FORM 10−Q

HANGER ORTHOPEDIC GROUP INC − HGR

Filed: August 12, 2003 (period: June 30, 2003)

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

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Part II.

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 June 30, 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 August 11, 2003, 20,715,874 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)

	June 30, 2003 (unaudited)	December 31, 2002 (unaudited)
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	$ 4,520	$ 6,566
Accounts receivable, less allowances for doubtful accounts of $8,456 and $8,649 in 2003 and 2002, respectively	111,060	107,604
Inventories	58,256	56,454
Prepaid expenses, other assets and income taxes receivable	6,247	15,432
Deferred income taxes	6,767	6,586
Total current assets	186,850	192,642
PROPERTY, PLANT AND EQUIPMENT		
Land	3,668	3,743
Buildings	6,526	6,715
Machinery and equipment	17,958	17,110
Computer and software	20,856	17,990
Furniture and fixtures	12,014	10,353
Leasehold improvements	21,426	18,671
Property, plant and equipment, gross	82,448	74,582
Less accumulated depreciation and amortization	43,575	39,036
Property, plant and equipment, net	38,873	35,546
INTANGIBLE ASSETS		
Excess cost over net assets acquired	459,533	453,988
Patents and other intangible assets, $10,232 and $10,232 less accumulated amortization of $4,849 and $4,404 in 2003 and 2002, respectively	5,383	5,828
Total intangible assets	464,916	459,816
OTHER ASSETS		
Debt issuance costs, net	13,540	13,741
Other assets	12,626	10,481
Total other assets	26,166	24,222
TOTAL ASSETS	$716,805	$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)

	June 30, 2003	December 31, 2002
	(unaudited)	(unaudited)
LIABILITIES, REDEEMABLE PREFERRED STOCK AND SHAREHOLDERS' EQUITY		
CURRENT LIABILITIES		
Current portion of long-term debt	$ 2,715	$ 5,181
Accounts payable	12,605	14,876
Accrued expenses	4,793	5,460
Accrued interest payable	7,226	7,507
Accrued compensation related cost	21,555	32,950
Income taxes payable	3,642	--
Total current liabilities	52,536	65,974
LONG-TERM LIABILITIES		
Long-term debt, less current portion	376,894	378,101
Deferred income taxes	26,698	22,965
Other liabilities	1,599	1,578
Total long-term liabilities	405,191	402,644
Total liabilities	457,727	468,618
REDEEMABLE PREFERRED STOCK		
7% Redeemable Convertible Preferred Stock, liquidation preference $1,000 per share	78,679	75,941
SHAREHOLDERS' EQUITY		
Common stock, $.01 par value; 60,000,000 shares authorized, 20,652,910 shares and 20,277,180 shares issued and outstanding in 2003 and 2002, respectively	207	203
Additional paid-in capital	151,037	150,287
Unearned compensation	(115)	--
Retained earnings	29,926	17,833
	181,055	168,323
Treasury stock, cost (133,495 shares)	(656)	(656)
Total shareholders' equity	180,399	167,667
TOTAL LIABILITIES, REDEEMABLE PREFERRED STOCK AND SHAREHOLDERS' EQUITY	$ 716,805	$ 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 and Six Months Ended June 30,
(Dollars in thousands, except share and per share amounts)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2003	2002	2003	2002
	(unaudited)		(unaudited)	
Net sales	$ 138,936	$ 133,056	$ 265,064	$ 256,566
Cost of goods sold (exclusive of depreciation and amortization)	65,416	63,189	126,106	122,726
Gross profit	73,520	69,867	138,958	133,840
Selling, general and administrative	45,712	44,691	90,478	89,468
Depreciation and amortization	2,620	2,294	5,073	5,078
Income from operations	25,188	22,882	43,407	39,294
Interest expense, net	9,354	9,977	18,450	19,056
Extinguishment of debt	--	--	--	4,686
Income before taxes	15,834	12,905	24,957	15,552
Provision for income taxes	6,481	5,234	10,126	6,359
Net income	9,353	7,671	14,831	9,193
Preferred stock dividend and accretion	1,381	1,291	2,738	2,557
Net income applicable to common stock	$ 7,972	$ 6,380	$ 12,093	$ 6,636
Basic Per Common Share Data				
Net income	$ 0.39	$ 0.33	$ 0.59	$ 0.35
Shares used to compute basic per common share amounts	20,572,473	19,336,954	20,582,064	19,221,865
Diluted Per Common Share Data				
Net income	$ 0.35	$ 0.29	$ 0.55	$ 0.31
Shares used to compute diluted per common share amounts	26,844,609	22,013,471	26,804,325	21,669,180

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

HANGER ORTHOPEDIC GROUP, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
For the Six Months Ended June 30,
(Dollars in thousands)

