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Type:	**10-Q**
Comment/Description:	**Quarterly Report**

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UNITED STATES
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, 2008

OR

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

Commission file number 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 a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definitions of "large accelerated filer", "accelerated filer", and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one).

Large accelerated filer |_|	Accelerated filer |X|
Non-accelerated filer |_|	Smaller reporting company |_|

Indicate by check mark whether the registrant is a shell company as defined in Rule 12b-2 of the Exchange Act. Yes |_| No |X|

As of April 30, 2008, 22,955,518 shares of common stock, $.01 par value per share, were outstanding.

HANGER ORTHOPEDIC GROUP, INC.

INDEX

HANGER ORTHOPEDIC GROUP, INC.
CONSOLIDATED BALANCE SHEETS
(Dollars in thousands)
(Unaudited)

	March 31, 2008	December 31, 2007
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	$ 12,947	$ 26,938
Short-term investments	6,966	7,500
Accounts receivable, less allowance for doubtful accounts of $3,790 and $3,965 in 2008 and 2007, respectively	93,000	99,117
Inventories	83,690	82,228
Prepaid expenses, other assets and income taxes receivable	13,956	10,747
Deferred income taxes	8,800	8,571
Total current assets	219,359	235,101
PROPERTY, PLANT AND EQUIPMENT		
Land	949	975
Buildings	4,881	4,881
Furniture and fixtures	12,877	12,747
Machinery and equipment	31,675	31,093
Leasehold improvements	42,743	41,520
Computer and software	57,353	56,231
Total property, plant and equipment, gross	150,478	147,447
Less accumulated depreciation	104,036	100,133
Total property, plant and equipment, net	46,442	47,314
INTANGIBLE ASSETS		
Excess cost over net assets acquired	463,055	459,562
Patents and other intangible assets, net	4,372	4,599
Total intangible assets, net	467,427	464,161
OTHER ASSETS		
Debt issuance costs, net	8,849	9,304
Other assets	1,988	3,803
Total other assets	10,837	13,107
TOTAL ASSETS	$ 744,065	$ 759,683

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

HANGER ORTHOPEDIC GROUP, INC.
CONSOLIDATED BALANCE SHEETS
(Dollars in thousands)
(Unaudited)

	March 31, 2008	December 31, 2007
LIABILITIES, CONVERTIBLE PREFERRED STOCK AND SHAREHOLDERS' EQUITY		
CURRENT LIABILITIES		
Current portion of long-term debt	$ 5,514	$ 5,691
Accounts payable	14,406	17,257
Accrued expenses	10,674	11,316
Accrued interest payable	6,435	1,937
Accrued compensation related costs	12,169	33,106
Total current liabilities	49,198	69,307
LONG-TERM LIABILITIES		
Long-term debt, less current portion	404,685	405,201
Deferred income taxes	30,478	30,574
Other liabilities	17,543	16,409
Total liabilities	501,904	521,491
COMMITMENTS AND CONTINGENCIES (Note H)		
CONVERTIBLE PREFERRED STOCK		
Series A Convertible Preferred stock, liquidation preference of $1,000 per share, 50,000 shares authorized, issued and outstanding	47,654	47,654
SHAREHOLDERS' EQUITY		
Common stock, $.01 par value; 60,000,000 shares authorized, 24,490,214 shares and 24,432,518 shares issued and outstanding in 2008 and 2007, respectively	245	244
Additional paid-in capital	163,309	161,955
Accumulated other comprehensive income	(534)	--
Retained earnings	32,143	28,995
	195,163	191,194
Treasury stock at cost (141,154 shares)	(656)	(656)
Total shareholders' equity	194,507	190,538
TOTAL LIABILITIES, CONVERTIBLE PREFERRED STOCK AND SHAREHOLDERS' EQUITY	$ 744,065	$ 759,683

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

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

	2008	2007
Net sales	$ 157,656	$ 143,850
Cost of goods sold (exclusive of depreciation and amortization)	79,069	72,549
Selling, general and administrative	60,207	55,157
Depreciation and amortization	4,181	3,748
Income from operations	14,199	12,396
Interest expense	8,258	9,340
Income before taxes	5,941	3,056
Provision for income taxes	2,376	1,272
Net income	3,565	1,784
Preferred stock dividend-Series A Convertible Preferred Stock	416	416
Net income applicable to common stock	$ 3,149	$ 1,368
Basic Per Common Share Data		
Net income applicable to common stock	$ 0.14	$ 0.06
Shares used to compute basic per common share amounts	22,880,973	22,191,920
Diluted Per Common Share Data		
Net income applicable to common stock	$ 0.12	$ 0.06
Shares used to compute diluted per common share amounts	30,661,996	23,368,871

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)
(Unaudited)

	2008	2007
Cash flows from operating activities:		
Net income	$ 3,565	$ 1,784
Adjustments to reconcile net income to net cash provided by operating activities:		
(Gain) loss on disposal of assets	21	(81)
Provision for bad debt	3,589	4,061
Provision for deferred income taxes	(208)	698
Depreciation and amortization	4,181	3,748
Amortization of debt issuance costs	455	447
Compensation expense on stock options and restricted stock	1,057	695
Changes in assets and liabilities, net of effects of acquired companies:		
Accounts receivable	3,101	2,031
Inventories	(1,282)	437
Prepaid expenses, other current assets, and income taxes receivable	(3,210)	(6,205)
Other assets	(60)	8
Accounts payable	(2,698)	(1,539)
Accrued expenses, accrued interest payable, and income taxes payable	3,835	2,026
Accrued compensation related costs	(20,937)	(9,611)
Other liabilities	1,133	3,656
Net cash provided by (used in) operating activities	(7,458)	2,155
Cash flows from investing activities:		
Purchase of property, plant and equipment (net of acquisitions)	(3,090)	(4,125)
Acquisitions and contingent purchase price (net of cash acquired)	(1,920)	(498)
Proceeds from sale of property, plant and equipment	5	158
Net cash used in investing activities	(5,005)	(4,465)
Cash flows from financing activities:		
Repayment of term loan	(575)	(577)
Scheduled repayment of long-term debt	(718)	(719)
Financing costs	--	(238)
Proceeds from issuance of Common Stock	181	575
Preferred stock dividends paid	(416)	(416)
Net cash used in financing activities	(1,528)	(1,375)
Decrease in cash and cash equivalents	(13,991)	(3,685)
Cash and cash equivalents, at beginning of period	26,938	23,139
Cash and cash equivalents, at end of period	$ 12,947	$ 19,454

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

HANGER ORTHOPEDIC GROUP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE A – BASIS OF PRESENTATION

The unaudited interim consolidated financial statements as of and for the three months ended March 31, 2008 and 2007 have been prepared by the Company pursuant to the rules and regulations of the Securities and Exchange Commission (the "SEC") for interim financial reporting. These consolidated statements are unaudited and, in the opinion of management, include all adjustments (consisting of normal recurring adjustments and accruals) necessary for a fair statement for the periods presented. The year-end consolidated data was derived from audited financial statements but does not include all disclosures required by accounting principles generally accepted in the United States of America ("GAAP").

These consolidated financial statements should be read in conjunction with the consolidated 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, 2007, filed by the Company with the SEC.

NOTE B – SIGNIFICANT ACCOUNTING PRINCIPLES

Principles of Consolidation

The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries. All intercompany transactions and balances have been eliminated.

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.

Cash and Cash Equivalents

The Company considers all highly liquid investments with original maturities of three months or less at the date of purchase to be cash equivalents. At various times throughout the year, the Company maintains cash balances in excess of Federal Deposit Insurance Corporation limits.

Short Term Investments

We account for our short-term investments in accordance with SFAS No. 115, "*Accounting for Certain Investments in Debt and Equity Securities"*. Our investments are classified as cash equivalents if the original maturity, from the date of purchase, is ninety days or less, and as short-term investments if the original maturity, from the date of purchase, is in excess of ninety days since we intend to convert them into cash as necessary to meet our liquidity requirements. At March 31, 2008, our short-term investments consist of two auction rate securities ("ARS") with a credit rating of either AA or AAA. ARS are securities that are structured with short-term interest rate reset dates which generally occur every 28 days and are linked to LIBOR. At the reset date, investors can sell or continue to hold the securities at par. As of March 31, 2008, both investments failed at auction due to sell orders exceeding buy orders. The funds associated with these securities will not be accessible until a successful auction occurs, a buyer is found outside of the auction process, the issuer refinances the underlying debt, or the underlying security matures. The Company's ARS are reported at fair value.

NOTE B — SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Short Term Investments (continued)

The Company believes there has been no marked deterioration in the credit risk of the underlying securities in our auction rate portfolio. However, given the deterioration in liquidity of the auction rate market during the first quarter, we recorded an unrealized loss on our securities in the amount of $0.5 million to reflect the estimated decline in fair value associated with the current illiquidity in the auction rate market. That estimated decline in fair value was calculated based upon a projected cash flow of the underlying securities, which is not necessarily indicative of the actual proceeds that could be received from sale of the securities on March 31, 2008. Despite the unrealized loss recorded at March 31, 2008 as a component of comprehensive income, we anticipate that we will be able to convert these investments to cash at full par value within the next 12 months. Further, the current illiquidity of these investments is not expected to impact our operating and capital expenditure needs.

Fair Value

Effective January 1, 2008, the Company adopted Statement of Financial Accounting Standard No. 157, *Fair Value Measurements*, or SFAS 157, which establishes a framework for measuring fair value and requires enhanced disclosures about fair value measurements.

As of March 31, 2008, the Company's only assets required to be measured at fair value on a recurring basis are the Company's ARS. The fair values of our ARSs were estimated through discounted cash flow models. These models consider, among other things, the timing of expected future successful auctions, collateralization of underlying security investments and the credit worthiness of the issuer. Since these inputs were not observable, they are classified as level 3 inputs. The auctions for all of the ARSs then held by us were unsuccessful as of March 31, 2008, resulting in our continuing to hold them beyond their typical auction reset dates and causing the level of inputs used to determine their fair values to be unobservable (level 3 inputs). As a result of the lack of liquidity in the ARS market and not as a result of the quality of the underlying collateral, for the three months ended March 31, 2008, we recorded an unrealized loss on our ARSs of $0.5 million, which is reflected in accumulated other comprehensive income in our consolidated balance sheet.

NOTE B — SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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, provided that (i) delivery has occurred or services have been rendered; (ii) persuasive evidence of an arrangement exists; (iii) the sales price is fixed or determinable; and (iv) collectibility is reasonably assured. 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, net of merchandise returns received and the amount established for anticipated returns. Discounted sales are recorded at net realizable value. Deferred revenue represents prepaid tuition and fees received from students enrolled in our practitioner education program.

Revenue at our patient-care centers segment is recorded net of all governmental adjustments, contractual adjustments and discounts. We employ a systematic process to ensure that our sales are recorded at net realizable value and that any required adjustments are recorded on a timely basis. The contracting module of our centralized, computerized billing system is designed to record revenue at net realizable value based on our contract with the patient's insurance company. Updated billing information is received periodically from payors and is uploaded into our centralized contract module and then disseminated to all patient-care centers electronically.

