HEARUSA INC
Form 10-K
April 11, 2011

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-K

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

For the fiscal year ended DECEMBER 25, 2010

OR

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

For the transition period from ________________ to ________________

Commission file number 001-11655

HearUSA, Inc.
(Exact Name of Registrant as Specified in Its Charter)

Delaware (State or Other Jurisdiction of Incorporation or Organization)	22-2748248 (I.R.S. Employer Identification No.)
1250 Northpoint Parkway, West Palm Beach, Florida (Address of Principal Executive Offices)	33407 (Zip Code)

Registrant's Telephone Number, Including Area Code (561) 478-8770

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

Title of each class	Name of each exchange on which registered
Common Stock, par value $0.10 per share	NYSE Amex

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

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

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

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 þ No ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (232.405 of this chapter) during the preceding 12 months (or for such short periods that the registrant was required to submit and post such files)

Yes ¨ No ¨

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of "large accelerated filer", "accelerated filer" "and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer	¨	Accelerated filer	¨
Non-accelerated filer (Do not check if a smaller reporting company)	¨	Smaller reporting company	þ

Indicate by check mark whether the registrant is a shell company (as defined by Rule 12b-2 of the Exchange Act). Yes ¨ No þ

As of June 25, 2010, the aggregate market value of the registrant's Common Stock held by non-affiliates (based upon the closing price of the Common Stock on the NYSE Amex) was approximately $36,151,816.

On April 6, 2011, 45,006,218 shares of the registrant's Common Stock were outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant's definitive proxy statement for the 2011 Annual Meeting of the registrant's stockholders ("2011 Proxy Statement"), to be filed with the Securities and Exchange Commission, are incorporated by reference in Part III hereof.

PART I

Item 1. Business

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

On April 27, 2009, the Company sold the assets of Helix Hearing Care of America Corp. and the stock of 3371727 Canada Inc., both indirect wholly-owned subsidiaries of the Company. As a result of the sale, the Company no longer has operations in Canada.

At December 25, 2010, HearUSA had 175 company-owned hearing care centers in eleven states. The Company also sponsors a network of approximately 2,000 credentialed audiology providers that participate in selected hearing benefit programs contracted by the Company with employer groups, health insurers and benefit sponsors. The centers and the network providers provide audiological products and services for the hearing impaired.

Products

HearUSA's centers provide a complete range of quality hearing aids, with emphasis on the latest digital technology along with assessment and evaluation of hearing. While the majority of the hearing aids sold by the centers are manufactured by Siemens Hearing Instruments, Inc. ("Siemens") and its subsidiary, Rexton, the centers may order and sell a hearing aid from almost any manufacturer, including Phonak, Oticon, Starkey, Sonic Innovations and Unitron. The Company has a supply agreement with Siemens for HearUSA centers. The Company has agreed to meet 90% of the centers' hearing aid requirements with Siemens products. HearUSA's centers also offer a large selection of assistive listening devices and other products related to hearing care.

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

AARP Hearing Program

HearUSA is the administrator of the AARP Hearing Care Program, designed to help millions of Americans aged 50+ who have hearing loss. This program is the only hearing care program endorsed by the American Association of Retired Persons ("AARP"). Under this program, the Company has agreed to provide to the members of AARP in the fifty states, the District of Columbia, and the five U.S. Territories, discounts on hearing aids and related services through the Company's company-owned centers and independent network of participating hearing care providers. Hearing aids sold under the program include a three year limited warranty and a three year supply of batteries included in the price of the hearing aid.

Managed Care, Institutional Contracts and Benefit Providers

Since 1991, the Company has entered into arrangements with institutional buyers relating to the provision of hearing care products and services. HearUSA believes that contractual relationships with institutional buyers of hearing aids are essential to the success of the Company's business plan. These institutional buyers include managed care companies, employer groups, health insurers, benefit sponsors, senior citizen buying groups and unions.

By developing contractual arrangements for the referral of patients, the plan members have access to standardized care and relationships with local area physicians are enhanced. Critical to providing care to members of these groups are the availability of distribution sites, quality and control and standardization of products and services. The Company believes its system of high quality, uniform company-owned centers meets the needs of the patients and their hearing benefit providers and that the network providers can expand available distribution sites for these patients. In the past few years, the Company has expanded its managed care contracts into areas serviced by the affiliated network providers.