	2003	2002
	(unaudited)	
Cash flows from operating activities:		
Net income	$ 14,831	$ 9,193
Adjustments to reconcile net income to net cash provided by operating activities:		
Extinguishment of debt	--	4,686
(Gain) loss on disposal of assets	(109)	557
Provision for obsolete inventory	60	--
Provision for bad debts	10,406	10,725
Depreciation and amortization	5,073	5,078
Amortization of debt issuance costs	1,256	1,099
Deferred income taxes	3,552	--
Changes in assets and liabilities, net of effects of acquired companies:		
Accounts receivable	(13,018)	(12,681)
Inventories	(1,815)	3,397
Prepaid expenses, other assets, and income taxes receivable	(1,195)	(3,445)
Other assets	35	(180)
Accounts payable	(2,377)	(12,374)
Accrued expenses, interest, and income taxes payable	13,062	17,468
Accrued compensation related costs	(11,413)	(6,368)
Other liabilities	19	(1,159)
Net cash provided by operating activities	18,367	15,996
Cash flows from investing activities:		
Purchase of property, plant and equipment	(8,166)	(3,936)
Acquisitions and earnouts	(3,780)	(2,952)
Proceeds from sale of certain assets	358	1,492
Net cash used in investing activities	(11,588)	(5,396)
Cash flows from financing activities:		
Borrowings under revolving credit agreement	18,000	43,975
Repayments under revolving credit agreement	(23,000)	(82,775)
Proceeds from sale of Senior Notes	--	200,000
Repayment and termination of bank loans	--	(153,587)
Scheduled repayment of long-term debt	(3,410)	(5,619)
Increase in financing costs	(1,054)	(9,487)
Proceeds from issuance of Common Stock	639	2,051
Net cash used in financing activities	(8,825)	(5,442)
(Decrease) increase in cash and cash equivalents	(2,046)	5,158
Cash and cash equivalents at beginning of period	6,566	10,043
Cash and cash equivalents at end of period	$ 4,520	$ 15,201

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 accounting principles generally accepted in the United States ("U.S. 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. Approximately $1.9 million in medical benefits for the quarter and six month period ended June 30, 2002 were reclassed from Selling, General and Administrative expenses to Cost of Goods Sold to conform to the current year presentation.

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 U.S. 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. At its Patient−Care Centers segment, 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") No. 20, Accounting Changes. At its Distribution segment, a perpetual inventory is maintained.

NOTE B - SIGNIFICANT ACCOUNTING PRINCIPLES (CONTINUED)

Stock Based Compensation

At June 30, 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 No. 25, Accounting for Stock Issued to Employees ("APB 25"), and related Interpretations. No stock-based employee compensation expense is reflected in net income as all options granted under these plans and the non-qualified options 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") No. 123, Accounting for Stock-Based Compensation, as amended by SFAS No. 148, Accounting for Stock-Based Compensation-Transition and Disclosure, to stock-based employee compensation:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2003	2002	2003	2002
(In thousands, except per share amounts)				
Net income applicable to common stock, as reported	$ 7,972	$ 6,380	$ 12,093	$ 6,636
Deduct: total stock-based employee compensation expense determined under fair value method for all awards, net of related tax effects	(730)	(733)	(1,368)	(1,361)
Pro forma net income applicable to common stock	$ 7,242	$ 5,647	$ 10,725	$ 5,275
Earnings per share:				
Basic - as reported	$ 0.39	$ 0.33	$ 0.59	$ 0.35
Basic - pro forma	$ 0.35	$ 0.29	$ 0.52	$ 0.27
Diluted - as reported	$ 0.35	$ 0.29	$ 0.55	$ 0.31
Diluted - pro forma	$ 0.32	$ 0.26	$ 0.50	$ 0.24

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 June 30,		Six Months Ended June 30,	
	2003	2002	2003	2002
Expected term	5%	5%	5%	5%
Volatility factor	77%	71%	77%	71%
Risk free interest rate	2.6%	5.8%	2.7%	5.8%
Dividend yield	0.00%	0.00%	0.00%	0.00%

Stock Based Compensation (continued)

For the quarters ended June 30, 2003 and 2002, the Company granted aggregate options to purchase 32,140 and 229,998 shares of the Company's common stock, respectively. The Company granted aggregate options to purchase 142,472 and 634,998 shares of the Company's common stock during the six month periods ended June 30, 2003 and 2002, respectively. The weighted average fair value of each option granted was $7.14 per share for 2003 and $6.80 per share for 2002.

During the quarter ended June 30, 2003 the Company granted 10,280 shares of the Company's common stock to certain directors, subject to various restrictions. No such shares were granted in 2002. The market value of the restricted shares at the date of grant will be amortized to expense ratably over the restriction period.

Segment Information

SFAS No. 131, Disclosures about Segments of an Enterprise and Related Information ("SFAS 131"), 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. 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 Standards Board ("FASB") issued SFAS No. 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 APB No. 30, Reporting the Results of Operations−Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions ("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.

NOTE B − SIGNIFICANT ACCOUNTING PRINCIPLES (CONTINUED)

New Accounting Standards (continued)

In July 2002, the FASB issued SFAS No. 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 May 2003, the FASB issued SFAS No. 150, Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity ("SFAS 150"). SFAS 150 identifies three classes of financial instruments that require reclassification from equity to liabilities and their measurement at fair value. SFAS 150 is applicable to financial instruments entered into or modified subsequent to May 31, 2003 and to all financial instruments at the beginning of the first interim period beginning after June 15, 2003. The Company will adopt the provisions of SFAS 150 as of July 1, 2003. The adoption of this statement is not expected to have a material impact on the Company's financial statements.