Disallowed sales generally relate to billings to payors with whom we do not have a formal contract. In these situations we record the sale at usual and customary rates and simultaneously record a disallowed sale to reduce the sale to net value, based on our historical experience with the payor in question. Disallowed sales may also result if the payor rejects or adjusts certain billing codes. Billing codes are frequently updated within our industry. As soon as updates are received, we reflect the change in our centralized billing system.

As part of our preauthorization process with payors, we validate our ability to bill the payor for the service we are providing before we deliver the device. Subsequent to billing for our devices and services, there may be problems with pre-authorization or with other insurance coverage issues with payors. If there has been a lapse in coverage, the patient is financially responsible for the charges related to the devices and services received. If we do not collect from the patient, we record bad debt expense. Occasionally, a portion of a bill is rejected by a payor due to a coding error on our part and we are prevented from pursuing payment from the patient due to the terms of our contract with the insurance company. We appeal these types of decisions and are generally successful. This activity is factored into our methodology to determine the estimate for the allowance for doubtful accounts. We immediately record, as a reduction of sales, a disallowed sale for any claims that we know we will not recover and adjust our future estimates accordingly.

Certain accounts receivable may be uncollectible, even if properly pre-authorized and billed. Regardless of the balance, accounts receivable amounts are periodically evaluated to assess collectibility. In addition to the actual bad debt expense recognized during collection activities, we estimate the amount of potential bad debt expense that may occur in the future. This estimate is based upon our historical experience as well as a review of our receivable balances. On a quarterly basis, we evaluate cash collections, accounts receivable balances and write-off activity to assess the adequacy of our allowance for doubtful accounts. Additionally, a company-wide evaluation of collectibility of receivable balances older than 180 days is performed at least semi-annually, the results of which are used in the next allowance analysis. In these detailed reviews, the account's net realizable value is estimated after considering the customer's payment history, past efforts to collect on the balance and the outstanding balance, and a specific reserve is recorded if needed. From time to time, the Company may outsource the collection of such accounts to outsourced agencies after internal collection efforts are exhausted. In the cases when valid accounts receivable cannot be collected, the uncollectible account is written off to bad debt expense.

NOTE B – SIGNIFICANT ACCOUNTING PRINCIPLES (CONTINUED)

Inventories

Inventories, which consist principally of raw materials, work-in-process and finished goods, are stated at the lower of cost or market using the first-in, first-out method. At our patient-care centers segment, we calculate cost of goods sold in accordance with the gross profit method for all reporting periods. 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, such as sales mix and purchasing trends, among other factors, affecting cost of goods sold during the current reporting periods. Cost of goods sold during the period is adjusted when the annual physical inventory is taken. We treat these adjustments as changes in accounting estimates. At our distribution segment, a perpetual inventory is maintained. 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. Shipping and handling costs are included in cost of goods sold.

Property, Plant and Equipment

We record property, plant and equipment at cost. Equipment acquired under capital leases is recorded at the lower of fair market value or the present value of the future lease payments. The cost and related accumulated depreciation of assets sold, retired or otherwise disposed of are removed from the respective accounts, and any resulting gains or losses are included in the Consolidated Statements of Operations. Depreciation is computed for financial reporting purposes using the straight-line method over the estimated useful lives of the related assets as follows:

Furniture and fixtures	5 years
Machinery and equipment	5 years
Computers and software	5 years
Buildings	10 to 40 years
Assets under capital leases	Shorter of asset life or term of lease
Leasehold improvements	Shorter of asset life or term of lease

NOTE B – SIGNIFICANT ACCOUNTING PRINCIPLES (CONTINUED)

Property, Plant and Equipment (continued)

We capitalize internally developed computer software costs incurred during the application development stage in accordance with Statement of Position 98-1, *Accounting for the Costs of Computer Software Developed or Obtained for Internal Use*.

Stock-Based Compensation

The Company issues options and restricted shares of common stock under two active share-based compensation plans, one for employees and the other for non-employee members of the Board of Directors. At March 31, 2008, 4.7 million shares of common stock are authorized for issuance under the Company's share-based compensation plans. Shares of common stock issued under the share-based compensation plans are released from the Company's authorized shares. Stock option and restricted share awards are granted at the fair market value of the Company's common stock on the date immediately preceding the date of grant. Stock option awards vest over a period determined by the compensation plan, ranging from one to three years, and generally have a maximum term of ten years. Restricted shares of common stock vest over a period of time determined by the Compensation Committee of the Board of Directors ranging from one to four years.

The Company follows the provisions of Statement of Financial Accounting Standards 123R, *Share-Based Payment* ("SFAS 123R"), which requires companies to measure and recognize compensation expense for all share-based payments at fair value. The Company recognized $1.1 million and $0.7 million in compensation expense for the three months periods ended March 31, 2008 and 2007, respectively, which primarily relates to restricted share grants. The amount of expense related to options is de minimus in all periods presented. The Company calculates the fair value of stock options using the Black-Scholes model. The total value of the share based awards is expensed ratably over the requisite service period of the employees receiving the awards.

Segment Information

The Company 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 are presented in Note M.

Income Taxes

The Company adopted the provisions of Financial Accounting Standards Board (FASB) Interpretation No. 48, "Accounting for Uncertainty in Income Taxes", on January 1, 2007. As a result of adoption, the Company recognized a decrease of approximately $0.2 million to the January 1, 2007 retained earnings balance. As of the adoption date, the Company had gross tax affected unrecognized tax benefits of $3.3 million of which $1.1 million, if recognized, would affect the effective tax rate. Over the next 12 months the Company may recognize gross tax affected unrecognized tax benefits of up to $1.5 million, of which $0.2 million is expected to impact the effective tax rate, due to the pending expiration of the period of limitations for assessing tax deficiencies for certain income tax returns. As of the adoption date, the Company had accrued interest expense and penalties related to the unrecognized tax benefits of $0.4 million and $0.4 million, respectively. The Company recognizes interest accrued and penalties related to unrecognized tax benefits as a component of income tax expense. Total penalties and interest accrued as of March 31, 2008 was $1.0 million, including less than $0.1 million in the current income tax provision for the three month period ended March 31, 2008. The Company files numerous consolidated and separate income tax returns in the United States Federal jurisdiction and in many state jurisdictions. The Company is no longer subject to US Federal income tax examinations for years before 2003 and with few exceptions is no longer subject to state and local income tax examinations by tax authorities for years before 2002.

NOTE B – SIGNIFICANT ACCOUNTING PRINCIPLES (CONTINUED)

New Accounting Guidance

In December 2007, the FASB issued SFAS 141(R), *Business Combinations* ("SFAS 141(R)"). SFAS 141(R) provides revised guidance to improve the relevance, representational faithfulness, and comparability of the information that a reporting entity provides in its financial reports about a business combination and its effects. SFAS 141(R) revises the accounting literature previously issued under SFAS 141, Business Combinations. SFAS 141(R) is effective for fiscal years beginning after December 15, 2008. The Company is currently evaluating the impact that adopting SFAS No. 141(R) will have on our financial statements.

In December 2007, the FASB issued SFAS 160, *Noncontrolling Interest in Consolidated Financial Statements* ("SFAS 160"). SFAS 160 revises ARB 51 accounting for non-controlling interests in subsidiaries. SFAS 160 is effective for fiscal years beginning after December 15, 2008. The Company is currently evaluating the impact that adopting SFAS No. 160 will have on our financial statements.

In March 2008, the FASB issued SFAS 161, *Disclosures about Derivative Instruments and Hedging Activities* ("SFAS 161"), an amendment of FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities*. SFAS 161 is intended to enhance the current disclosure framework in Statement 133. SFAS 161 requires that objectives for using derivative instruments be disclosed in terms of underlying risk and accounting designation. SFAS 161 is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008, with early application encouraged. The Company is currently evaluating the impact that adopting SFAS No.161 will have on our financial statements.

NOTE C — SUPPLEMENTAL CASH FLOW FINANCIAL INFORMATION

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

(In thousands)	Three Months Ended March 31, 2008	2007
Cash paid during the period for:		
Interest	$ 3,663	$ 4,837
Income taxes	1,911	1,709
Non-cash financing and investing activities:		
Unrealized loss on auction rate securities	534	--
Issuance of notes in connection with acquistions	600	180
Issuance (cancellation) of restricted shares of common stock	94	(9)

NOTE D – ACQUISITIONS

During the three month period ended March 31, 2008 the Company acquired six patient care centers for an aggregate purchase price of $2.4 million, consisting of $1.2 million in cash, $1.0 million in promissory notes, and a $0.2 million holdback. The Company acquired the assets of a footwear company during the three month period ended March 31, 2007, for which it paid an aggregate purchase price of $0.5 million, $0.3 million in cash and a $0.2 million promissory note.

The Company accounts for its acquisitions using the purchase method of accounting. In conjunction with the acquisitions completed during the three months ended March 31, 2008, the Company recorded approximately $1.8 million of goodwill. The results of operations for these acquisitions are included in the Company's results of operations from their date of acquisition. Pro forma results would not be materially different.

In connection with acquisitions, the Company occasionally agrees to pay contingent considerations if cash collection targets are reached that verify the value of the target negotiated at acquisition. Contingent considerations are defined in the purchase agreement and are accrued based on attainment of these targets. In connection with these agreements, the Company made payments of $0.3 million and $0.2 million during the three month periods ended March 31, 2008 and 2007, 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 up to a total of $6.2 million related to contingent consideration provisions in future periods.

NOTE E — GOODWILL

The Company determined that it has two reporting units with goodwill, which are the same as its reportable segments: (i) patient-care centers and (ii) distribution. The Company completes its annual goodwill impairment analysis in October. The fair value of the Company's reporting units are primarily determined based on the income approach and considers the market and cost approach.

