statement 13, and Technical Corrections ("SFAS 145"). Under SFAS 145, gains and losses from the early extinguishment of debt are no longer classified as extraordinary items, unless they satisfy the criteria in Accounting Principles Board Opinion 30 ("APB 30") where extraordinary items are stated to be distinguishable by their unusual nature and by the infrequency of their occurrence. Any gain or loss on extinguishment of debt that was classified as an extraordinary item in prior periods presented that does not meet the criteria in APB 30 for classification as an extraordinary item has been reclassified. In addition, under SFAS 145, certain lease modifications that have economic effects similar to sale−leaseback transactions are to be accounted for in the same manner as sale−leaseback transactions. SFAS 145 was effective for fiscal years beginning after May 15, 2002. SFAS 145 was adopted by us on January 1, 2003 and resulted in a reclassification of existing extraordinary losses on the early extinguishment of debt from an extraordinary item to a non−operating item.

In July 2002, the FASB issued Statement of Financial Accounting Standards 146, Accounting for Costs Associated with Exit or Disposal Activities ("SFAS 146"). Under SFAS 146, costs associated with exit or disposal activities are to be recognized when they are incurred rather than at the date of a commitment to an exit or disposal plan. Such costs include lease termination costs and certain employee severance costs that are associated with a restructuring, discontinued operation, plant closing, or other exit or disposal activity. SFAS 146 is to be applied prospectively to exit or disposal activities initiated after December 31, 2002. SFAS 146 has not had a material effect on our financial statements.

In December 2002, the FASB issued Statement of Financial Accounting Standards 148, Accounting for Stock−Based Compensation − Transition and Disclosure, an amendment of SFAS Statement 123 ("SFAS 148"). SFAS 148 amends SFAS 123, Accounting for Stock−Based Compensation, to provide alternative methods of transition for a voluntary change to the fair value based method of accounting for stock−based compensation. We continue to use the intrinsic−value−based method of accounting for stock−based employee compensation as prescribed by APB Opinion 25. In addition, SFAS 148 amends the disclosure requirements of SFAS 123 to require prominent disclosures in both annual and interim financial statements about the method of accounting for stock−based employee compensation and the effect of the method used on reported results. We adopted the disclosure provisions of SFAS 148 as of December 31, 2002. The adoption had no material impact on our financial statements.

In November 2002, the FASB issued FASB Interpretation 45, Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others ("FIN 45"). FIN 45 requires that, upon issuance of a guarantee, a guarantor must recognize a liability for the fair value of an obligation assumed under a guarantee. FIN 45 also requires additional disclosures by a guarantor in its interim and annual financial statements about the obligations associated with guarantees issued. The recognition provisions of FIN 45 are effective for any guarantees that are issued or modified after December 31, 2002. The disclosure requirements are effective for our quarter ended March 31, 2003. The adoption had no material impact on our financial statements.

Critical Accounting Estimates

Our analysis and discussion of our financial condition and results of operations are based upon our Consolidated Financial Statements that have been prepared in accordance with generally accepted accounting principles in the United States ("U.S. GAAP"). The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. U.S. GAAP provides the framework from which to make these estimates, assumptions and disclosures. We have chosen accounting policies within U.S. GAAP that management believes are appropriate to accurately and fairly report our operating results and financial position in a consistent manner. Management regularly assesses these policies in light of current and forecasted economic conditions. Our accounting principles are stated in Note B to the Consolidated Financial Statements as presented elsewhere in this Form 10-Q and in our Annual Report on Form 10-K for the year ended December 31, 2002. We believe the following accounting policies are critical to understanding the results of operations and affect the more significant judgments and estimates used in the preparation of the consolidated financial statements.

- Revenue Recognition: Revenues on the sale of orthotic and prosthetic devices and associated services to patients are recorded when the device is accepted by the patient. Revenues on the sale of orthotic and prosthetic devices to customers by our distribution segment are recorded upon the shipment of products, in accordance with the terms of the invoice. Revenue is recorded at its net realizable value taking into consideration all governmental and contractual adjustments and discounts. Deferred revenue represents both deposits made prior to the final fitting and acceptance by the patient and unearned service contract revenue. Subsequent to billing for our devices and services, disallowed sales may result if there are problems with pre-authorization or with other insurance coverage issues with third party payers. If these problems occur, they are recognized as reductions in sales. Other revenue may be uncollectible, even if properly pre-authorized and billed. In the cases when valid revenue cannot be collected, a bad debt expense is recognized. In addition to the actual bad debt expense encountered during collection activities, we estimate the amount of potential bad debt expense that may occur in the future as we collect our receivables. This estimate is based upon our historical experience as well as a detailed review of our receivable balances.