In November 2002, the FASB issued FASB Interpretation No. 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 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 consolidated statements of cash flows:

(In thousands)	Six Months Ended June 30, 2003	2002
Cash paid (received) during the period for:		
Interest	$ 18,593	$ 21,568
Income taxes	$ (7,472)	$ 916
Non-cash financing and investing activities:		
Preferred stock dividends declared and accretion	$ 2,738	$ 2,557

NOTE D - ACQUISITIONS

During the three months ended June 30, 2003, the Company acquired two orthotic and prosthetic companies. The Company did not acquire any companies during the three months ended June 30, 2002.

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 earnout agreements relating to the Company's acquisitions, the Company paid $0.4 million and $3.0 million in the six month periods ended June 30, 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 $2.4 million related to earn-out provisions in future periods.

The activity related to goodwill for the six month period ended June 30, 2003 is as follows (in thousands:

Balance at December 31, 2002	$ 453,988
Additions due to acquisitions	5,119
Additions due to earnouts	426
Balance at June 30, 2003	$ 459,533

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.

NOTE E – NET INCOME PER COMMON SHARE (CONTINUED)

Income per share is computed as follows:

(In thousands, except share amounts)	Three Months Ended June 30, 2003	Three Months Ended June 30, 2002	Six Months Ended June 30, 2003	Six Months Ended June 30, 2002
Net income	$ 9,353	$ 7,671	$ 14,831	$ 9,193
Less preferred stock dividends declared and accretion	(1,381)	(1,291)	(2,738)	(2,557)
Net income available to common stockholders used to compute basic per common share amounts	7,972	6,380	12,093	6,636
Plus preferred stock dividends declared and accretion (b)	1,381	--	2,738	--
Net income used to compute diluted per common share amounts	$ 9,353	$ 6,380	$ 14,831	$ 6,636
Shares of common stock outstanding used to compute basic per common share amounts	20,572,473	19,336,954	20,582,064	19,221,865
Effect of dilutive options	1,503,710	2,452,016	1,453,835	2,252,874
Effect of dilutive warrants	--	224,501	--	194,441
Effect of dilutive preferred shares	4,768,426	(a)	4,768,426	(a)
Shares used to compute dilutive per common share amounts	26,844,609	22,013,471	26,804,325	21,669,180

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

(b) During the three months ended June 30, 2003 it became more dilutive to net income per common share to convert the Company's outstanding preferred stock to common stock. Therefore, the preferred stock dividends declared and accretion were not included in the computation of diluted per common share data for the three and six month periods ended June 30, 2003.

Options to purchase 1,570,322 and 980,797 shares of common stock were outstanding at June 30, 2003 and 2002, respectively, and are not included in the computation of diluted income per share for the three month periods ended June 30, 2003 and 2002, respectively, as these options are anti-dilutive. Options to purchase 1,382,998 and 1,069,165 shares of common stock were outstanding at June 30, 2003 and 2002, respectively, and are not included in the computation of diluted income per share for the six month periods ended June 30, 2003 and 2002, respectively, as these options are anti-dilutive.

NOTE F - INVENTORY

Inventories consist of the following:

(In thousands)	June 30, 2003	December 31, 2002
Raw materials	$27,890	$26,905
Work in process	19,719	19,719
Finished goods	10,647	9,830
	$58,256	$56,454

NOTE G - LONG TERM DEBT

Long-term debt consists of the following:

(In thousands)	June 30, 2003	December 31, 2002
Revolving credit facility	$ 10,000	$ 15,000
10 3/8% Senior Notes due 2009 (1)	210,578	208,398
11 1/4% Senior Subordinated Notes due 2009	150,000	150,000
Subordinated seller notes, non-collateralized, net of unamortized discount of $0.05 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	9,031	9,884
	379,609	383,282
Less current portion	(2,715)	(5,181)
Total long-term debt	$ 376,894	$ 378,101

(1) Includes $10.6 million and $8.4 million adjustments for June 30, 2003 and December 31, 2002, respectively, related to the interest rate swaps.

As a result of retiring the previously existing credit facility during 2002, the Company wrote off $4.7 million in unamortized debt issuance costs. These costs are included in extinguishment of debt for the six month period ended June 30, 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.

NOTE G − LONG TERM DEBT (CONTINUED)

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 "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 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.

During April 2003, the total availability under the Revolving Credit Facility was increased from $75.0 million to $100.0 million and the administrative agent was changed from BNP Paribas to GE Capital Corporation. As of June 30, 2003, the Company had unused availability of $86.7 million under the Revolving Credit Facility.

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 the 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. The Company does not believe that its obligation under its existing contracts containing indemnification or clauses of guarantees will result in any material liability.

NOTE I − SEGMENT AND RELATED INFORMATION

The Company has identified two reportable segments based on the products and services it provides. The Company evaluates segment performance and allocates resources based on the segment's 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 U.S. GAAP. Other EBITDA not directly attributable to reportable segments is primarily related to corporate general and administrative expenses.

NOTE I - SEGMENT AND RELATED INFORMATION (CONTINUED)

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 orthotic and prosthetic ("O&P") patient-care centers, fabrication centers of O&P components and OPNET. The patient-care centers provide services to design and fit O&P 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 centers. 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 centers.

The accounting principles of the segments are the same as those described in the summary of Note B, "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 that approximate market values.