The activity related to goodwill for the three month period ended March 31, 2008 is as follows:

(In thousands)	Patient-Care Centers	Distribution	Total
Balance at December 31, 2007	$ 421,174	$ 38,388	$ 459,562
Additions due to acquisitions	3,493		3,493
Balance at March 31, 2008	$ 424,667	$ 38,388	$ 463,055

NOTE F – INVENTORY

Inventories, which are recorded at the lower of cost or market using the first-in, first-out method, were as follows:

(In thousands)	March 31, 2008	December 31, 2007
Raw materials	$ 30,431	$ 30,482
Work-in-process	35,491	32,641
Finished goods	17,768	19,105
	$ 83,690	$ 82,228

NOTE G – LONG TERM DEBT

Long-term debt consists of the following:

(In thousands)	March 31, 2008	December 31, 2007
Term Loan	$ 225,975	$ 226,550
10 1/4% Senior Notes due 2014	175,000	175,000
Subordinated seller notes, non-collateralized, net of unamortized discount with principal and interest payable in either monthly, quarterly or annual installments at effective interest rates ranging from 5.0% to 10.8%, maturing through December 2011	9,224	9,342
	410,199	410,892
Less current portion	(5,514)	(5,691)
	$ 404,685	$ 405,201

NOTE G – LONG TERM DEBT (CONTINUED)

Revolving Credit Facility

The $75.0 million Revolving Credit Facility matures on May 26, 2011 and bears interest, at the Company's option, of LIBOR plus 2.75% or a Base Rate (as defined in the credit agreement) plus 1.75%. The obligations under the Revolving Credit Facility are guaranteed by the Company's subsidiaries and are secured by a first priority perfected interest in the Company's subsidiaries' shares, all of the Company's assets and all the assets of the Company's subsidiaries. The Revolving Credit Facility requires compliance with various covenants including but not limited to a maximum total leverage ratio and a maximum annual capital expenditures limit. As of March 31, 2008, the Company has not made draws on the Revolving Credit Facility and has $71.7 million available under that facility. Availability under the Company's Revolving Credit Facility is net of standby letters of credit of approximately $3.3 million.

Term Loan

The $230.0 million Term Loan matures on May 26, 2013 and requires quarterly payments which commenced on September 30, 2006. From time to time, mandatory payments may be required as a result of capital stock issuances, additional debt incurrence, asset sales or other events as defined in the credit agreement. The Term Loan bears interest, at the Company's option, at LIBOR plus 2.00% or a Base Rate (as defined in the credit agreement) plus 1.50%. At March 31, 2008, the interest rate on the Term Loan was 4.68%. The obligations under the Term Loan are guaranteed by the Company's subsidiaries and are secured by a first priority perfected interest in the Company's subsidiaries' shares, all of the Company's assets and all the assets of the Company's subsidiaries. The Term Loan is subject to covenants that mirror those of the Revolving Credit Facility.

10 ¼% Senior Notes

The 10 ¼% Senior Notes mature June 1, 2014, are senior indebtedness and are guaranteed in full and unconditionally, on a senior unsecured basis by all of the Company's current and future domestic subsidiaries as well as all the assets of the Company. The parent company has no independent assets or operations and all subsidiaries are 100% owned by the Company. Interest is payable semi-annually on June 1 and December 1, commencing December 1, 2006. On or prior to June 1, 2009, the Company may redeem up to 35% of the aggregate principal amount of the notes at a redemption price of 110.250% of the principal amount thereof, plus accrued and unpaid interest and additional interest, if any, with the net cash proceeds of an equity offering; provided that (i) at least 65% of the aggregate principal amount of the notes remains outstanding immediately after the redemption (excluding notes held by the Company and its subsidiaries); and (ii) the redemption occurs within 90 days of the date of the closing of the equity offering. Except as discussed above, the notes are not redeemable at the Company's option prior to June 1, 2010. On or after June 1, 2010, the Company may redeem all or part of the notes upon not less than 30 days and no more than 60 days' notice, for the twelve-month period beginning on June 1 of the following years: at (i) 105.125% during 2010; (ii) 102.563% during 2011; and (iii) 100.0% during 2012 and thereafter.

NOTE G – LONG TERM DEBT (CONTINUED)

General

The terms of the Senior Notes and the Revolving Credit Facility limit the Company's ability to, among other things, incur additional indebtedness, create liens, pay dividends on or redeem capital stock, make certain investments, make restricted payments, make certain dispositions of assets, engage in transactions with affiliates, engage in certain business activities and engage in mergers, consolidations and certain sales of assets. At March 31, 2008, the Company is in compliance with all covenants under these debt agreements.

NOTE H – COMMITMENTS AND CONTINGENT LIABILITIES

Commitments

The Company's wholly-owned subsidiary, Innovative Neurotronics, Inc. ("IN, Inc."), is party to a non-binding purchase agreement under which it agrees to purchase assembled WalkAide System kits. As of March 31, 2008, IN, Inc. had outstanding purchase commitments of approximately $0.6 million.

Contingencies

The Company is subject to legal proceedings and claims which arise in the ordinary course of its business, including 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.

On June 15, 2004, the Company announced that an employee at its patient-care center in West Hempstead, New York alleged in a television news story aired on June 14, 2004 that there were instances of billing discrepancies at that facility.

On June 18, 2004, the Company announced that on June 17, 2004, the Audit Committee of the Company's Board of Directors had engaged a law firm to serve as independent counsel to the Audit Committee and to conduct an independent investigation of the allegations. The scope of that independent investigation was expanded to cover certain of the Company's other patient-care centers and included consideration of some of the allegations made in the Amended Complaint filed in the class actions discussed below. On June 17, 2004, the U.S. Attorney's Office for the Eastern District of New York subpoenaed records of the Company regarding various billing activities and locations. In addition, the Company also announced on June 18, 2004 that the Securities and Exchange Commission had commenced an informal inquiry into the matter. The Company is cooperating with the regulatory authorities. The Audit Committee's investigation will not be complete until all regulatory authorities have indicated that their inquiries are complete.

NOTE H – COMMITMENTS AND CONTINGENT LIABILITIES (CONTINUED)

Contingencies (continued)

Management believes that any billing discrepancies are likely to be primarily at the West Hempstead patient-care center. Furthermore, management does not believe the resolution of the matters raised by the allegations will have a materially adverse effect on the Company's financial statements. The West Hempstead facility generated $0.1 million and $0.1 million of net sales during the three months ending March 31, 2008 and 2007, respectively, or less than 0.1% of the Company's net sales, for each quarter.

It should be noted that additional regulatory inquiries may be raised relating to the Company's billing activities at other locations. No assurance can be given that the final results of the regulatory agencies' inquiries will be consistent with the results to date or that any discrepancies identified during the ongoing regulatory review will not have a material adverse effect on the Company's financial statements.

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 has reviewed its existing contracts containing indemnification or clauses of guarantees and does not believe that its liability under such agreements will result in any material liability.

NOTE I — PREFERRED STOCK

In May 2006, the Company issued 50,000 shares of Series A Convertible Preferred Stock ("Series A Preferred") with a stated value of $1,000 per share. The Series A Preferred provides for cumulative dividends at a rate of 3.33% per annum, payable quarterly in arrears. The Company may elect to defer the payment of dividends. The Series A Preferred may be converted into common shares at $7.56 per share at the option of the holders after a required holding period of 61 days which has since passed or at the option of the Company upon satisfaction of certain conditions. In addition, the initial holders of the Series A Preferred are entitled to have representation on the board of directors of the Company and are entitled to vote on all matters on which the holders of the Company's common stock are entitled to vote.

The Series A Preferred can be redeemed for cash, at the option of the holder, upon the occurrence of a "Fundamental Transaction", as defined in the Certificate of Designations. These events or transactions include (i) acquisition of more than thirty-five percent of voting equity interest of the Company by a legal entity or group; (ii) replacement of more than one-half of the members of the board of directors with members that are not approved by the persons who were directors on May 25, 2006; (iii) a merger or consolidation of the Company or any subsidiary or a sale of all or substantially all of the assets of the Company in one or a series of related transactions, unless following such transaction or series of transactions, the holders of the Company's securities prior to the first such transaction continue to hold at least half of the voting rights or voting equity interests of the surviving entity or acquirer of such assets; (iv) a recapitalization, reorganization or other transaction involving the Company or any significant subsidiary that constitutes or results in a transfer of more than one-half of the voting rights or voting equity interests in the Company; (v) consummation of a "Rule 13e-3 transaction" as defined in Rule 13e-3 under the Securities Exchange Act of 1934 with respect to the Company; (vi) any tender offer or exchange offer (whether by the Company or another person) is completed pursuant to which holders of the Company's common stock are permitted to tender or exchange their shares for other securities, cash or property; (vii) the Company effects any reclassification of its common stock or any compulsory share exchange pursuant to which its common stock is effectively converted into or exchanged for other securities, cash or property; or (viii) the execution by the Company of an agreement directly or indirectly providing for any of the foregoing events. The redemption price per share of Series A Preferred in the event a holder elects redemption following the occurrence of a Fundamental Event, is equal to the stated value per share, plus accrued but unpaid dividends as of the date of the Fundamental Transaction.

NOTE I — PREFERRED STOCK (CONTINUED)

In addition, the initial holders of the Series A Preferred are entitled to have representation on the board of directors of the Company and are entitled to vote on all matters on which the holders of the Company's common stock are entitled to vote.

NOTE J – 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, restricted shares, and convertible preferred stock, and are calculated using the treasury stock method.

NOTE J – NET INCOME PER COMMON SHARE (CONTINUED)

Net income per share is computed as follows:

(In thousands, except share and per share data)	Three Months Ended March 31, 2008	2007
Net income	$ 3,565	$ 1,784
Preferred stock dividends -Series A Convertible Preferred Stock (1)	416	416
Net income applicable to common stock	$ 3,149	$ 1,368
Shares of common stock outstanding used to compute basic per common share amounts	22,880,973	22,191,920
Effect of dilutive restricted stock and options	1,167,266	1,176,951
Effect of dilutive convertible preferred stock	6,613,757	--
Shares used to compute dilutive per common share amounts (1)(2)	30,661,996	23,368,871
Basic income per share applicable to common stock	$ 0.14	$ 0.06
Diluted income per share applicable to common stock	0.12	0.06

(1) For the three month period ended March 31, 2007, excludes the effect of the conversion of Preferred Stock as it is considered anti-dilutive.

(2) For the three months ended March 31, 2008 and March 31, 2007, options to purchase 1,042,665 and 1,555,815 shares of common stock, respectively, are not included in the computation of diluted income per share as these options are anti-dilutive because the exercise prices of these options were greater than the average market price of the Company's stock during the period.

NOTE K – SUPPLEMENTAL EXECUTIVE RETIREMENT PLAN

The Company's unfunded noncontributory defined benefit plan (the "Plan") covers certain senior executives, is administered by the Company and calls for annual payments upon retirement based on years of service and final average salary. Benefit costs and liabilities balances are calculated based on certain assumptions including benefits earned, discount rates, interest costs, mortality rates and other factors. Actual results that differ from the assumptions are accumulated and amortized over future periods, affecting the recorded obligation and expense in future periods.