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

All contracts are for one calendar year and are usually cancelable with ninety days or less notice by either party. The early termination of or failure to renew the provider agreements could adversely affect the operation of the centers located in the related market area.

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

Sales Development

The Company provides sales development programs to assist its professionals in developing the necessary skills to perform successfully. By providing training on methods, techniques, trouble shooting, dispensing and counseling skills, the Company believes these programs help provide better service to patients and improve key performance indicators such as conversion, binaural fitting rates and reduced return rates.

Marketing

HearUSA's marketing plan includes:

- Print Media and Special Events: HearUSA utilizes a variety of print media, some for branding and others for lead generation. Brand ads promote the importance of hearing care while promoting the qualitative differences and advantages offered by HearUSA. Other print vehicles may be used for lead generation, and utilize specific images and headlines that evoke an immediate response for hearing aids at a variety of technology levels and prices that are competitive in the applicable marketplace. In addition, the Company has implemented a variety of special events in order to increase the number of hearing tests.

- Direct Marketing: Utilizing HearUSA's database, HearUSA conducts consistent, scheduled, customized direct mailings to all patients and prospects based on their status and purchasing patterns. Direct mail achieves top of mind awareness, ensures retention and promotes repeat business.

- Physician Awareness: HearUSA educates the medical and consumer communities on the need for regular hearing testing as part of an overall health assessment and the importance of hearing aids and other assistive listening devices. HearUSA works to further its image as a provider of highly professional services, quality products for the hearing impaired, and comprehensive post-sale consumer education.

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

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Facilities and Services

Each HearUSA center is staffed by a licensed and credentialed audiologist or hearing instrument specialist and at least one office manager or patient care coordinator. Experienced audiologists supervise the clinical operations. The majority of the Company's centers are conveniently located in shopping or medical centers, and the centers are typically 1,000 to 3,900 square feet in size. The Company's goal is to have all centers similar in design and exterior marking and signage because a uniform appearance reinforces the message of consistent service and quality of care.

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

- Comprehensive hearing testing using standardized practice guidelines
- Interactive hearing aid selection and fitting processes
- Aural rehabilitation and follow up care
- Standardized reporting and physician communications

In some markets, additional in-depth audiovestibular testing is also available to assist in the evaluation of auditory and vestibular disorders.

Revenues

For the fiscal years 2010 and 2009, HearUSA net revenues were approximately $83.5 million and $88.9 million, respectively. During these years, the Company did not have revenues from a single customer which totaled 10% or more of total net revenues.

Segments

The Company operates two business segments: the company-owned centers and the network of independent providers. Financial information regarding these business segments is provided in Note 17 - Segments, Notes to Consolidated Financial Statements included herein.

Centers

At the end of 2010, the Company owned 175 centers in Florida, New York, New Jersey, Massachusetts, Ohio, Michigan, Missouri, North Carolina, Pennsylvania, South Carolina and California (through HEARx West). These centers offer patients a complete range of hearing care services and products, including diagnostic audiologic testing, the latest technology in hearing aids and assistive listening devices to improve their quality of life.

The centers owned through HEARx West are located in California. HearUSA is responsible for the daily operation of the centers. All clinical and quality issues are the responsibility of a joint committee comprised of HearUSA and Kaiser Permanente clinicians. HEARx West centers concentrate on providing hearing aids and audiology testing to Kaiser Permanente's members and self-pay patients in the state of California. At the end of 2010, there were 25 full-time and 13 part-time HEARx West centers.

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

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Network

The Company sponsors a network of credentialed audiology providers that supports hearing benefit programs with employer groups, health insurers and benefit sponsors in 48 states.

Each of the approximate 2,000 network providers operates independently from the Company. To ensure compliance with its hearing benefit programs, the Company performs annual credential verification for each of the network providers. The Company also performs random patient surveys on the quality of network providers' services.

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

Distinguishing Features

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

Utilization Review Accreditation Commission (URAC) Accreditation

HearUSA has a three-year accreditation by the Utilization Review Accreditation Commission ("URAC"), an independent nonprofit organization which is a recognized leader in promoting health care quality. URAC provides a symbol of excellence for organizations to validate their commitment to quality and accountability and ensures that all stakeholders are represented in establishing meaningful quality measures for the entire health care industry.