(In thousands)	Patient-Care Centers	Distribution	Other and Eliminations	Total
Three Months Ended June 30, 2003				
Net sales				
Customers	$130,092	$ 8,844	$ --	$138,936
Intersegment	--	15,882	(15,882)	--
EBITDA	31,160	2,456	(5,808)	27,808
Three Months Ended June 30, 2002				
Net sales				
Customers	$126,123	$ 6,933	$ --	$133,056
Intersegment	--	12,796	(12,796)	--
EBITDA	28,292	1,864	(4,980)	25,176

NOTE I - SEGMENT AND RELATED INFORMATION (CONTINUED)

(In thousands)	Patient-Care Centers	Distribution	Other and Eliminations	Total
Six Months Ended June 30, 2003				
Net sales				
Customers	$248,202	$ 16,862	$ --	$265,064
Intersegment	--	29,823	(29,823)	--
EBITDA	54,395	5,020	(10,935)	48,480
Six Months Ended June 30, 2002				
Net sales				
Customers	$243,070	$ 13,496	$ --	$256,566
Intersegment	--	25,195	(25,195)	--
EBITDA	50,895	3,008	(9,531)	44,372

The following tables reconcile EBITDA to consolidated net income:

(In thousands)	Three Months Ended June 30, 2003	2002
EBITDA	$27,808	$25,176
Depreciation and amortization	2,620	2,294
Interest expense, net	9,354	9,977
Provision for income taxes	6,481	5,234
Net income	$ 9,353	$ 7,671

(In thousands)	Six Months Ended June 30, 2003	2002
EBITDA	$48,480	$44,372
Depreciation and amortization	5,073	5,078
Interest expense, net	18,450	19,056
Extinguishment of debt	--	4,686
Provision for income taxes	10,126	6,359
Net income	$14,831	$ 9,193

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 June 30, 2003 and December 31, 2002, and for the three and six month periods ended June 30, 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.

NOTE J - CONSOLIDATING FINANCIAL INFORMATION (CONTINUED)

BALANCE SHEET - June 30, 2003 (In thousands)	Hanger Orthopedic Group (Parent Company)	Guarantor Subsidiaries	Consolidating Adjustments	Consolidated Totals
ASSETS				
Cash and cash equivalents	$ 666	$ 3,854	$ --	$ 4,520
Accounts receivable	--	111,060	--	111,060
Inventories	--	58,256	--	58,256
Prepaid expenses, other assets and income taxes receivable	665	5,582	--	6,247
Intercompany receivable	500,434	--	(500,434)	--
Deferred income taxes	6,767	--	--	6,767
Total current assets	508,532	178,752	(500,434)	186,850
Property, plant and equipment, net	4,689	34,184	--	38,873
Intangible assets, net	--	464,916	--	464,916
Investment in subsidiaries	138,819	--	(138,819)	--
Other assets	24,363	1,803	--	26,166
Total assets	$ 676,403	$ 679,655	$(639,253)	$ 716,805
LIABILITIES, REDEEMABLE PREFERRED STOCK AND SHAREHOLDERS' EQUITY				
Current portion of long-term debt	$ --	$ 2,715	$ --	$ 2,715
Accounts payable	473	12,132	--	12,605
Accrued expenses	3,047	1,746	--	4,793
Accrued interest payable	7,005	221	--	7,226
Accrued compensation related cost	2,323	19,232	--	21,555
Income taxes payable (receivable)	6,921	(3,279)	--	3,642
Total current liabilities	19,769	32,767	--	52,536
Long-term debt, less current portion	370,578	6,316	--	376,894
Deferred income taxes	26,698	--	--	26,698
Intercompany payable	--	500,434	(500,434)	--
Other liabilities	280	1,319	--	1,599
Total long-term liabilities	397,556	508,069	(500,434)	405,191
Total liabilities	417,325	540,836	(500,434)	457,727
Redeemable preferred stock	78,679	--	--	78,679
Common stock	207	35	(35)	207
Additional paid-in capital	151,037	7,460	(7,460)	151,037
Unearned compensation	(115)	--	--	(115)
Retained earnings	29,926	131,864	(131,864)	29,926
Treasury stock	(656)	(540)	540	(656)
Total shareholders' equity	180,399	138,819	(138,819)	180,399
Total liabilities, redeemable preferred stock and shareholders' equity	$ 676,403	$ 679,655	$(639,253)	$ 716,805

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
Unearned compensation	--	--	--	--
Retained earnings	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

STATEMENT OF OPERATIONS
Three Months ended June 30, 2003
(In thousands)

	Hanger Orthopedic Group (Parent Company)	Guarantor Subsidiaries	Consolidating Adjustments	Consolidated Totals
Net sales	$ --	$ 138,936	$ --	$ 138,936
Cost of goods sold (exclusive of depreciation and amortization)	--	65,416	--	65,416
Gross profit	--	73,520	--	73,520
Selling, general and administrative	5,808	39,904	--	45,712
Depreciation and amortization	365	2,255	--	2,620
(Loss) income from operations	(6,173)	31,361	--	25,188
Interest expense, net	9,206	148	--	9,354
Equity in earnings of subsidiaries	31,213	--	(31,213)	--
Extinguishment of debt	--	--	--	--
Income before taxes	15,834	31,213	(31,213)	15,834
Provision for income taxes	6,481	--	--	6,481
Net income	$ 9,353	$ 31,213	$ (31,213)	$ 9,353