The following assumptions were used in the calculation of the net benefit cost and obligation at March 31, 2008:

Discount rate	6.25%
Average rate of increase in compensation	3.00%

We believe the assumptions used are appropriate, however, changes in assumptions or differences in actual experience may affect our benefit obligation and future expenses. The change in the Plan's net benefit obligation is as follows:

	(In thousands)
Net benefit cost accrued at December 31, 2007	$ 8,269
Service cost	555
Interest cost	130
Net benefit cost accrued at March 31, 2008	$ 8,954

NOTE L — STOCK-BASED COMPENSATION

Employee Plans

Under the Company's 2002 Stock Option Plan, 1.5 million shares of common stock were authorized for issuance. Options may only be granted at an exercise price that is not less than the fair market value of the common stock on the date of grant and may expire no later than ten years after grant. Vesting and expiration periods are established by the Compensation Committee of the Board of Directors, generally with vesting of four years following the date of grant and generally with expirations of ten years after grant. During 2003, the 2002 Stock Option Plan was amended to permit the grant of restricted shares of common stock in addition to stock options and to change the name of the plan to the 2002 Stock Incentive Plan. During May 2006, an additional 2.7 million shares of common stock were authorized for issuance. During May 2007, the Company's shareholders approved amendments to the 2002 Stock Incentive Plan, most notably the incorporation of the Company's current annual incentive plan for certain executive officers into the 2002 Stock Incentive Plan. The amendments resulted in the following changes to the 2002 Stock Incentive Plan: (i) addition of performance-based cash awards ("Incentive Awards") and renaming the 2002 Stock Incentive Plan to be the 2002 Stock Incentive and Bonus Plan; (ii) limitation on the number of options, shares of restricted stock, annual Incentive Awards and long term Incentive Awards that an individual can receive during any calendar year; (iii) addition of a list of specific performance goals that the Company may use for the provision of awards under the 2002 Stock Incentive and Bonus Plan; (iv) limitation on the total number of shares of stock issued pursuant to the exercise of incentive stock options; and (v) addition of a provision allowing for the Company to institute a compensation recovery policy, which would allow the Compensation Committee, in appropriate circumstances, to seek reimbursement of certain compensation realized under awards granted under the 2002 Stock Incentive and Bonus Plan. In August 2007, 205,000 performance-based restricted shares were granted to certain executives. These performance-based restricted shares are subject to the same vesting period as the service-based restricted shares for employees. However, the quantity of restricted shares to be released under this grant is dependent on the diluted EPS for the twelve month period July 1, 2007 through June 30, 2008. Note that the agreements which include these performance-based awards are expected to be renewed annually, at which time a new target performance period will be established.

During the three months ended March 31, 2008, no options and 750 restricted shares were cancelled under the 2002 Stock Incentive and Bonus Plan. At March 31, 2008, 1,413,419 shares of common stock were available for issuance.

Director Plans

During April and May 2003, the Compensation Committee of the Board of Directors and the shareholders of the Company, respectively, approved the 2003 Non-Employee Directors' Stock Incentive Plan ("2003 Directors' Plan") which replaced the Company's 1993 Non-Employee Director Stock Option Plan ("Director Plan"). The 2003 Directors' Plan authorized 500,000 shares of common stock for grant and permits the issuance of stock options and restricted shares of common stock. The 2003 Directors' Plan also provides for the automatic annual grant of 8,500 shares of restricted shares of common stock to each director and permits the grant of additional restricted stock in the event the director elects to receive his or her annual director fee in restricted shares of common stock rather than cash. Options may only be granted at an exercise price that is not less than the fair market value of the common stock on the date of grant and may expire no later than ten years after grant. Vesting and expiration periods are established by the Compensation Committee of the Board of Directors, generally with vesting of three years following grant and generally with expirations of ten years after grant. In May 2007, the Company's shareholders further approved an amendment to the 2003 Directors' Plan providing for the issuance by the Company of restricted stock units to its non-employee directors, at the option of such director. The restricted stock units effectively allow the director to elect to defer receipt of the shares of restricted stock which the director would ordinarily receive on an annual basis until (i) the January 15th of the year following the calendar year in which the director terminates service on the Board of Directors, or (ii) the fifth, tenth or fifteenth anniversary of the annual meeting date on the election form for that year. The director may elect to receive his or her annual grant of restricted stock, including shares to be received in lieu of the annual director fee, in the form of restricted stock units, with such election to take place on or prior to the date of the annual meeting of stockholders for such year. The restricted stock units are subject to the same vesting period as the shares of restricted stock issued under the 2003 Directors' Plan. During the three months ended March 31, 2008, no restricted shares or options were cancelled under the 2003 Directors' Plan. At March 31, 2008, 208,365 shares of common stock were available for issuance.

NOTE L — STOCK-BASED COMPENSATION (CONTINUED)

Restricted Shares of Common Stock

A summary of the activity of restricted shares of common stock for the three months ended March 31, 2008 is as follows:

	Employee Plans		Director Plans	
	Shares	Weighted Average Grant Date Fair Value	Shares	Weighted Average Grant Date Fair Value
Nonvested at December 31, 2007	1,470,687	$ 8.67	122,956	$ 9.73
Granted	10,000	10.63	--	--
Vested	(63,000)	6.61	--	--
Forfeited	(750)	9.51	--	--
Nonvested at March 31, 2008	1,416,937	$ 8.78	122,956	$ 9.73

During the three month period ended March 31, 2008, 63,000 restricted shares of common stock, with an intrinsic value of $0.4 million became fully vested. As of March 31, 2008, total unrecognized compensation cost related to unvested restricted shares of common stock was approximately $10.8 million and the related weighted-average period over which it is expected to be recognized is approximately 2.8 years. The aggregate granted shares have vesting dates through January 2012.

NOTE L — STOCK-BASED COMPENSATION (CONTINUED)

Options

The summary of option activity and weighted average exercise prices are as follows:

	Employee Plans		Director Plans		Non-Qualified Awards	
(In thousands, except per share and weighted average price amounts)	Shares	Weighted Average Price	Shares	Weighted Average Price	Shares	Weighted Average Price
Outstanding at December 31, 2007	1,510,649	$ 11.10	153,113	$ 11.04	406,000	$ 5.95
Granted	--	--	--	--	--	--
Terminated	(86,564)	7.00	--	--	--	--
Exercised	(72,280)	3.03	--	--	--	--
Outstanding at March 31, 2008	1,351,805	$ 11.79	153,113	$ 11.04	406,000	$ 5.95
Aggregate intrinsic value at March 31, 2008	$ 15,944,187		$ 1,691,179		$ 2,415,000	
Weighted average remaining contractual term (years)	3.3		4.5		2.0	

The intrinsic value of options exercised during the three months ended March 31, 2008 was $0.2 million. Options exercisable under the Company's share-based compensation plans at March 31, 2008 were 1.9 million shares with a weighted average exercise price of $13.88, an average remaining contractual term of 3.1 years, and an aggregate intrinsic value of $20.0 million. Cash received by the Company related to the exercise of options during the three months ended March 31, 2008 amounted to $52,000. As of March 31, 2008, total unrecognized compensation cost related to stock option awards was approximately $3,700, all of which will be recorded as of the quarter ending September 30, 2008.

Information concerning outstanding and exercisable options as of March 31, 2008 is as follows:

	Options Outstanding			Options Exercisable		
		Weighted Average				
Range of Exercise Prices	Number of Options or Awards	Remaining Life (Years)	Exercise Price	Number of Options or Awards	Wt Avg Remaining Life (Years)	Weighted Average Exercise Price
$1.64 to $1.65	315,141	1.2	$ 1.64	315,141	1.2	$ 1.64
4.63 to 6.02	453,112	2.4	5.87	439,474	2.3	5.89
8.08 to 12.10	124,605	6.4	8.72	124,605	6.4	8.72
12.96 to 18.63	913,060	3.9	14.73	913,060	3.9	14.73
22.13 to 22.50	105,000	0.7	22.31	105,000	0.7	22.31
	1,910,918	3.1	$ 10.49	1,897,280	3.1	$ 10.53

NOTE M – 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' income from operations. The reportable segments are: (i) patient-care centers and (ii) distribution. The reportable segments are described further below:

NOTE M – SEGMENT AND RELATED INFORMATION (CONTINUED)

Patient-Care Centers – This segment consists of the Company's owned and operated patient-care centers and fabrication centers of O&P components. 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.

Distribution – This segment distributes orthotic and prosthetic ("O&P") products and components to both the O&P industry and the Company's own patient-care practices.

Other – This segment consists of Hanger Corporate, IN, Inc. and Linkia. IN, Inc. specializes in bringing emerging MyoOrthotics Technologies® to the O&P market. MyoOrthotics Technologies represents the merging of orthotic technologies with electrical stimulation. Linkia is a national managed-care agent for O&P services and a patient referral clearing house.

The accounting policies of the segments are the same as those described in the summary of "Significant Accounting Policies" in Note B to the consolidated financial statements.

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.

	Patient-Care Centers	Distribution	Other	Consolidating Adjustments	Total
(In thousands)					
Three Months Ended March 31, 2008					
Net sales					
Customers	$ 137,764	$ 18,940	952	$ --	$ 157,656
Intersegments	--	31,599	1,629	(33,228)	--
Depreciation and amortization	3,003	174	1,004	--	4,181
Income from operations	19,422	5,222	(10,464)	19	14,199
Interest expense	(1,632)	1,778	8,112	--	8,258
Income before taxes	21,054	3,444	(18,576)	19	5,941
Total assets	681,316	78,737	(15,988)	--	744,065
Capital expenditures	2,089	158	843	--	3,090
Three Months Ended March 31, 2007					
Net sales					
Customers	$ 130,609	$ 13,047	$ 194	$ --	$ 143,850
Intersegments	--	28,840	426	(29,266)	--
Depreciation and amortization	3,004	82	662	--	3,748
Income from operations	19,153	3,619	(10,712)	336	12,396
Interest expense	(1,628)	1,733	9,235	--	9,340
Income before taxes	20,781	1,886	(19,947)	336	3,056
Total assets	613,239	92,179	9,116	--	714,534
Capital expenditures	1,777	127	2,221	--	4,125

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

Overview

The following is a discussion of our results of operations and financial condition for the periods described below. This discussion should be read in conjunction with the Consolidated Financial Statements included in this report. Our discussion of our results of operations and financial condition includes various forward-looking statements about our markets, the demand for our products and services and our future results. These statements are based on our current expectations, which are inherently subject to risks and uncertainties. Our actual results and the timing of certain events may differ materially from those indicated in the forward looking statements.

Business Overview

General

We are the largest owner and operator of orthotic and prosthetic ("O&P") patient-care centers ("patient -care centers"), accounting for approximately 25% of the estimated $2.5 billion O&P patient-care market, in the United States. At March 31, 2008, we operated 653 O&P patient-care centers in 45 states and the District of Columbia and employed in excess of 1,000 revenue-generating O&P practitioners ("practitioners"). In addition, through our wholly-owned subsidiary, Southern Prosthetic Supply, Inc. ("SPS"), we are the largest distributor of branded and private label O&P devices and components in the United States, all of which are manufactured by third parties. We also create new products, through our wholly-owned subsidiary, Innovative Neurotronics, Inc. ("IN, Inc.") for patients who have had a loss of mobility due to strokes, multiple sclerosis or other similar conditions. Another subsidiary, Linkia LLC ("Linkia"), develops programs to manage all aspects of O&P patient care for large private payors.

For the three month period ended March 31, 2008, our net sales were $157.7 million and we recorded net income of $3.6 million. For the three month period ended March 31, 2007, our net sales were $143.8 million and we recorded net income of $1.8 million.