Center Management System, Medical Reporting and HearUSA Data Link

The Company has developed a proprietary center management and data system called the Center Management System ("CMS"). CMS primarily has two functions: to manage patient information and to process point-of-sale customer transactions. The CMS system is hosted over a secured internet portal that links all locations with the corporate office. As the Company acquires new centers, a critical part of the integration process is the inclusion of the new center into the CMS.

The Company's corporate system is fully integrated with CMS to provide additional benefits and functionality that can be better supported centrally. Data redundancy is built into the system architecture as data are stored in a collocation environment utilizing a datacenter in Miami. The consolidated data repository is constructed to support future expected revenues and business units.

One of the outputs of CMS is a computerized reporting system that provides referring physicians the test results and recommended action for every patient examined by HearUSA staff in a company-owned center. Consistent with the Company's mission of increasing awareness of hearing conditions in the medical community, this reporting system makes hearing a part of the individual's health profile. Another unique aspect of CMS is its data mining capability which allows for targeted marketing to its customer base. The national call center also has the ability to access the CMS system and can schedule appointments real time in any HearUSA center.

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Competition

The U.S. hearing care industry is highly fragmented with approximately 12,000 independent practitioners providing hearing care products and services. The Company competes on the basis of price and service and, as described above, tries to distinguish itself as a leading provider of hearing care to health care providers and the patients. The Company competes for the managed care customer on the basis of access, quality and cost.

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

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

Reliance on Manufacturers

The Company's supply agreement with Siemens requires that at least 90% of the Company's hearing aid purchases will be of Siemens devices. There can be no guarantee that Siemens' technology or product line will remain competitive in the marketplace. In addition, if Siemens' manufacturing capacity cannot satisfy the demand of HearUSA and other customers, HearUSA's business may be adversely affected. In the event of a disruption of supply from Siemens or another of the Company's current suppliers, the Company believes it could obtain comparable products from other manufacturers. Few manufacturers offer dramatic product differentiation. HearUSA has not experienced any significant disruptions in supply in the past.

Regulation

Federal

While audiologists and other professionals are not regulated at the federal level the United States Food and Drug Administration ("FDA") is responsible for monitoring the hearing care products industry. The FDA enforces regulations that deal specifically with the manufacture and sale of hearing aids. FDA requires that all dispensers meet certain conditions relating to suitability of the patient for hearing aids and the advisability of medical evaluation prior to being fitted with a hearing aid. Before selling a hearing aid the FDA requires that hearing aid purchasers receive medical clearance from a physician within six (6) months prior to purchase; however, patients may sign a waiver in lieu of a physician's examination. FDA regulations require hearing aid dispensers to provide customers with certain warnings and statements regarding the use of hearing aids. Also, the FDA requires hearing aid dispensers to review instructional manuals for hearing aids with patients before the hearing aid is purchased.

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A portion of the Company's revenues comes from participation in Medicare and Medicaid. Medicare is a federally funded health insurance program for the elderly and disabled. The Medicare fee-for-service program does not generally provide reimbursement to for hearing aids. However, many Medicare managed care plans, known as Medicare Advantage plans, provide reimbursement for hearing aids. Health care reform legislation which became effective in 2010 changes the way in which payments are made to Medicare Advantage plans. There can be no assurance that the Medicare Advantage plans with which the Company contracts will continue to participate in Medicare Advantage or will continue to cover hearing aids for their members.

Subject to certain statutory and regulatory exceptions, the federal "anti-kickback" law prohibits the knowing and willful offer or payment of any remuneration to induce or reward the referral of an individual or the purchase, lease or order (or the arranging for or recommending of the purchase, lease or order) of healthcare items or services paid for in whole or in part by Medicare, Medicaid or other government-funded healthcare programs. Violation of the federal anti-kickback statute could subject the Company to criminal and/or civil penalties including suspension or exclusion from Medicare and Medicaid programs and other government-funded healthcare programs. The Company's management carefully considers the importance of the anti-kickback law when structuring its operations, and believes that it is in compliance with these laws. However, there can be no guarantee that enforcement authorities would concur with management's analysis.