STATEMENT OF OPERATIONS
Three Months Ended June 30, 2002
(In thousands)

	Hanger Orthopedic Group (Parent Company)	Guarantor Subsidiaries	Consolidating Adjustments	Consolidated Totals
Net sales	$ --	$ 133,056	--	$ 133,056
Cost of goods sold (exclusive of depreciation and amortization)	--	63,189	--	63,189
Gross profit	--	69,867	--	69,867
Selling, general and administrative	4,980	39,711	--	44,691
Depreciation and amortization	337	1,957	--	2,294
(Loss) income from operations	(5,317)	28,199	--	22,882
Interest (income) expense, net	(2,481)	12,458	--	9,977
Equity in earnings of subsidiaries	15,741	--	(15,741)	--
Extinguishment of debt	--	--	--	--
Income before taxes	12,905	15,741	(15,741)	12,905
Provision for income taxes	5,234	--	--	5,234
Net income	$ 7,671	$ 15,741	$ (15,741)	$ 7,671

NOTE J - CONSOLIDATING FINANCIAL INFORMATION (CONTINUED)

STATEMENT OF OPERATIONS Six Months Ended June 30, 2003 (In thousands)	Hanger Orthopedic Group (Parent Company)	Guarantor Subsidiaries	Consolidating Adjustments	Consolidated Totals
Net sales	$ --	$ 265,064	$ --	$ 265,064
Cost of goods sold (exclusive of depreciation and amortization)	--	126,106	--	126,106
Gross profit	--	138,958	--	138,958
Selling, general and administrative	10,936	79,542	--	90,478
Depreciation and amortization	722	4,351	--	5,073
(Loss) income from operations	(11,658)	55,065	--	43,407
Interest expense, net	18,158	292	--	18,450
Equity in earnings of subsidiaries	54,773	--	(54,773)	--
Extinguishment of debt	--	--	--	--
Income before taxes	24,957	54,773	(54,773)	24,957
Provision for income taxes	10,126	--	--	10,126
Net income	$ 14,831	$ 54,773	$ (54,773)	$ 14,831

STATEMENT OF OPERATIONS Six Months Ended June 30, 2002 (In thousands)				
Net sales	$ --	$ 256,566	$ --	$ 256,566
Cost of goods sold (exclusive of depreciation and amortization)	--	122,726	--	122,726
Gross profit	--	133,840	--	133,840
Selling, general and administrative	9,533	79,935	--	89,468
Depreciation and amortization	672	4,406	--	5,078
(Loss) income from operations	(10,205)	49,499	--	39,294
Interest expense, net	(5,877)	24,933	--	19,056
Equity in earnings of subsidiaries	24,566	--	(24,566)	--
Extinguishment of debt	4,686	--	--	4,686
Income before taxes	15,552	24,566	(24,566)	15,552
Provision for income taxes	6,359	--	--	6,359
Net income	$ 9,193	$ 24,566	$ (24,566)	$ 9,193

NOTE J - CONSOLIDATING FINANCIAL INFORMATION (CONTINUED)

STATEMENTS OF CASH FLOWS Six Months Ended June 30, 2003 (In thousands)	Hanger Orthopedic Group (Parent Company)	Guarantor Subsidiaries	Consolidating Adjustments	Consolidated Totals
Cash flows (used in) provided by operating activities	$ 46,848	$ 26,292	$ (54,773)	$ 18,367
Cash flows provided by (used in) investing activities				
Purchase of property, plant and equipment	(779)	(7,387)	--	(8,166)
Acquisitions and earnouts	--	(3,780)	--	(3,780)
Investment in subsidiaries	(54,773)	--	54,773	--
Intercompany dividend	14,212	(14,212)	--	--
Proceeds from sale of certain assets	4	354	--	358
Net cash provided by (used in) investing activities	(41,336)	(25,025)	54,773	(11,588)
Cash flows used in financing activities				
Borrowings under revolving credit agreement	18,000	--	--	18,000
Repayments under revolving credit agreement	(23,000)	--	--	(23,000)
Proceeds from sale of Senior Notes	--	--	--	--
Repayment and termination of bank loans	--	--	--	--
Scheduled repayment of long-term debt	--	(3,410)	--	(3,410)
Increase in financing costs	(1,054)	--	--	(1,054)
Proceeds from issuance of Common Stock	639	--	--	639
Net cash used in financing activities	(5,415)	(3,410)	--	(8,825)
Net increase (decrease) in cash and cash equivalents	97	(2,143)	--	(2,046)
Cash and cash equivalents, beginning of period	570	5,996	--	6,566
Cash and cash equivalents, end of period	$ 667	$ 3,853	$ --	$ 4,520