- Inventories: Inventories, which consist principally of purchased parts and work in process, are stated at the lower of cost or market using the first-in, first-out (FIFO) method. We calculate cost of goods sold in accordance with the gross profit method. We base the estimates used in applying the gross profit method on the actual results of the most recently completed fiscal year and other factors affecting cost of goods sold during the current reporting periods. Estimated cost of goods sold during the period is adjusted when the annual physical inventory is taken. In 2001, a favorable adjustment was made in the fourth quarter as a result of completing the physical inventory. In 2002, virtually no adjustment was required in the fourth quarter as we were more accurately estimating our cost of goods sold throughout the year. Management adjusts our reserve for inventory obsolescence whenever the facts and circumstances indicate that the carrying cost of certain inventory items is in excess of its market price.

- Intangible Assets: Excess cost over net assets acquired ("Goodwill") represents the excess of purchase price over the value assigned to net identifiable assets of purchased businesses. We assess Goodwill for impairment when events or circumstances indicate that the carrying value may not be recoverable, or, at a minimum, annually as required by SFAS 142. Any impairment would be recognized by a charge to operating results and a reduction in the carrying value of the intangible asset. We completed the annual impairment test as of October 1, 2002, which did not result in the impairment of Goodwill. This assessment included assumptions regarding estimated future cash flows, discount rates and other factors.

  Non-compete agreements are recorded based on the terms of the agreements we have entered into and are amortized over their terms ranging from 5 to 7 years using the straight-line method. Other definite-lived intangible assets are recorded at cost and are amortized over their estimated useful lives of up to 16 years using the straight-line method. Whenever the facts and circumstances indicate that the carrying amounts of these intangibles may not be recoverable, management reviews and assesses the future cash flows expected to be generated from the related intangible for possible impairment. Any impairment would be recognized as a charge to operating results and a reduction in the carrying value of the intangible asset.

- Deferred Tax Assets (Liabilities): We account for certain income and expense items differently for financial accounting purposes than for income tax purposes. Deferred income taxes are provided in recognition of these temporary differences. We recognize deferred tax assets, in accordance with SFAS 109, if it is more likely than not the assets will be realized in future years.

Class Action

On November 28, 2000, a class action complaint (Norman Ottmann v. Hanger Orthopedic Group, Inc., Ivan R. Sabel and Richard A. Stein; Civil Action No. 00CV3508) was filed against the Company in the United States District Court for the District of Maryland on behalf of all purchasers of our common stock from November 8, 1999 through and including January 6, 2000. The complaint also names as defendants Ivan R. Sabel, the Company's Chairman of the Board and Chief Executive Officer (and then President), and Richard A. Stein, the Company's former Chief Financial Officer, Secretary and Treasurer (the "Class Action Lawsuit").

The complaint alleges that during the above period of time, the defendants violated Section 10(b) and 20(a) of the Securities Exchange Act of 1934 by, among other things, knowingly or recklessly making material misrepresentations concerning the Company's financial results for the quarter ended September 30, 1999, and the progress of the Company's efforts to integrate the recently-acquired operations of NovaCare O&P. The complaint further alleges that by making those material misrepresentations, the defendants artificially inflated the price of the Company's common stock. The plaintiff seeks to recover damages on behalf of all of the class members.

The Class Action Lawsuit has been dismissed by the District Court for failure to comply with statutory requirements. On November 5, 2002, plaintiffs filed a notice of appeal to the United States Court of Appeals for the Fourth Circuit.

The Company believes that the allegations have no merit and is vigorously defending the Class Action Lawsuit. Additionally, the Company believes that it is remote that any claims would result from this action and therefore, no related liabilities have been recorded.

Other

Inflation has not had a significant effect on our operations, as increased costs generally have been offset by increased prices of products and services sold. We primarily provide customized devices and services throughout the United States and are reimbursed, in large part, by the patients' third-party insurers or governmentally-funded health insurance programs. The ability of our debtors to meet their obligations is principally dependent upon the financial stability of the insurers of our patients and future legislation and regulatory actions.

Forward Looking Statements

This report contains forward-looking statements setting forth our beliefs or expectations relating to future revenues and operations. Actual results may differ materially from projected or expected results due to changes in the demand for our O&P products and services, uncertainties relating to the results of operations or recently or newly acquired O&P patient-care practices, our ability to successfully attract and retain qualified O&P practitioners, federal laws governing the health-care industry, governmental policies affecting O&P operations and other risks and uncertainties generally affecting the health-care industry. Readers are cautioned not to put undue reliance on forward-looking statements. We disclaim any intent or obligation to publicly update these forward-looking statements, whether as a result of new information, future events or otherwise.

ITEM 3: Quantitative and Qualitative Disclosures about Market Risk

We have existing obligations relating to our Senior Notes, Senior Subordinated Notes, subordinated seller notes, and outstanding 7% Redeemable Convertible Preferred Stock. We do not have cash flow exposure to changing interest rates on these obligations because the interest and dividend rates of these securities are fixed. However, as discussed below, we entered into two fixed-to-floating interest rate swaps, in connection with the sale of our Senior Notes, whereby the aggregate notional amount of the swaps equaled one-half of the principal amount of the Senior Notes.

We have a $75 million Revolving Credit Facility, with an outstanding balance of $23.0 million at March 31, 2003, as discussed in Note G to Hanger's Consolidated Financial Statements ("Note G"). The rates at which interest accrues under the entire outstanding balance are variable.