A range of federal civil and criminal laws target false claims and fraudulent billing activities. One of the most significant is the Federal False Claims Act (the "False Claims Act"), which imposes civil penalties for knowingly making or causing to be made false claims in order to secure a reimbursement from government-sponsored programs, such as Medicare and Medicaid. Investigations or actions commenced under the False Claims Act may be brought either by the government or by private individuals on behalf of the government, through a "whistleblower" or "qui tam" action. The False Claims Act authorizes the payment of a portion of any recovery to the individual bringing suit. Such actions are initially required to be filed under seal pending their review by the Department of Justice. If the government intervenes in the lawsuit and prevails, the whistleblower (or plaintiff filing the initial complaint) may share with the federal government in any settlement or judgment. If the government does not intervene in the lawsuit, the whistleblower plaintiff may pursue the action independently. The False Claims Act generally provides for the imposition of civil penalties and for treble damages, resulting in the possibility of substantial financial penalties for small billing errors that are replicated in a large number of claims, as each individual claim could be deemed to be a separate violation of the False Claims Act.

The False Claims Act also has been used by the federal government and private whistleblowers to bring enforcement actions under the federal anti-kickback statute. Such actions are not based on a contention that an entity has submitted claims that are facially invalid. Instead, such actions are based on the theory that when an entity submits a claim, it either expressly or impliedly certifies that it has provided the underlying services in compliance with applicable laws, and therefore that services provided and billed for during an anti-kickback statute violation result in false claims, even if such claims are billed accurately for appropriate and medically necessary services. The availability of the False Claims Act to enforce alleged fraud and abuse violations has increased the potential for such actions and which often are costly and time-consuming to defend, to be brought.

The Health Insurance Portability and Accountability Act of 1996 ("HIPAA") requires the use of uniform electronic data transmission standards for health care claims and payment transaction submitted or received electronically. On April 14, 2003 the U.S. Department of Health and Human Services ("HHS") issued final regulations regarding the privacy of individually identifiable health information (the "Privacy Regulations") pursuant to HIPAA. The Privacy Regulations are designed to protect the medical information of a healthcare patient or health plan enrollee that could be used to identify the individual, known as protected health information ("PHI"). The Privacy Regulations apply directly to certain entities known as "covered entities," which include health plans, health care clearinghouses and healthcare providers who conduct certain healthcare transactions electronically. In addition, the Privacy Regulations require covered

entities to enter into contracts requiring their "business associates" to agree to certain restrictions regarding the use and disclosure of PHI. The Privacy Regulations apply to PHI maintained in any format, including both electronic and paper records, and impose extensive restrictions on the way in which covered entities (and indirectly their business associates) may use and disclose PHI. In addition, the Privacy Regulations also give patients significant rights to understand and control how their PHI is used and disclosed. Often, use and disclosure of PHI must be limited to the minimum amount necessary to achieve the purpose of the use or disclosure.

HHS also promulgated rules governing transaction standards and code sets issued by HHS pursuant to HIPAA (the "Transactions Standards") that were effective October 16, 2003. The Transactions Standards establish uniform standards to be utilized by covered entities in the electronic transmission of health information in connection with certain common healthcare financing transactions, such as healthcare claims. Under the Transactions Standards, any party transmitting or receiving health transactions electronically must send and receive data in a single format, rather than the large number of different data formats currently used.

In addition, in February 2003, HHS issued final regulations governing the security of PHI pursuant to HIPAA (the "Security Standards"). The Security Standards impose substantial requirements on covered entities and their business associates regarding the storage, utilization of, access to and transmission of electronic PHI.

The requirements imposed by the Privacy Regulations, the Transactions Standards, and the Security Standards are extensive and have required substantial cost and effort to assess and implement. The Company has taken and will continue to take steps that it believes are reasonable to ensure that its policies and procedures are in compliance with the Privacy Regulations, the Transactions Standards and the Security Standards.

On February 17, 2009, the American Recovery and Reinvestment Act of 2009 ("ARRA") was enacted, and included Title XIII, the Health Information Technology for Economic and Clinical Health Act (the "HITECH Act"). The HITECH Act modified certain provisions of HIPAA, and included additional requirements, including, but not limited to, a new federal breach notification obligation applicable to HIPAA covered entities and their business associates. HHS, as required by the HITECH Act, has issued a regulation setting forth the breach notification obligations applicable to covered entities and their business associates (the "HHS Breach Notification Rule"). The various requirements of the HITECH Act and the HHS Breach Notification Rule have different compliance dates, some of which have passed and some of which will occur in the future. With respect to those requirements whose compliance dates have passed, the Company believes that it is in compliance with these provisions. With respect to those requirements whose compliance dates are in the future, the Company is in the process of implementing these new requirements or has done so already, and believes that it will be in compliance with these requirements on or before the applicable compliance date.