STATEMENTS OF CASH FLOWS Six Months Ended June 30, 2002 (In thousands)				
Cash flows provided by operating activities	$ 31,451	$ 9,111	$ (24,566)	$ 15,996
Cash flows used in investing activities				
Purchase of property, plant and equipment	(280)	(3,656)	--	(3,936)
Acquisitions and earnouts	--	(2,952)	--	(2,952)
Investment in subsidiaries	(24,566)	--	24,566	--
Intercompany dividend	--	--	--	--
Proceeds from sale of certain assets	--	1,492	--	1,492
Net cash used in investing activities	(24,846)	(5,116)	24,566	(5,396)
Cash flows provided by (used in) financing activities				
Borrowings under revolving credit agreement	43,975	--	--	43,975
Repayments under revolving credit agreement	(82,775)	--	--	(82,775)
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	--	(5,619)	--	(5,619)
Increase in financing costs	(9,487)	--	--	(9,487)
Proceeds from issuance of Common Stock	2,051	--	--	2,051
Net cash provided by (used in) financing activities	177	(5,619)	--	(5,442)
Net increase (decrease) in cash and cash equivalents	6,782	(1,624)	--	5,158
Cash and cash equivalents, beginning of period	(212)	10,255	--	10,043
Cash and cash equivalents, end of period	$ 6,570	$ 8,631	$ --	$ 15,201

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 June 30,		Six Months Ended June 30,	
	2003	2002	2003	2002
Net sales	100.0 %	100.0 %	100.0 %	100.0 %
Cost of goods sold	47.1	47.5	47.6	47.8
Gross profit	52.9	52.5	52.4	52.2
Selling, general and administrative	32.9	33.6	34.1	34.9
Depreciation and amortization	1.9	1.7	1.9	2.0
Income from operations	18.1	17.2	16.4	15.3
Interest expense, net	6.7	7.5	7.0	7.4
Extinguishment of debt	-	-	-	1.8
Income before taxes	11.4	9.7	9.4	6.1
Provision for income taxes	4.7	3.9	3.8	2.5
Net income	6.7	5.8	5.6	3.6

Three Months Ended June 30, 2003 Compared to the Three Months Ended June 30, 2002

Net Sales. Net sales for the quarter ended June 30, 2003 were $138.9 million, an increase of $5.8 million, or 4.4%, versus net sales of $133.1 million for the quarter ended June 30, 2002. The sales growth was primarily the result of a $2.3 million, or 1.9%, increase in same center sales in the Company's O&P patient-care centers and a $1.9 million, or 27.6%, increase in outside sales of the distribution segment.

Gross Profit. Gross profit for the quarter ended June 30, 2003 was $73.5 million, an increase of approximately $3.6 million, or 5.2%, versus $69.9 million for the quarter ended June 30, 2002. Gross profit as a percentage of net sales for the second quarter of 2003 increased slightly to 52.9% from 52.5% for the second quarter of 2002. The improvement in gross profit, in both dollars and as a percentage of net sales, was due to the increase in net sales and a reduction in labor costs.

Selling, General and Administrative. Selling, general and administrative expenses in the quarter ended June 30, 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 0.7 percentage points.

Depreciation and Amortization. Depreciation and amortization for the three months ended June 30, 2003 was $2.6 million versus $2.3 million for the three months ended June 30, 2002.

Income from Operations. Principally as a result of the above, income from operations for the quarter ended June 30, 2003 was $25.2 million, an increase of $2.3 million, or 10.1%, compared to the quarter ended June 30, 2002. Income from operations, as a percentage of net sales, increased by 0.9 percentage points to 18.1% of net sales in the second quarter of 2003 versus 17.2% for the prior year's comparable period.

Interest Expense, Net. Interest expense in the second quarter of 2003 decreased compared to the same quarter in 2002 due to decreased borrowings and a reduction in LIBOR.

Income Taxes. The provision for income taxes for the three months ended June 30, 2003 was $6.5 million compared to $5.2 million for the three months June 30, 2002. The change in the income tax provision was due to the Company's increased profitability. The effective rate for the three months ended June 30, 2003 and 2002 was 40.9% and 40.6%, respectively.

Net Income. As a result of the above, we recorded net income of $9.4 million for the three months ended June 30, 2003, an improvement of $1.7 million, or 21.9%, over the three months ended June 30, 2002.

Six Months Ended June 30, 2003 Compared to the Six Months Ended June 30, 2002

Net Sales. Net sales for the six months ended June 30, 2003, were $265.1 million, an increase of $8.5 million, or 3.3%, versus net sales of $256.6 million for the six months ended June 30, 2002. The sales growth was primarily the result of a $2.6 million, or 1.1%, increase in same center sales in the Company's O&P patient-care centers and a $3.4 million, or 24.9%, increase in outside sales of the distribution segment.

Gross Profit. Gross profit in the six months ended June 30, 2003 was $139.0 million, an increase of $5.2 million, or 3.9%, versus $133.8 million for the six months ended June 30, 2002. Gross profit as a percentage of net sales increased to 52.4% in the first six months of 2003 versus 52.2% in the first six months of 2002. The improvement in gross profit, in both dollars and as a percentage of net sales, was due to a reduction in material and labor costs as well as the increase in net sales.

Selling, General and Administrative. Selling, general and administrative expenses in the six months ended June 30, 2003 increased by $1.0 million, or 1.1%, compared to the six months ended June 30, 2002. Selling, general and administrative expenses as a percentage of net sales decreased to 34.1% in the first six months of 2003 compared to 34.9% for the same period in 2002. The decrease in selling, general and administrative expenses, in both dollars and as a percentage of net sales, was primarily due to a decrease in labor costs and legal fees.

Depreciation and Amortization. Depreciation and amortization for the six months ended June 30, 2003 was consistent with the six months ended June 30, 2002 at $5.1 million.