We conduct our operations primarily in two reportable segments – patient-care centers and distribution. For the three months ended March 31, 2008, net sales attributable to our patient-care services segment and distribution segment were $137.8 million and $18.9 million, respectively. See Note M to our consolidated financial statements contained herein for further information related to our segments.

Patient Care Services

As of March 31, 2008, we provided O&P patient care services through 653 patient-care centers and over 1,000 practitioners in 45 states and the District of Columbia. Substantially all of our practitioners are certified, or candidates for formal certification, by the O&P industry certifying boards. One or more practitioners closely manage each of our patient-care centers. Our patient-care centers also employ highly trained technical personnel who assist in the provision of services to patients and who fabricate various O&P devices, as well as office administrators who schedule patient visits, obtain approvals from payors and bill and collect for services rendered.

An attending physician determines a patient's treatment, writes a prescription and refers the patient to one of our patient-care centers. Our practitioners then consult with both the referring physician and the patient with a view toward assisting in the formulation of the prescription for, and design of, an orthotic or prosthetic device to meet the patient's need.

The fitting process often involves several stages in order to successfully achieve desired functional and cosmetic results. The practitioner creates a cast and takes detailed measurements, frequently using our digital imaging system (Insignia), of the patient to ensure an anatomically correct fit. Prosthetic devices are custom fabricated by technicians and fit by skilled practitioners. The majority of the orthotic devices provided by us are custom designed, fabricated and fit; the remainder are prefabricated but custom fit.

Custom devices are fabricated by our skilled technicians using the plaster castings, measurements and designs made by our practitioners as well as utilization of our proprietary Insignia system. The Insignia system replaces plaster casting of a patient's residual limb with the generation of a computer scanned image. Insignia provides a very accurate image, faster turnaround for the patient, and a more professional overall experience. Technicians use advanced materials and technologies to fabricate a custom device under quality assurance guidelines. Custom designed devices that cannot be fabricated at the patient-care centers are fabricated at one of several central fabrication facilities. After final adjustments to the device by the practitioner, the patient is instructed in the use, care and maintenance of the device. Training programs and scheduled follow-up and maintenance visits are used to provide post-fitting treatment, including adjustments or replacements as the patient's physical condition and lifestyle change.

To provide timely service to our patients, we employ technical personnel and maintain laboratories at many of our patient-care centers. We have earned a strong reputation within the O&P industry for the development and use of innovative technology in our products, which has increased patient comfort and capability, and can significantly enhance the rehabilitation process. The quality of our products and the success of our technological advances have generated broad media coverage, building our brand equity among payors, patients and referring physicians.

A substantial portion of our O&P services involves the treatment of a patient in a non-hospital setting, such as our patient-care centers, a physician's office, an out-patient clinic or other facility. In addition, O&P services are increasingly rendered to patients in hospitals, long-term care facilities, rehabilitation centers and other alternate-site healthcare facilities. In a hospital setting, the practitioner works with a physician to provide either orthotic devices or temporary prosthetic devices that are later replaced by permanent prosthetic devices.

Patient-Care Center Administration

We provide all accounting, accounts payable, payroll, sales and marketing, management information systems, real estate, acquisitions and human resources services for our patient-care centers on either a centralized or out-sourced basis. As a result, we are able to provide these services more efficiently and cost-effectively than if these services had to be generated at each patient-care center. Moreover, the centralization or out-sourcing of these services permits our practitioners to allocate a greater portion of their time to patient care activities by reducing their administrative responsibilities.

We also develop and implement programs designed to increase sales and enhance the efficiency of our patient-care centers. These programs include: (i) sales and marketing initiatives to attract new patient referrals by establishing relationships with physicians, therapists, employers, managed care organizations, hospitals, rehabilitation centers, out-patient clinics and insurance companies; (ii) professional management and information systems to improve efficiencies of administrative and operational functions; (iii) professional education programs for practitioners emphasizing new developments in the increasingly sophisticated field of O&P clinical therapy; (iv) the establishment of shared fabrication and centralized purchasing activities, which provide access to component parts and products within two business days at prices that are typically lower than traditional procurement methods; (v) access to virtually every product available at lower cost due to the combined purchasing power of our patient-care centers; and (vi) access to technology, such as Insignia, that is not available to our competitors.

Distribution Services

We distribute O&P components to the O&P market as a whole and to our own patient-care centers through our wholly-owned subsidiary, SPS, which is the nation's largest O&P distributor. In July 2007, SPS acquired certain assets of SureFit, LLC, a leading manufacturer and distributor of therapeutic footwear for diabetic patients in the podiatric market. SPS maintains in inventory approximately 21,000 O&P related items, all of which are manufactured by other companies. SPS maintains distribution facilities in California, Florida, Georgia, Pennsylvania, and Texas, which allows us to deliver products via ground shipment anywhere in the United States within two business days.

Our distribution business enables us to:

- lower our material costs by negotiating purchasing discounts from manufacturers;
- reduce our patient-care center inventory levels and improve inventory turns through centralized purchasing control;
- quickly access prefabricated and finished O&P products;
- perform inventory quality control;
- encourage our patient-care centers to use clinically appropriate products that enhance our profit margins; and
- coordinate new product development efforts with key vendor “partners”.

This is accomplished at competitive prices as a result of our direct purchases from manufacturers.

Marketing of our distribution services is conducted on a national basis through a dedicated sales force, print and e-commerce catalogues and exhibits at industry and medical meetings and conventions. We direct specialized catalogues to segments of the healthcare industry, such as orthopedic surgeons, physical and occupational therapists, and podiatrists.

Product Development

In 2004, we formed a new subsidiary, IN, Inc. Specializing in the field of functional electrical stimulation, IN, Inc. identifies emerging MyoOrthotics Technologies® developed at research centers and universities throughout the world that use neuromuscular stimulation to improve the functionality of an impaired limb. MyoOrthotics Technologies® represents the merging of orthotic technologies with electrical stimulation. Working with the inventors under licensing and consulting agreements, IN, Inc. advances the design and manufacturing and regulatory and clinical aspects of the technology, and then introduces the devices to the marketplace through a variety of distribution channels. IN, Inc’s. first product, the WalkAide System (“WalkAide”), has received FDA approval, achieved ISO 13485:2004 and ISO 9001:2000 certification, as well as the European CE Mark, which are widely accepted quality management standards for medical devices and related services. In addition, in September 2007 the WalkAide earned the esteemed da Vinci Award for Adaptive Technologies from the National Multiple Sclerosis Society. In the spirit of the 15th century artist and visionary Leonardo da Vinci, the da Vinci Awards honor outstanding engineering achievements in adaptive and assistive technology that provide solutions to accessibility issues for people with disabilities. Although not currently covered by Medicare, the WalkAide is sold in the United States through the Company’s patient care centers and SPS. IN, Inc is also marketing the WalkAide internationally through licensed distributors. In July 2007, IN, Inc announced an agreement granting Teijin Pharma Limited exclusive rights to develop and commercialize the WalkAide in Japan.

Provider Network Management

Linkia is the first provider network management service company dedicated solely to serving the O&P market. Linkia was created by us during 2003 and is dedicated to managing the O&P services of national insurance companies. Linkia partners with healthcare insurance companies by securing national and regional contracts to manage their O&P networks, of which our patient care centers represent the majority of the participating providers. In 2004, Linkia entered into its first contract, and in September 2005, Linkia signed an agreement with CIGNA HealthCare which presently will cover approximately nine million beneficiaries. We will continue to invest in and develop Linkia networks and capabilities, as well as market to other national payors.

Industry Overview

We estimate that the O&P patient care market in the United States is approximately $2.5 billion, of which we account for approximately 25%. The O&P patient care services market is highly fragmented and is characterized by local, independent O&P businesses, with the majority generally having a single facility with annual revenues of less than $1.0 million. We do not believe that any of our patient care competitors account for a market share of more than 2% of the country's total estimated O&P patient care services revenue.

The care of O&P patients is part of a continuum of rehabilitation services including diagnosis, treatment and prevention of future injury. This continuum involves the integration of several medical disciplines that begins with the attending physician's diagnosis. A patient's course of treatment is generally determined by an orthopedic surgeon, vascular surgeon or physiatrist, who writes a prescription and refers the patient to an O&P patient care services provider for treatment. A practitioner then, using the prescription, consults with both the referring physician and the patient to formulate the design of an orthotic or prosthetic device to meet the patient's needs.

The O&P industry is characterized by stable, recurring revenues, primarily resulting from the need for periodic replacement and modification of O&P devices. Based on our experience, the average replacement time for orthotic devices is one to three years, while the average replacement time for prosthetic devices is three to five years. There is also an attendant need for continuing O&P patient care services. In addition to the inherent need for periodic replacement and modification of O&P devices and continuing care, we expect the demand for O&P services will continue to grow as a result of several key trends, including:

Aging U.S. Population. The growth rate of the over-65 age group is nearly triple that of the under-65 age group. There is a direct correlation between age and the onset of diabetes and vascular disease, which are the leading causes of amputations. With broader medical insurance coverage, increasing disposable income, longer life expectancy, greater mobility expectations and improved technology of O&P devices, we believe the elderly will increasingly seek orthopedic rehabilitation services and products.

Growing Physical Health Consciousness. The emphasis on physical fitness, leisure sports and conditioning, such as running and aerobics, is growing, which has led to increased injuries requiring orthopedic rehabilitative services and products. These trends are evidenced by the increasing demand for new devices that provide support for injuries, prevent further or new injuries or enhance physical performance.

Increased Efforts to Reduce Healthcare Costs. O&P services and devices have enabled patients to become ambulatory more quickly after receiving medical treatment in the hospital. We believe that significant cost savings can be achieved through the early use of O&P services and products. The provision of O&P services and products in many cases reduces the need for more expensive treatments, thus representing a cost savings to third-party payors.

Advancing Technology. The range and effectiveness of treatment options for patients requiring O&P services have increased in connection with the technological sophistication of O&P devices. Advances in design technology and lighter, stronger and more cosmetically acceptable materials have enabled patients to replace older O&P devices with new O&P products that provide greater comfort, protection and patient acceptability. As a result, treatment can be more effective or of shorter duration, giving the patient greater mobility and a more active lifestyle. Advancing technology has also increased the prevalence and visibility of O&P devices in many sports, including skiing, running and tennis.