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

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

the national “Do Not Call” registry.

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

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

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

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

State

Regulation of the hearing care industry exists in every state and is primarily concerned with the formal licensure of audiologists and those who dispense hearing aids, including procedures involving the fitting and dispensing of hearing aids. These state regulations are subject to change and we cannot predict if these changes will have a material adverse effect upon the Company. New regulations might include more stringent licensure requirements for dispensers of hearing aids, inspections of centers for the dispensing of hearing aids and the regulation of advertising by dispensers of hearing aids.

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

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

Most states require a return policy for consumers allowing for the return of products, generally within 30 days. HearUSA offers all its customers a full 30 day, or longer, return period or the return period under applicable state guidelines. For patients that participate in the family hearing counseling program, the return period is extended to 60 days, and for patients who are members of AARP, the return period is extended to 90 days.

The Company employs licensed audiologists and hearing aid dispensers. Under the regulatory framework of certain states, business corporations are not able to employ audiologists or offer hearing services. We believe we have structured our operations in compliance with these laws. However, no assurance can be given that the Company's interpretation of applicable laws will be found to be in compliance with laws and regulations governing the corporate practice of audiology or, if its activities are not in compliance, that the legal structure of the Company's operations in such a state can be modified to permit compliance.

In addition, many states have laws that prohibit remuneration for referrals of Medicaid and/or private pay patients, similar to federal anti-kickback statutes discussed above. Many, but not all of these laws follow the general framework of the federal anti-kickback statutes.

In addition to being subject to HIPPA requirements, many states have laws that impose sanctions on businesses when there has been a breach of security of sensitive customer information.

Regulatory schemes in some states require the licensing or registration of the Company's provider networks, for example as a preferred provider organization, preferred provider program administrator, or independent practice association. The Company has obtained and maintains licenses and registrations for those states which it believes require such licensure or registration; however, such laws often change and such changes may subject the Company to additional requirements. In addition, many states have licensing requirements for third party administrators ("TPA") or other similar entities that process or adjudicate claims on behalf of members of managed care plans. It is the position of the Company that the ministerial services it performs on behalf of the managed care plans is limited to pass-through reprising for designated services and does not involve the type of discretionary authority consistent with a claims adjudication activity for which a TPA license or registration would be required. No assurance can be given that any given state will not challenge the Company's interpretation of the state's laws and regulations. Finally, many states have established parameters for licensing or registration of risk bearing provider networks. Although the Company has determined that such licensure or registration is not required for its activities, it cannot provide assurance that such states will not challenge that conclusion or change the applicable law such that it pertains to us.

Medicaid is a joint state-federal health insurance program for low-income individuals and individuals with disabilities. Medicaid coverage varies from state to state. Most state Medicaid programs are currently facing significant budget pressures as a result of the economic downturn and resulting loss of revenue and increase of eligible individuals. Because of this many states are cutting benefits that are offered to Medicaid beneficiaries. We cannot offer any assurances that states that currently cover hearing aids will continue to do so in the future.

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

Product and Professional Liability

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

Seasonality

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

Employees

At December 25, 2010, HearUSA had 427 full-time employees and 58 part-time employees.

Where to Find More Information

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

Item 1A. Risk Factors

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

Risk Related to our Operations

HearUSA has a history of operating losses which raises substantial doubt about our ability to continue as a going concern and HearUSA may never be profitable.

HearUSA has historically incurred net losses since its organization. Our accumulated deficit at December 25, 2010 was approximately $123 million. We expect quarterly and annual operating results to fluctuate, depending primarily on the following factors:

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

There can be no assurance that HearUSA will achieve profitability in the near or long term or ever. These circumstances raise substantial doubt about our ability to continue as a going concern as described in an explanatory paragraph to our independent registered public accounting firm's report on our audited financial statements for the year ended December 25, 2010. The assets and liabilities as reflected in the consolidated balance sheet as of December 25, 2010 do not include any adjustments for this uncertainty. If we are unable to continue as a going concern, investors will likely lose all of their investment in our Company.

Our independent auditors have expressed substantial doubt about our ability to continue as a going concern.