Income from Operations. Principally as a result of the above, income from operations for the six months ended June 30, 2003 was $43.4 million, an increase of $4.1 million, or 10.4%, compared to $39.3 million for the six months ended June 30, 2002. Income from operations as a percentage of net sales increased by 1.1 percentage points to 16.4% of net sales in the first six months of 2003 versus 15.3% for the prior year's comparable period.

Interest Expense, Net. Interest expense in the first six months of 2003 was $18.5 million, a decrease of $0.6 million from the $19.1 million incurred in the first six months of 2002. The decrease in dollars of interest expense was primarily attributable to a decrease in average borrowings and a reduction in LIBOR.

Extinguishment of Debt. Extinguishment of debt was $4.7 million (unamortized debt issuance costs) in the six months ended June 30, 2002 as a result of retiring the previously existing credit facility.

Income Taxes. The provision for income taxes for the six months ended June 30, 2003 was $10.1 million compared to that of $6.4 million for the six months ended June 30, 2002. The change in the income tax provision was due to the increase in the Company's income before taxes. The effective rate for the six months ended June 30, 2003 and 2002 was 40.6% and 40.9%, respectively.

Net Income. As a result of the above, we recorded net income of $14.8 million for the six months ended June 30, 2003, compared to net income of $9.2 million in the comparable period in the prior year, an improvement of $5.6 million, or 60.9%.

Financial Condition, Liquidity, and Capital Resources

Our working capital at June 30, 2003 was $134.3 million compared to $126.7 million at December 31, 2002. While current assets decreased by $5.8 million, current liabilities decreased by a larger amount, $13.4 million. The decline in current liabilities was due principally to decreased obligations related to accrued compensation costs. Our cash and cash equivalents amounted to $4.5 million at June 30, 2003, and $6.6 million at December 31, 2002. The ratio of current assets to current liabilities increased to 3.6 to 1 at June 30, 2003, compared to 2.9 to 1 at December 31, 2002. Available cash under our Revolving Credit Facility increased to $86.7 million at June 30, 2003 compared to $60.0 million at December 31, 2002 due to the modification of the credit facility in the second quarter of 2003 and a $5 million reduction in outstanding debt.

Net cash provided by operating activities for the six months ended June 30, 2003 was $18.4 million, compared to net cash provided by operating activities of $16.0 million in the six months ended June 30, 2002. The increase was primarily due to an increase in net income.

Net cash used in investing activities was $11.6 million for the six months ended June 30, 2003, versus $5.4 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 used in financing activities was $8.8 million for the six months ended June 30, 2003 compared to $5.4 million for the six months ended June 30, 2003. The increase in cash used in financing activities was primarily due to the payments on the revolving credit facility.

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 ("Revolving Credit Facility"). The proceeds from the sale of Senior Notes and the 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 Revolving Credit Facility.

During April 2003, the total availability under the Revolving Credit Facility was increased from $75.0 million to $100.0 million and the administrative agent was changed from BNP Paribas to GE Capital Corporation. At June 30, 2003, the Company had unused availability of $86.7 million under the Revolving Credit Facility.

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 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 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 Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 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 ("APB") No. 30, Reporting the Results of Operations−Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions ("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 SFAS No. 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 May 2003, the FASB issued SFAS No. 150, Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity ("SFAS 150"). SFAS 150 identifies three classes of financial instruments that require reclassification from equity to liabilities and their measurement at fair value. SFAS 150 is applicable to financial instruments entered into or modified subsequent to May 31, 2003 and to all financial instruments at the beginning of the first interim period beginning after June 15, 2003. We will adopt the provisions of SFAS 150 as of July 1, 2003. The adoption of this statement is not expected to have a material impact on our financial statements.

In November 2002, the FASB issued FASB Interpretation No. 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 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 accounting principles generally accepted 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 at its Patient-Care Centers segment, 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 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. At its Distribution segment, a perpetual inventory is maintained.

- 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. 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, 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 a 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. 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 acquired O&P patient-care centers, 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 $100 million Revolving Credit Facility, with an outstanding balance of $10 million at June 30, 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 June 30, 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)	$ 14,983	$ 15,483	$ 15,983	$ 16,483	$ 16,983	$ 17,483	$ 17,983
Revolving Credit Facility	265	315	365	415	465	515	565
	$ 15,248	$ 15,798	$ 16,348	$ 16,898	$ 17,448	$ 17,998	$ 18,548

ITEM 4: Controls and Procedures

Our Chief Executive Officer and Chief Financial Officer have concluded that our disclosure controls and procedures are effective as of June 30, 2003. There has been no change in our internal control over financial reporting during the quarter ended June 30, 2003 that has materially affected or is reasonably likely to materially affect our internal control over financial reporting.

PART II OTHER INFORMATION

ITEM 4: Submission of Matters to a Vote of Security Holders

The Company's Annual Meeting of Stockholders was held on May 30, 2003.