Competitive Strengths

The combination of the following competitive strengths will help us in growing our business through an increase in our net sales, net income and market share:

- Leading market position, with an approximate 25% share of total industry revenues and operations in 45 states and the District of Columbia, in an otherwise fragmented industry;
- National scale of operations, which has better enabled us to:
  - establish our brand name and generate economies of scale;
  - implement best practices throughout the Company;
  - utilize shared fabrication facilities;
  - contract with national and regional managed care entities;
  - identify, test and deploy emerging technology; and
  - increase our influence on, and input into, regulatory trends;

- Distribution of, and purchasing power for, O&P components and finished O&P products, which enables us to:
  - negotiate greater purchasing discounts from manufacturers and freight providers;
  - reduce patient-care center inventory levels and improve inventory turns through centralized purchasing control;
  - quickly access prefabricated and finished O&P products;
  - promote the usage by our patient-care centers of clinically appropriate products that also enhance our profit margins;
  - engage in co-marketing and O&P product development programs with suppliers; and
  - expand the non-Hanger client base of our distribution segment;
- Development of leading-edge technology to be brought to market through our patient practices and licensed distributors worldwide;
- Full O&P product offering, with a balanced mix between orthotics services and products and prosthetics services and products;
- Practitioner compensation plans that financially reward practitioners for their efficient management of accounts receivable collections, labor, materials, and other costs, and encourage cooperation among our practitioners within the same local market area;
- Proven ability to rapidly incorporate technological advances in the fitting and fabrication of O&P devices;
- History of successful integration of small and medium-sized O&P business acquisitions, including 65 O&P businesses since 1997, representing over 168 patient-care centers;
- Highly trained practitioners, whom we provide with the highest level of continuing education and training through programs designed to inform them of the latest technological developments in the O&P industry, and our certification program located at the University of Connecticut; and
- Experienced and committed management team.
- Successful Government Relations efforts including:
  - Supported our patients' efforts to pass "The Prosthetic Parity Act" in 10 states.
  - Increased Medicaid reimbursement levels in several states.
  - Creation of the Hanger Orthopedic PAC (The Hanger PAC).

Business Strategy

Our goal is to continue to provide superior patient care and to be the most cost-efficient, full service, national O&P operator. The key elements of our strategy to achieve this goal are to:

- Improve our performance by:

- developing and deploying new processes to improve the productivity of our practitioners;
- continuing periodic patient evaluations to gauge patients' device and service satisfaction;
- improving the utilization and efficiency of administrative and corporate support services;
- enhancing margins through continued consolidation of vendors and product offering; and
- leveraging our market share to increase sales and enter into more competitive payor contracts;

• Increase our market share and net sales by:

- continued marketing of Linkia to regional and national providers and contracting with national and regional managed care providers who we believe select us as a preferred O&P provider because of our reputation, national reach, density of our patient-care centers in certain markets and our ability to monitor quality and outcomes as well as reducing administrative expenses;
- increasing our volume of business through enhanced comprehensive marketing programs aimed at referring physicians and patients, such as our Patient Evaluation Clinics program, which reminds patients to have their devices serviced or replaced and informs them of technological improvements of which they can take advantage; and our "People in Motion" program which introduces potential patients to the latest O&P technology;
- expanding the breadth of products being offered out of our patient-care centers; and
- increasing the number of practitioners through our residency program;

• Develop businesses that provide services and products to the broader rehabilitation and post-surgical healthcare areas;

• Continue to create, license or patent and market devices based on new cutting edge technology. We anticipate bringing new technology to the market through our IN, Inc. product line;

• Selectively acquire small and medium-sized O&P patient care service businesses and open satellite patient-care centers primarily to expand our presence within an existing market and secondarily to enter into new markets; and

• Provide our practitioners with:

- the training necessary to utilize existing technology for different patient service facets, such as the use of our Insignia scanning system for burns and cranial helmets;
- career development and increased compensation opportunities;
- a wide array of O&P products from which to choose;
- administrative and corporate support services that enable them to focus their time on providing superior patient care; and
- selective application of new technology to improve patient care.

• Lobby government officials at both the state and federal level on issues important to Hanger, our patients, and the O&P industry.

Results

Net sales for the three months ended March 31, 2008 increased by $13.8 million, or 9.6%, to $157.7 million from $143.9 million in the prior year's first quarter. The sales increase was principally the result of a $5.5 million, or 4.2%, increase in same-center sales in our patient care business, a $3.4 million, or 25.7%, increase in external sales of our distribution segment, and $4.9 million associated with acquisitions. Income from operations increased by $1.8 million for the three months ended March 31, 2008, to $14.2 million, or 9.0% of net sales, from $12.4 million, or 8.6% of net sales, in the same period in 2007. Income from operations increased due principally to the increase in sales volume and improvement in costs of goods sold. Net income applicable to common stock for the three months ended March 31, 2008 increased $1.7 million to $3.1 million, compared to income of $1.4 million in the same period of the prior year. The current period benefited from improved income from operations and lower interest costs.

Critical Accounting Policies and Estimates

Our analysis and discussion of our financial condition and results of operations is based upon our Consolidated Financial Statements that have been prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP"). 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 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. GAAP provides the framework from which to make these estimates, assumptions and disclosures. We have chosen accounting policies within 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 policies are stated in Note B to the Consolidated Financial Statements as presented elsewhere in this Quarterly Report on Form 10-Q. 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 our Consolidated Financial Statements.

- *Revenue Recognition:* Revenues from the sale of orthotic and prosthetic devices and associated services to patients are recorded when the device is accepted by the patient, provided that (i) delivery has occurred or services have been rendered; (ii) persuasive evidence of an arrangement exists; (iii) the sales price is fixed or determinable; and (iv) collectibility is reasonably assured. Revenues from 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, net of merchandise returns received and the amount established for anticipated returns. Discounted sales are recorded at net realizable value. Deferred revenue represents prepaid tuition and fees received from students enrolled in our practitioner education program.

  Revenue at our patient-care centers segment is recorded net of all governmental adjustments, contractual adjustments and discounts. We employ a systematic process to ensure that our sales are recorded at net realizable value and that any required adjustments are recorded on a timely basis. The contracting module of our centralized, computerized billing system is designed to record revenue at net realizable value based on our contract with the patient's insurance company. Updated billing information is received periodically from payors and is uploaded into our centralized contract module and then disseminated to all patient-care centers electronically.

  The following represents the composition of our patient-care segment's accounts receivable balance by payor:

March 31, 2008

(In thousands)	**0-60 days**	**61-120 days**	**Over 120 days**	**Total**
Commercial and other	$ 37,956	$ 8,213	$ 6,733	$ 52,902
Private pay	3,767	1,158	1,382	6,307
Medicaid	9,355	1,996	2,082	13,433
Medicare	19,207	2,004	1,638	22,849
VA	1,076	179	44	1,299
	$ 71,361	$ 13,550	$ 11,879	$ 96,790

December 31, 2007

(In thousands)	**0-60 days**	**61-120 days**	**Over 120 days**	**Total**
Commercial and other	$ 41,806	$ 9,561	$ 6,836	$ 58,203
Private pay	3,124	1,326	1,266	$ 5,716
Medicaid	8,506	2,320	2,084	$ 12,910
Medicare	20,557	2,622	1,603	$ 24,782
VA	1,140	196	135	$ 1,471
	$ 75,133	$ 16,025	$ 11,924	$ 103,082

Disallowed sales generally relate to billings to payors with whom we do not have a formal contract. In these situations, we record the sale at usual and customary rates and simultaneously record an estimate to reduce the sale to net realizable value, based on our historical experience with the payor in question. Disallowed sales may also result if the payor rejects or adjusts certain billing codes. Billing codes are frequently updated within our industry. As soon as updates are received, we reflect the change in our centralized billing system.

As part of our preauthorization process with payors, we validate our ability to bill the payor for the service we are providing before we deliver the device. Subsequent to billing for our devices and services, there may be problems with pre-authorization or with other insurance coverage issues with payors. If there has been a lapse in coverage, the patient is financially responsible for the charges related to the devices and services received. If we do not collect from the patient, we record bad debt expense. Occasionally, a portion of a bill is rejected by a payor due to a coding error on our part and we are prevented from pursuing payment from the patient due to the terms of our contract with the insurance company. We appeal these types of decisions and are generally successful. This activity is factored into our methodology to determine the estimate for the allowance for doubtful accounts. We immediately record, as a reduction of sales, a disallowed sale for any claims that we know we will not recover and adjust our future estimates accordingly.

Certain accounts receivable may be uncollectible, even if properly pre-authorized and billed. Regardless of the balance, accounts receivable amounts are periodically evaluated to assess collectibility. In addition to the actual bad debt expense recognized during collection activities, we estimate the amount of potential bad debt expense that may occur in the future. This estimate is based upon our historical experience as well as a review of our receivable balances. On a quarterly basis, we evaluate cash collections, accounts receivable balances and write-off activity to assess the adequacy of our allowance for doubtful accounts. Additionally, a company-wide evaluation of collectibility of receivable balances older than 180 days is performed at least semi-annually, the results of which are used in the next allowance analysis. In these detailed reviews, the account's net realizable value is estimated after considering the customer's payment history, past efforts to collect on the balance and the outstanding balance, and a specific reserve is recorded if needed. From time to time, the Company may outsource the collection of such accounts to outsourced agencies after internal collection efforts are exhausted. In the cases when valid accounts receivable cannot be collected, the uncollectible account is written off to bad debt expense.

- *Inventories:* Inventories, which consist principally of raw materials, work in process and finished goods, are stated at the lower of cost or market using the first-in, first-out method. At our patient-care centers segment, we calculate cost of goods sold in accordance with the gross profit method for all reporting periods. We base the estimates used in applying the gross profit method on the actual results of the most recently completed physical inventory and other factors, such as sales mix and purchasing trends among other factors, affecting cost of goods sold during the interim reporting periods. Cost of goods sold during the period is adjusted when the annual physical inventory is taken. We treat these inventory adjustments as changes in accounting estimates. At our distribution segment, a perpetual inventory is maintained. 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. Shipping and handling costs are included in cost of goods sold.

- *Property, Plant and Equipment*: We record property, plant and equipment at cost. Equipment acquired under capital leases is recorded at the lower of fair market value or the present value of the future lease payments. The cost and related accumulated depreciation of assets sold, retired or otherwise disposed of are removed from the respective accounts, and any resulting gains or losses are included in the Consolidated Statements of Operations. Depreciation is computed for financial reporting purposes using the straight-line method over the estimated useful lives of the related assets as follows:

Furniture and fixtures	5 years
Machinery and equipment	5 years
Computers and software	5 years
Buildings	10 to 40 years
Assets under capital leases	Shorter of asset life or term of lease
Leasehold improvements	Shorter of asset life or term of lease

We capitalize internally developed computer software costs incurred during the application development stage in accordance with Statement of Position 98-1, *Accounting for the Costs of Computer Software Developed or Obtained for Internal Use*.

- *Goodwill and Other 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 annually on October 1, or when events or circumstances indicate that the carrying value of the reporting units may not be recoverable. Any impairment would be recognized by a charge to operating results and a reduction in the carrying value of the intangible asset. Our annual impairment test for goodwill primarily utilizes the income approach and considers the market approach and the cost approach in determining the value of our reporting units.

  Non-compete agreements are recorded based on agreements entered into by us and are amortized, using the straight-line method, over their terms ranging from five to seven years. Other definite-lived intangible assets are recorded at cost and are amortized, using the straight-line method, over their estimated useful lives of up to 16 years. 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.