The report of our independent registered public accounting firm on our financial statements for the year ended December 25, 2010 includes a paragraph stating that we have suffered recurring operating losses, have negative cash from operations and negative working capital; which raises substantial doubt about our ability to continue as a going concern. The assets and liabilities as reflected in the consolidated balance sheet as of December 25, 2010 do not include any adjustments for this uncertainty. Our ability to continue as a going concern is dependent upon our ability to raise additional financing and to generate profitable operations in the future to meet our obligations and repay our liabilities as they come due. The outcome of these efforts cannot be predicted with any certainty at this time and if these efforts are unsuccessful, we will not be able to meet our obligations and repay our liabilities, which could include the monthly payments due to Siemens under the supply agreement, as they come due. Failure to make

payments under the supply agreement would constitute a breach of the supply agreement and could constitute a cross-default under the credit agreement.

We have historically satisfied our capital raising needs primarily by issuing securities. If we are unable to generate cash from operations and/or raise capital through the issuance of securities we might have to cease operations.

We are currently involved in litigation against Siemens regarding a dispute under the credit agreement which, if decided adversely to us, would have a material adverse effect on the Company.

We are currently seeking adjudication of a dispute with Siemens Hearing Instruments, Inc. regarding a loan prepayment in the amount of $2.3 million which Siemens claims is due. While this case was pending, on March 17, 2011, Siemens issued a notice of default under the credit agreement in respect of this unpaid disputed amount, accelerated all remaining payments under the credit agreement and demanded immediate payment of $32.7 million. Although we are defending our rights under the credit agreement and objecting to Siemens' issuance of the notice and acceleration, we cannot predict the outcome of this matter. A hearing on our motion for preliminary injunction to enjoin Siemens from engaging in self-help to collect under the credit agreement and from making any efforts to seize assets or take control of our business, as well as from declaring the default and accelerating the loan, is scheduled for May 2, 2011. If the case is decided adversely to the Company on May 2, 2011, the Company may be unable to meet its obligations and Siemens may proceed to collect under the credit agreement. This would have a material adverse impact on our business, financial condition and results of operations. In addition, if upon the resolution of the dispute with Siemens it is determined there is a default under the credit agreement, the Company will remain obligated to perform under the supply agreement, including buying the specified products from Siemens in accordance with the supply agreement.

We may not be able to obtain additional capital on reasonable terms, or at all, to fund our operations or pay our obligations as they become due.

We require additional financing. If adequate funds are not available on acceptable terms, or at all, we may be unable to fund our operations or pay our obligations as they become due, including any obligations arising from the dispute with Siemens concerning the alleged prepayment obligation. If additional funds are raised through the issuance of convertible debt or equity securities, Siemens has certain rights of first refusal and preemptive rights under its existing agreements with us which may complicate or eliminate our ability to close on reasonable financing with third parties. In addition, any equity financing will be dilutive to existing stockholders and such securities may have rights and preferences senior to those of our common stockholders. The terms of any such securities may impose significant restrictions on operations. If adequate funds are not available on acceptable terms, or at all, we may be unable to remain in business.

We are performing a goodwill impairment analysis which may result in a write down of our goodwill and other intangible assets which will negatively affect our financial condition and results of operations during the first quarter of 2011.

Based on Siemens' March 17, 2011 declaration of default under the credit agreement, our operating results and lack of liquidity, we concluded that there were sufficient indicators to require us to perform an interim goodwill impairment analysis during the first quarter of 2011. As of December 25, 2010 we had goodwill of $51.9 million and other intangible assets of $12.1 million, representing 246% and 58%, respectively, of stockholders' equity. The first step of our interim goodwill impairment analysis is indicating that there is a probable likelihood that the goodwill recorded in our centers reporting unit was impaired. We are in the process of completing the first step of the impairment analysis, and will then complete the second step of the assessment. As of the date of the filing of the annual report, we have not yet been able to determine the extent of the impairment or the impairment loss or range of loss related to goodwill, other intangible assets and long-lived assets. Any material impairment charge would have a negative effect on our financial condition and results of operations during the first quarter of 2011.

The current severe economic downturn has adversely affected our sales.

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

We may not effectively compete in the hearing care industry.

The hearing care industry is highly fragmented and barriers to entry are low. Approximately 12,000 practitioners provide testing and dispense products and services that compete with those sold and provided by HearUSA. We also compete with small retailers, as well as large networks of franchisees and distributors established by larger companies, such as those manufacturing and selling Miracle Ear and Beltone products. Some of the larger companies have far greater resources than HearUSA and could expand and/or change their operations to capture the market targeted by HearUSA. Large discount retailers, such as Costco Wholesale Corporation, also sell hearing aids and present a competitive threat in our markets. In addition, it is possible that the hearing care market could be effectively consolidated by the establishment of cooperatives, alliances or associations that could compete more successfully for the market targeted by us.