The first proposal was the election of directors. The following persons were nominated and elected to serve as members of the Board of Directors for one year or until their successors are elected and qualified by the votes indicated: Mitchell J. Blutt, M.D. (12,721,653 shares for and 1,763,138 shares withheld), Edmond E. Charrette, M.D. (12,957,647 shares for and 1,527,144 shares withheld), Thomas P. Cooper, M.D. (8,988,271 shares for and 5,496,520 shares withheld), Eric Green (13,332,053 shares for and 1,152,738 shares withheld), C. Raymond Larkin, Jr. (8,987,171 shares for and 5,497,620 shares withheld), Risa J. Lavizzo-Mourey, M.D. (9,052,951 shares for and 5,431,840 shares withheld), Ivan R. Sabel (13,110,013 shares for and 1,374,778 shares withheld), Thomas F. Kirk (13,333,473 shares for and 1,151,318 shares withheld), and H.E. Thranhardt (13,333,473 shares for and 1,151,318 shares withheld).

The second proposal was the proposed approval of the Company's 2003 Non-Employee Directors' Stock Incentive Plan and authorization of 500,000 shares of the Company's Common Stock for issuance under that Plan. The proposal was approved by the holders of more than the required majority of the shares of Common Stock voting at the meeting. The proposal was approved by a vote of 7,882,524 shares of Common Stock for (representing approximately 54.42% of the shares voting), 6,118,981 shares of Common Stock against, with 483,289 shares of Common Stock abstaining.

The third proposal was a proposed amendment to the Company's 2002 Stock Option Plan to provide for the grant of restricted stock awards under that Plan and to rename the Plan to be the 2002 Stock Incentive Plan. The proposal was approved by the holders of more than the required majority of the shares of Common Stock voting at the meeting. The proposal was approved by a vote of 12,068,596 shares of Common Stock for (representing approximately 83.32% of the shares voting), 2,353,283 shares of Common Stock against, with 62,912 shares of Common Stock abstaining.

ITEM 5: Other Information

Corporate Governance Matters

Set forth below is disclosure relating to certain corporate governance matters:

1. Size of Board. Section 2 of Article III of the Company's By-Laws provides for there to be no more than nine members of the Company's Board of Directors. It currently is the Board's policy to retain its size at nine members. Section 13 of Article III of the By-Laws provides that any vacancy on the Board, other than an increase by more than two members, may be filled by the majority vote of the remaining members of the Board. Any vacancy, including one created as an increase in the number of directors, may be filled by stockholders at a meeting called for such purpose.

2. Approval of Mergers. There are no supermajority vote requirements to approve mergers or business combinations.

3. Procedures for By-Law Amendments. The Company's By-Laws include provisions setting forth procedures for amendments to the By-Laws. Section 1 of Article VIII of the By-Laws provides that the Board of Directors by a majority vote has the power to amend By-Laws at any regular or special meeting of the Board. However, under the Delaware General Corporation Law, any amendment to the By-Laws must be approved by the holders of a majority of the shares of the Company's common stock present in person or represented by proxy and entitled to vote on the matter. Section 2 of Article VIII provides that stockholders may amend the By-Laws by a vote of a majority of the total number of outstanding shares entitled to vote at any annual or special meeting, and that stockholders may provide that certain By-Laws adopted or designated by them may not be amended except by a certain specified percentage and interest of the stockholders or by a certain specified percentage and interest of a particular class of stockholders.

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
31.1	Written Statement of the Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Written Statement of the Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32	Written Statement of the Chief Executive Officer and Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

(b) Forms 8-K. Current Report on Form 8-K dated August 1, 2003 furnishing the press release reporting the results of the first quarter of 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: August 12, 2003	/s/ Ivan R. Sabel Ivan R. Sabel, CPO Chairman and Chief Executive Officer (Principal Executive Officer)
Dated: August 12, 2003	/s/ George E. McHenry George E. McHenry Executive Vice President and Chief Financial Officer (Principal Financial Officer)
Dated: August 12, 2003	/s/ Glenn M. Lohrmann Glenn M. Lohrmann Vice President, Secretary and Controller (Chief Accounting Officer)

EXHIBIT INDEX

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Exhibit 31.1

Certification of Chief Executive Officer
Pursuant to Section 302 of the Sarbanes−Oxley Act and Rule 13a−14(a)
or 15d−14(a) under the Securities Exchange Act of 1934

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−15(e) and 15d−15(e)) for the registrant and have:

   a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, 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 and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this quarterly report based on such evaluation, and

   c) disclosed in this quarterly report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, 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 and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 12, 2003

/s/ Ivan R. Savel

Ivan R. Sabel, CPO
Chairman and
Chief Executive Officer

Exhibit 31.2

Certification of Chief Financial Officer
Pursuant to Section 302 of the Sarbanes−Oxley Act and Rule 13a−14(a)
or 15d−14(a) under the Securities Exchange Act of 1934

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−15(e) and 15d−15(e)) for the registrant and have:

    a) designed such disclosure controls and procedures, or caused such disclosure and procedures to be designed under our supervision, 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 and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this quarterly report based on such evaluation; and

    c) disclosed in this quarterly report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, 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 and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 12, 2003

/s/ George E. McHenry

George E. McHenry
Chief Financial Officer

Exhibit 32

Written Statement of the Chief Executive Officer and 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. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, the undersigned Chief Executive Officer and Chief Financial Officer of Hanger Orthopedic Group, Inc. (the "Company"), hereby certify, based on our knowledge, that the Quarterly Report on Form 10-Q of the Company for the quarter ended June 30, 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
Chief Executive Officer

/s/ George E. McHenry

George E. McHenry
Chief Financial Officer

August 12, 2003