- *Income Taxes:* We adopted the provisions of Financial Accounting Standards Board Interpretation No. 48, "Accounting for Uncertainty in Income Taxes"("FIN 48"), on January 1, 2007. As a result of adoption, we recognized a decrease of approximately $0.2 million in the January 1, 2007 retained earnings balance. We recognize interest accrued and penalties related to unrecognized tax benefits as a component of income tax expense.

We recognize deferred income tax liabilities and assets for the expected future tax consequences of events that have been included in the financial statements or tax returns. Deferred income tax liabilities and assets are determined based on the difference between the financial statement and the tax basis of assets and liabilities using enacted tax rates in effect for the year in which the differences are expected to reverse. We recognize a valuation allowance on the deferred tax assets if it is more likely than not that the assets will not be realized in future years.

- *Stock-Based Compensation:* Stock-based compensation is accounted for using the grant-date fair value method. Compensation expense is recognized ratably over the service period. We estimate a 2% forfeiture rate for unvested restricted stock awards. Based on our history of restricted stock forfeitures, we do not believe future forfeitures will have a material impact on future compensation expense or earnings per share.

New Accounting Guidance

In December 2007, the FASB issued SFAS 141(R), *Business Combinations* ("SFAS 141(R)"). SFAS 141(R) provides revised guidance to improve the relevance, representational faithfulness, and comparability of the information that a reporting entity provides in its financial reports about a business combination and its effects. SFAS 141(R) revises the accounting literature previously issued under SFAS 141, Business Combinations. SFAS 141(R) is effective for fiscal years beginning after December 15, 2008. The Company is currently evaluating the impact that adopting SFAS No. 141(R) will have on our financial statements.

In December 2007, the FASB issued SFAS 160, *Noncontrolling Interest in Consolidated Financial Statements* ("SFAS 160"). SFAS 160 revises ARB 51 with regards to the accounting for non-controlling interests in subsidiaries. SFAS 160 is effective for fiscal years beginning after December 15, 2008. The Company is currently evaluating the impact that adopting SFAS No. 160 will have on our financial statements.

In March 2008, the FASB issued SFAS 161, *Disclosures about Derivative Instruments and Hedging Activities* ("SFAS 161"), an amendment of FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities*. SFAS 161 is intended to enhance the current disclosure framework in Statement 133. SFAS 161 requires that objectives for using derivative instruments be disclosed in terms of underlying risk and accounting designation. SFAS 161 is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008, with early application encouraged. The Company is currently evaluating the impact that adopting SFAS No.161 will have on our financial statements.

Results of Operations

The following table sets forth for the periods indicated certain items from our Consolidated Statements of Operations as a percentage of our net sales:

	Three Months Ended March 31,	
	2008	2007
Net sales	100.0 %	100.0 %
Cost of goods sold	50.1	50.4
Selling, general and administrative	38.2	38.4
Depreciation and amortization	2.7	2.6
Income from operations	9.0	8.6
Interest expense	5.2	6.5
Income before taxes	3.8	2.1
Provision for income taxes	1.5	0.9
Net income	2.3	1.2

Three Months Ended March 31, 2008 Compared to the Three Months Ended March 31, 2007

Net Sales. Net sales for the three months ended March 31, 2008 were $157.7 million, an increase of $ 13.8 million, or 9.6%, versus net sales of $143.9 million for the three months ended March 31, 2007. The sales growth was primarily the result of a $5.5 million, or 4.2%, same-center sales growth, a $3.4 million, or 25.7%, increase in external sales of our distribution segment, and $4.9 million associated with acquisitions.

Cost of Goods Sold. Cost of goods sold for the three months ended March 31, 2008 was $79.1 million, an increase of $6.6 million, or 9.1%, over $72.5 million for the same period in the prior year. The increase was the result of growth in sales. Cost of goods sold as a percentage of net sales improved to 50.1% in 2008 from 50.4% in 2007. The improvement is a result of leveraging the labor portion of cost of goods sold over a larger sales volume.

Selling, General and Administrative. Selling, general and administrative expenses for the three months ended March 31, 2008 increased by $5.0 million to $60.2 million from $55.2 million, for the three months ended March 31, 2007. The increase was principally due to $1.8 million related to acquisitions, $1.4 million increase in the investments in the Company's growth strategies, and the balance of $1.8 million was due to a combination of merit salary increases, the impact of inflation on our fixed expenses such as rent and additional overhead to support our increased sales volume. Selling, general, and administrative costs as a percentage of net sales improved 0.2% from 38.4% for the three months period ended March 31, 2007 to 38.2% for the three months period ended March 31, 2008, as a result of leveraging our fixed expenses.

Depreciation and Amortization. Depreciation and amortization for the three months ended March 31, 2008 was $4.2 million versus $3.7 million for the three months ended March 31, 2007. The increase is a result of increased depreciation related to infrastructure improvements we made during 2007.

Income from Operations. Principally due to the increase in net sales, income from operations increased $1.8 million to $14.2 million for the three months ended March 31, 2008. Income from operations, as a percentage of net sales, improved to 9.0% for the three months ended March 31, 2008 versus 8.6% for the prior year's comparable period. Income from operations as a percentage of net revenues improved due to leveraging cost of sales-labor and fixed costs over increased sales.

Interest Expense. Interest expense in the three months ended March 31, 2008 decreased to $8.3 million compared to $9.3 million in the three months ended March 31, 2007 primarily due to a decrease in variable rates.

Income Taxes. An income tax provision of $2.4 million was recognized for the three months ended March 31, 2008 compared to $1.3 million for the same period of the prior year. The change in the income tax provision was primarily the result of higher income from operations. The effective tax rate for the three months ended March 31, 2008 was 40.0% compared to 41.6% for the three months ended March 31, 2007. The effective tax rate for the three month periods ended March 31, 2008 and 2007 consists principally of the federal statutory tax rate of 35.0% and state income taxes.

Net Income. As a result of the above, we recorded net income of $3.6 million for the three months ended March 31, 2008, compared to $1.8 million for the same period in the prior year.

Financial Condition, Liquidity, and Capital Resources

Cash Flows

Our working capital at March 31, 2008 was $170.2 million compared to $165.8 million at December 31, 2007. Working capital increased principally as a result of continued strong cash collections. Cash flows used in operations of $7.5 million for the three months ended March 31, 2008 compared unfavorably to $2.2 million of cash provided by operations in the prior year primarily due to the payment of incentive compensation costs related to the Company's 2007 plan year during the current quarter. Days sales outstanding ("DSO"), which is the number of days between the billing for our O&P services and the date of our receipt of payment thereof, for the three months ended March 31, 2008, decreased to 51 days, compared to 56 days for the same period last year. The decrease in DSO is due to a continued effort at our patient-care centers to target collections. At March 31, 2008 the Company's availability under its Revolving Credit Facility was $71.7 million, net of $3.3 million of standby letters of credit.

Net cash used in investing activities was $5.0 million for the three months ended March 31, 2008, versus $4.5 million for the same period in the prior year. Cash used in investing activities in the current period included $3.1 million related to the purchase of computer related assets, machinery and equipment and leasehold improvements and $1.9 million related to acquisitions of patient-care centers. In conjunction with the acquisitions completed during the three months ended March 31, 2008, the Company recorded approximately $1.8 million of goodwill.

Net cash used in financing activities was $1.5 million for the three months ended March 31, 2008, compared to $1.4 million for the three months ended March 31, 2007. The increase in cash used by financing activities was primarily due to the larger amount of proceeds from sale of common stock during the period ending March 31, 2007, resulting from a higher amount of shares issued.

Long-term debt consists of the following:

	March 31, 2008	December 31, 2007
(In thousands)		
Term Loan	$ 225,975	$ 226,550
10 1/4% Senior Notes due 2014	175,000	175,000
Subordinated seller notes, non-collateralized, net of unamortized discount with principal and interest payable in either monthly, quarterly or annual installments at effective interest rates ranging from 5.0% to 10.8%, maturing through December 2011	9,224	9,342
	410,199	410,892
Less current portion	(5,514)	(5,691)
	$ 404,685	$ 405,201

Revolving Credit Facility

The $75.0 million Revolving Credit Facility matures on May 26, 2011 and bears interest, at the Company's option, of LIBOR plus 2.75% or a Base Rate (as defined in the credit agreement) plus 1.75%. The obligations under the Revolving Credit Facility are guaranteed by the Company's subsidiaries and are secured by a first priority perfected interest in the Company's subsidiaries' shares, all of the Company's assets and all the assets of the Company's subsidiaries. The Revolving Credit Facility requires compliance with various covenants including but not limited to a maximum total leverage ratio and a maximum annual capital expenditures limit. As of March 31, 2008, the Company has not made draws on the Revolving Credit Facility and has $71.7 million available under that facility. Availability under the Company's Revolving Credit Facility is net of standby letters of credit of approximately $3.3 million.

Term Loan

The $230.0 million Term Loan matures on May 26, 2013 and requires quarterly payments which commenced on September 30, 2006. From time to time, mandatory payments may be required as a result of capital stock issuances, additional debt incurrence, asset sales or other events as defined in the credit agreement. The Term Loan bears interest, at the Company's option, at LIBOR plus 2.00% or a Base Rate (as defined in the credit agreement) plus 1.50%. At March 31, 2008, the interest rate on the Term Loan was 4.68%. The obligations under the Term Loan are guaranteed by the Company's subsidiaries and are secured by a first priority perfected interest in the Company's subsidiaries' shares, all of the Company's assets and all the assets of the Company's subsidiaries. The Term Loan is subject to covenants that mirror those of the Revolving Credit Facility.

10 ¼% Senior Notes

The 10 ¼% Senior Notes mature June 1, 2014, are senior indebtedness and are guaranteed in full and unconditionally, on a senior unsecured basis by all of the Company's current and future domestic subsidiaries as well as all the assets of the Company. The parent company has no independent assets or operations and all subsidiaries are 100% owned by the Company. Interest is payable semi-annually on June 1 and December 1, commencing December 1, 2006. On or prior to June 1, 2009, the Company may redeem up to 35% of the aggregate principal amount of the notes at a redemption price of 110.250% of the principal amount thereof, plus accrued and unpaid interest and additional interest, if any, with the net cash proceeds of an equity offering; provided that (i) at least 65% of the aggregate principal amount of the notes remains outstanding immediately after the redemption (excluding notes held by the Company and its subsidiaries); and (ii) the redemption occurs within 90 days of the date of the closing of the equity offering. Except as discussed above, the notes are not redeemable at the Company's option prior to June 1, 2010. On or after June 1, 2010, the Company may redeem all or part of the notes upon not less than 30 days and no more than 60 days' notice, for the twelve-month period beginning on June 1 of the following years: at (i) 105.125% during 2010; (ii) 102.563% during 2011; and (iii) 100.0% during 2012 and thereafter.