We are dependent on manufacturers.

HearUSA is not a hearing aid manufacturer. We rely on major manufacturers to supply our hearing aids and to supply hearing enhancement devices. Under our strategic and financial relationship with Siemens, we are required to purchase 90% of our requirement of hearing aids from Siemens. A significant disruption in supply from Siemens could materially adversely affect our business.

Our credit facility with Siemens contains certain restrictive covenants that we must satisfy in order to avoid an event of default.

HearUSA and Siemens are parties to a credit agreement pursuant to which HearUSA has obtained a $50 million secured credit facility from Siemens. As of December 25, 2010, an aggregate of approximately $32 million in loans was outstanding under the credit facility. We are required to comply with the terms of the credit facility, including compliance with certain restrictive covenants. There can be no assurance that we will be able to comply with these covenants in the future. If we are unable to comply with these covenants, we may be found in default by Siemens and all loans could be immediately due and payable under the credit agreement. In addition, we have entered into a supply agreement with Siemens, which imposes certain purchase requirements on us. If we fail to comply with the supply agreement or if the supply agreement is terminated (except for termination by us upon breach by Siemens) the credit agreement may be terminated and all loans could be immediately due and payable. This would have a material adverse effect on our ability to do business and on our results of operations.

Current credit and financial market conditions could prevent or delay us from obtaining financing which could adversely affect our business, our operating results and financial condition.

Current market conditions could severely limit our ability to access capital. Because our stock has a low trading volume, we may not be able to access the equity market or may be limited in the amount of equity financing available. If we need to obtain equity or debt financing, we may not be able to do so on satisfactory terms. This could adversely affect our business, operating results and financial condition.

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

HearUSA enters into provider agreements with health insurance companies and managed care organizations for the furnishing of hearing care in exchange for fees. The terms of most of these agreements are to be renegotiated annually, and these agreements may be terminated by either party, usually on 90 days or less notice at any time. In 2009, a number of health insurance and managed care organizations re-evaluated benefits coverage for their participants, including hearing care benefits, in response to the difficult economic situation and rising health care costs. Effective

in January 2011, few plans eliminated hearing care benefits, while others continued but changed or limited the benefit. Still other companies retained hearing care coverage. There is no certainty that we will be able to maintain all of our agreements on favorable terms or at all.

The AARP Hearing Care Program is still in its early stages and there can be no assurance that the program will generate the expected increases to Company revenue over time or at all.

The success of the AARP program is and will remain subject to several risks and variables over the next several quarters, some of which cannot be ascertained with certainty at this time. Among those risks are risks related to:

- the effectiveness of AARP's and the Company's marketing initiatives to generate interest of AARP members in the program;
- the Company's ability to capitalize on the increased number of calls to the AARP call center by converting those calls to appointments;
- whether AARP member appointments will result in identified needs and related sales;
- the Company's ability to expand the number of qualified network providers in order to extend the program to AARP members in all 50 states and the U.S. territories in accordance with the terms of the Company's agreement with AARP and AARP Services, Inc. ("ASI"); and
- the Company's ability to fund its performance obligations under the Company's agreements with AARP and ASI.

Failure of the AARP program to generate expected increases in revenues could have a material adverse effect on the financial condition of the Company.

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

HearUSA currently employs approximately 178 licensed hearing professionals, of whom approximately 124 are audiologists and 54 are licensed hearing aid specialists. If we are not able to attract and retain qualified providers, we will be less able to compete with networks of hearing aid retailers or with the independent audiologists who also sell hearing aids and our business may be adversely affected. Many audiologists are obtaining doctorate degrees, and the increased educational time required at the doctoral level is further restricting the pool of audiologists available for employment. In addition to our employed hearing professionals, we rely on our network of audiologists and hearing aid specialists. If we are not able to maintain our network, our business could suffer.