In addition, in the normal course of business, we are exposed to fluctuations in interest rates. We address this risk by using interest rate swaps from time to time. In March 2002, we entered into two fixed-to-floating interest rate swaps with an aggregate notional amount of $100 million in connection with the sale of our Senior Notes, as discussed in Note G. Variable rate debt and fixed-to-floating interest rate swaps subject us to cash flow exposure resulting from changing interest rates, as illustrated in the table below.

Presented below is an analysis as of March 31, 2003 of our financial instruments that are sensitive to changes in interest rates. The table demonstrates the change in cash flow related to the Senior Notes, as affected by the related fixed-to-floating interest rate swaps, and the outstanding balance under the Revolving Credit Facility, calculated for an instantaneous parallel shift in interest rates, plus or minus 50 basis points ("BPS"), 100 BPS, and 150 BPS.

Cash Flow Risk	Annual Interest Expense Given an Interest Rate Decrease of X Basis Points			No Change in Interest Rates	Annual Interest Expense Given an Interest Rate Increase of X Basis Points		
(In thousands)	(150 BPS)	(100 BPS)	(50 BPS)	Fair Value	50 BPS	100 BPS	150 BPS
Senior Notes (as affected by related interest-rate swaps)	$ 15,093	$ 15,593	$ 16,093	$ 16,593	$ 17,093	$ 17,593	$ 18,093
Revolving Credit Facility	637	752	867	982	1,097	1,212	1,327
	$ 15,730	$ 16,345	$ 16,960	$ 17,575	$ 18,190	$ 18,805	$ 19,420

ITEM 4: Controls and Procedures

Based upon an evaluation within the 90 days prior to the filing date of this report, our Chief Executive Officer and Chief Financial Officer have concluded that our disclosure controls and procedures are effective. There have been no significant changes in our internal controls or in other factors that could significantly affect our internal controls subsequent to the date of the evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

ITEM 6: Exhibits and Reports on Form 8-K

Exhibits and Reports on Form 8-K

(a) Exhibits. The following exhibits are filed herewith:

Exhibit No. Document

99.1 Written Statement of the Chief Executive Officer Pursuant to 18 U.S.C.ss.1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

99.2 Written Statement of the Chief Financial Officer Pursuant to 18 U.S.C.ss.1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

(b) Forms 8-K. No Current Report on Form 8-K was filed during the quarter ended March 31, 2003.

SIGNATURES

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

HANGER ORTHOPEDIC GROUP, INC.

Dated: May 13, 2003

/s/ Ivan R. Sabel

Ivan R. Sabel, CPO
Chairman and Chief Executive Officer
(Principal Executive Officer)

Dated: May 13, 2003

/s/ George E. McHenry

George E. McHenry
Chief Financial Officer
(Principal Financial Officer)

Dated: May 13, 2003

/s/ Glenn M. Lohrmann

Glenn M. Lohrmann
Controller
(Chief Accounting Officer)

CERTIFICATIONS

I, Ivan R. Sabel, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Hanger Orthopedic Group, Inc.;

2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;

3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and have:
   a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;
   b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and
   c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):
   a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and
   b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and

6. The registrant's other certifying officers and I have indicated in this quarterly report whether there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: May 13, 2003

/s/ Ivan R. Sabel

Ivan R. Sabel, CPO
Chairman and Chief Executive Officer

I, George E. McHenry, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Hanger Orthopedic Group, Inc.;

2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;

3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and have:
   a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;
   b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and
   c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):
   a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and
   b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and

6. The registrant's other certifying officers and I have indicated in this quarterly report whether there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: May 13, 2003

/s/ George E. McHenry

George E. McHenry
Chief Financial Officer

Exhibit 99.1

Written Statement of the Chief Executive Officer
Pursuant to 18 U.S.C. ss.1350,
As Adopted Pursuant to Section 906 of
The Sarbanes-Oxley Act of 2002

Solely for the purposes of complying with 18 U.S.C. ss.1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, I, the undersigned Chairman and Chief Executive Officer of Hanger Orthopedic Group, Inc. (the "Company"), hereby certify, based on my knowledge, that the Quarterly Report on Form 10-Q of the Company for the quarter ended March 31, 2003 (the "Report") fully complies with the requirements of Section 13(a) of the Securities Exchange Act of 1934 and that information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ Ivan R. Sabel

Ivan R. Sabel
May 13, 2003

Exhibit 99.2

Written Statement of the Chief Financial Officer
Pursuant to 18 U.S.C. ss.1350,
As Adopted Pursuant to Section 906 of
The Sarbanes-Oxley Act of 2002

Solely for the purposes of complying with 18 U.S.C. ss.1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, I, the undersigned Chief Financial Officer of Hanger Orthopedic Group, Inc. (the "Company"), hereby certify, based on my knowledge, that the Quarterly Report on Form 10-Q of the Company for the quarter ended March 31, 2003 (the "Report") fully complies with the requirements of Section 13(a) of the Securities Exchange Act of 1934 and that information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ George E. McHenry

George E. McHenry
May 13, 2003