General

The terms of the Senior Notes and the Revolving Credit Facility limit the Company's ability to, among other things, incur additional indebtedness, create liens, pay dividends on or redeem capital stock, make certain investments, make restricted payments, make certain dispositions of assets, engage in transactions with affiliates, engage in certain business activities and engage in mergers, consolidations and certain sales of assets. At March 31, 2008, the Company is in compliance with all covenants under these debt agreements.

Obligations and Commercial Commitments

The following table sets forth our contractual obligations and commercial commitments as of March 31, 2008:

	Payments Due by Period						
	2008	2009	2010	2011	2012	Thereafter	Total
(In thousands)							
Long-term debt	$ 4,424	$ 4,377	$ 3,815	$ 3,798	$ 3,698	$ 390,087	$ 410,199
Interest payments on long-term debt	26,344	28,769	28,552	28,352	28,155	29,445	169,617
Operating leases	23,472	24,991	17,143	11,791	6,923	4,209	88,529
Capital leases and other long-term obligations (1)	3,969	1,144	921	1,313	1,512	8,287	17,146
Total contractual cash obligations	$ 58,209	$ 59,281	$ 50,431	$ 45,254	$ 40,288	$ 432,028	$ 685,491

(1) Other long-term obligations consist primarily of amounts related to our Supplemental Executive Retirement Plan, earnout payments and payments under the restructuring plans.

In addition to the table above, the Company has certain other tax liabilities as of March 31, 2008 comprised of $3.4 million of unrecognized tax benefits, of which $1.5 million is expected to be settled in the fiscal year 2008, with the remainder thereafter.

Dividends.

The Series A Convertible Preferred Stock is entitled to cumulative dividends, accruing at an annual rate of 3.33%, or $1.7 million, payable quarterly in arrears. We have elected to pay the dividend; however, we may elect to defer the future payments of dividends otherwise payable on a dividend payment date. In such event, the amount of deferred dividends will be added to the stated value. Accrued but unpaid dividends will be payable upon our liquidation in cash and upon a Holder Conversion (as defined in the Amended and Restated Preferred Stock Purchase Agreement), at the option of the Holder, either in cash (to the extent permitted under applicable law and the terms of our indebtedness) or in additional shares of our common stock. Immediately prior to the occurrence of an acceleration event prior to the fifth anniversary of the original issue date, the stated value of each share of Series A Convertible Preferred Stock will be increased by an amount per share equal to all dividends that would otherwise be payable on a share of Series A Convertible Preferred Stock on each dividend payment date on and after the occurrence of such acceleration event and prior to and including the fifth anniversary of the original issuance date.

Off-Balance Sheet Arrangements

The Company's wholly-owned subsidiary, Innovative Neurotronics, Inc. ("IN, Inc."), is party to a non-binding purchase agreement under which it agrees to purchase assembled WalkAide System kits. As of March 31, 2008, IN, Inc. had outstanding purchase commitments of approximately $0.6 million.

Market Risk

We are exposed to the market risk that is associated with changes in interest rates. At March 31, 2008, all our outstanding debt, with the exception of the Revolving Credit Facility and the Term Loan, is subject to a fixed interest rate. (See Item 3 below.)

Forward Looking Statements

This report contains forward-looking statements setting forth our beliefs or expectations relating to future revenues, contracts and operations, as well as the results of an internal investigation and certain legal proceedings. 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 enter into and derive benefits from managed-care contracts, our ability to successfully attract and retain qualified O&P practitioners, federal laws governing the health-care industry, uncertainties inherent in incomplete investigations and legal proceedings, 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 10 ¼ % Senior Notes, Term Loan, Subordinated Seller Notes, and Series A Convertible Preferred Stock. As of March 31, 2008, we have cash flow exposure to the changing interest rate on the Term Loan and Revolving Credit Facility. The other obligations have fixed interest or dividend rates.

We have a $75.0 million revolving credit facility, with no outstanding balance at March 31, 2008, as discussed in Note G to our Consolidated Financial Statements. 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. From time to time, we execute LIBOR contracts to fix interest rate exposure for specific periods of time. At March 31, 2008, we had one contract outstanding which fixed LIBOR at 4.68% and expires on April 30, 2008.

Presented below is an analysis of our financial instruments as of March 31, 2008 that are sensitive to changes in interest rates. The table demonstrates the change in estimated annual cash flow related to the outstanding balance under the Term Loan and the Revolving Credit Facility (the Revolving Credit Facility did not have an outstanding balance at March 31, 2008), 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 Decreas 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)		50 BPS	100 BPS	150 BPS
Term Loan	$ 7,186	$ 8,316	$ 9,446	$ 10,576	$ 11,706	$ 12,835	$ 13,965
Revolving Credit Facility	--	--	--	--	--	--	--
	$ 7,186	$ 8,316	$ 9,446	$ 10,576	$ 11,706	$ 12,835	$ 13,965

ITEM 4. Controls and Procedures

Disclosure Controls and Procedures

The Company's disclosure controls and procedures are designed to provide reasonable assurance that information required to be disclosed by it in its periodic reports filed with the Securities and Exchange Commission is recorded, processed, summarized and reported, within the time periods specified in the Commission's rules and forms. Based on an evaluation of the Company's disclosure controls and procedures conducted by the Company's Chief Executive Officer and Chief Financial Officer, such officers concluded that the Company's disclosure controls and procedures were effective as of March 31, 2008 to ensure that information required to be disclosed in the reports filed under the Exchange Act was accumulated and communicated to management, including the Company's Chief Executive Officer and Chief Financial Officer, to allow timely decisions regarding required disclosures.

Change in Internal Control Over Financial Reporting

In accordance with Rule 13a-15(d) under the Securities Exchange Act of 1934, management, with the participation of the Company's Chief Executive Officer and Chief Financial Officer, determined that there was no change in the Company's internal control over financial reporting that occurred during the quarter ended March 31, 2008, that has materially effected, or is reasonably likely to materially effect, the Company's internal control over financial reporting.

Part II. Other Information

ITEM 1A. RISK FACTORS.

Item 1A ("Risk Factors") of the Company's Annual Report on Form 10-K for the year ended December 31, 2007 sets forth information relating to important risks and uncertainties that could materially adversely affect the Company's business, financial condition or operating results. Those risk factors continue to be relevant to an understanding of the Company's business, financial condition and operating results. Certain of those risk factors have been updated in this Form 10-Q to provide updated information, as set forth below. References to "we," "our" and "us" in these risk factors refer to the Company.

Changes in government reimbursement levels could adversely affect our net sales, cash flows and profitability.

We derived 39.5% and 40.3% of our net sales for the three months ended March 31, 2008 and 2007, respectively, from reimbursements for O&P services and products from programs administered by Medicare, Medicaid and the U.S. Veterans Affairs. Each of these programs sets maximum reimbursement levels for O&P services and products. If these agencies reduce reimbursement levels for O&P services and products in the future, our net sales could substantially decline. In addition, the percentage of our net sales derived from these sources may increase as the portion of the U.S. population over age 65 continues to grow, making us more vulnerable to maximum reimbursement level reductions by these organizations. Reduced government reimbursement levels could result in reduced private payor reimbursement levels because fee schedules of certain third-party payors are indexed to Medicare. Furthermore, the healthcare industry is experiencing a trend towards cost containment as government and other third-party payors seek to impose lower reimbursement rates and negotiate reduced contract rates with service providers. This trend could adversely affect our net sales. Medicare provides for reimbursement for O&P products and services based on prices set forth in fee schedules for ten regional service areas. If the U.S. Congress were to legislate additional modifications to the Medicare fee schedules, our net sales from Medicare and other payors could be adversely and materially affected. We cannot predict whether any such modifications to the fee schedules will be enacted or what the final form of any modifications might be. In addition, the WalkAide is not currently covered by Medicare and no assurances can be given as to whether or to what extent coverage will be granted by the Centers for Medicare & Medicaid Services.

On April 24, 2006, the Centers for Medicare & Medicaid Services announced a proposed rule that would call for a competitive bidding program for certain covered prosthetic and orthotic equipment as required by the Medicare Modernization Act of 2003. The rule became effective on June 11, 2007 following its adoption by the Centers for Medicare & Medicaid Services. We cannot now identify the impact of such rule on us.

Funds associated with certain of our auction rate securities may not be accessible and our auction rate securities may experience an other than temporary decline in value, which would adversely affect our income.

Our short-term investments are two auction rate securities (“ARS”) reported at fair value of $7.0 million and with a cost of $7.5 million. ARS are securities that are structured with short-term interest rate reset dates which generally occur every 28 days, but with contractual maturities that can be well in excess of ten years. At the end of each reset period, investors can sell or continue to hold the securities at par. Based on an analysis of other-than-temporary impairment factors, we recorded an unrealized loss within accumulated other comprehensive income, a component of shareholders’ equity, of approximately $0.5 million at March 31, 2008 related to these auction rate securities. Although we believe that the decline in the fair market value of these securities is temporary, if the decline in value were ultimately deemed to be other than temporary, it would result in a loss being recognized in our statement of operations, which could be material. The funds associated with failed auctions will not be accessible until a successful auction occurs, a buyer is found outside of the auction process or the underlying securities have matured.

ITEM 6. Exhibits

(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.

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 7, 2008

/s/ Thomas F. Kirk
Thomas F. Kirk
President and Chief Executive Officer
(Principal Executive Officer)

Dated: May 7, 2008

/s/ George E. McHenry
George E. McHenry
Executive Vice President and
Chief Financial Officer
(Principal Financial Officer)

Dated: May 7, 2008

/s/ Thomas C. Hofmeister
Thomas C. Hofmeister
Vice President of Finance
(Chief Accounting Officer)

Filename:	**cmw3533a.htm**
Type:	**EX-31.1**
Comment/Description:	**Certification**

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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, Thomas F. Kirk, certify that:

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

2. Based on my knowledge, this 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 report;

3. Based on my knowledge, the financial statements, and other financial information included in this 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 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)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) 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 report is being prepared;
b) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
c) 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 report based on such evaluation, and
d) disclosed in this 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: May 7, 2008

/s/ Thomas F. Kirk
Thomas F. Kirk
President and Chief Executive Officer

Filename:	**cmw3533b.htm**
Type:	**EX-31.2**
Comment/Description:	**Certification**

(this header is not part of the document)

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 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 report;

3. Based on my knowledge, the financial statements, and other financial information included in this 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 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)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) 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 report is being prepared;
b) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
c) 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 report based on such evaluation, and
d) disclosed in this 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: May 7, 2008

/s/ George E. McHenry
George E. McHenry
Executive Vice President and
Chief Financial Officer

Filename:	**cmw3533c.htm**
Type:	**EX-32**
Comment/Description:	**Certification**

(this header is not part of the document)

Exhibit 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

Solely for the purposes of complying with 18 U.S.C. §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 three months ended March 31, 2008 (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/ Thomas F. Kirk
Thomas F. Kirk
President and Chief Executive Officer

/s/ George E. McHenry
George E. McHenry
Executive Vice President and
Chief Financial Officer

May 7, 2008