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

HEARx West LLC, our joint venture with Kaiser Permanente, operates 38 full-service centers in California. Since their inception, HEARx West centers have derived approximately two-thirds of their revenues from sales to Kaiser Permanente members, including revenues through an agreement between the joint venture and Kaiser Permanente's California division servicing its hearing benefited membership. If Kaiser Permanente does not perform its obligations under the agreement, or if the agreement is not renewed upon expiration, the loss of Kaiser patients in the HEARx West centers would adversely affect our business. In addition, HEARx West centers would be adversely affected by the loss of the ability to market to Kaiser members and promote the business within Kaiser's medical centers, including the referral of potential customers by Kaiser.

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

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

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

HearUSA has a three-year accreditation from the URAC through 2011. There can be no assurance that we can maintain our URAC accreditation. If we are not able to maintain our accredited status after the current accreditation period expires in 2011, our revenues may suffer.

We are subject to numerous federal and state laws and regulations and changes to any of them could have an impact on our operations.

We are subject to a variety of federal and state governmental laws and regulations. If any of these laws or regulations changes, or if the applicable governmental agency changes its interpretation, our operations may be affected.

Failure to comply with government regulations could subject us to civil and criminal penalties.

Federal and state governments have enacted fraud and abuse laws, laws to protect patients' privacy and licensure laws. Violation of these and other laws or regulations governing our operations or the operations of our employed or network hearing professionals could result in the imposition of civil or criminal penalties, the suspension or revocation of our licenses or our exclusion from participating in Medicare or Medicaid. If we were to become subject to these penalties or exclusions as the result of our actions or omissions, it would negatively affect our ability to operate our business.

HIPAA broadened the scope of fraud and abuse laws applicable to healthcare companies. HIPAA created civil penalties for, among other things, billing for medically unnecessary goods or services. HIPAA established new enforcement mechanisms to combat fraud and abuse, including civil and, in some instances, criminal penalties for failure to comply with specific standards relating to the privacy, security and electronic transmission of most individually identifiable health information. The HITECH Act expanded the scope of these provisions by mandating individual notification in instances of data breach, providing enhanced penalties for HIPAA violations, and granting enforcement authority to states' Attorneys General in addition to the HHS Office of Civil Rights. It is possible that Congress may enact additional legislation in the future to increase penalties and to create a private right of action under HIPAA, which could entitle patients to seek monetary damages for violations of the privacy rules.

Changes in state and federal regulation of the delivery of health care services and products may have a material adverse effect on our business.

In the current economic and political climate, many changes to the delivery of health care services and products are being considered. In particular, federal healthcare reform law may significantly impact our business. While some provisions of the health care reform law have been implemented, many are still subject to future rule-making and implementation. Further, there have been a number of lawsuits filed that challenge all or part of the law. Further, various Congressional members have indicated a desire to revisit some or all of the health care reform law during 2011. There have been a number of bills introduced that would repeal or change certain provisions of the law. It is unclear what effect that the law will have on our business; some changes to reimbursement and to the Medicare system could have a material adverse effect on our business.

In addition, some states have proposed new regulation of health care services and products. We cannot predict the impact of any such new state regulation on our business or operations.

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

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

will maintain adequate insurance or otherwise be able to pay such liability.

Risks Relating to HearUSA Common Stock

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

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

- the amount of our cash resources and ability to obtain additional funding;
- economic conditions in markets we are targeting;
- fluctuations in operating results;
- changes in government regulation of the healthcare industry;
- failure to meet estimates or expectations of the market;
- rate of acceptance of hearing aid products in the geographic markets we are targeting;
- market perception of the potential for our success with the AARP Program; and
- events relating to changes in our relationship with our strategic partner, Siemens, including an adverse decision in the Siemens dispute described in Legal Proceedings.

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

Exercise of outstanding HearUSA options could cause substantial dilution.

As of December 25, 2010, there were options to purchase approximately 6.8 million shares of common stock outstanding. To the extent outstanding options are exercised or additional shares of capital stock are issued, stockholders will incur additional dilution.

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

If substantial stockholders sell shares of HearUSA common stock into the public market, or investors become concerned that substantial sales might occur, the market price of HearUSA common stock could decrease. For example, the Company has registered 6.4 million shares for resale by Siemens from time to time. Such a decrease in market price of our stock could make it difficult for us to raise capital by selling stock or to pay for acquisitions using stock. In addition, HearUSA employees hold a significant number of options to purchase shares, many of which are presently exercisable. Employees may exercise their options and sell shares soon after such options become exercisable, particularly if they need to raise funds to pay for the exercise of such options or to satisfy tax liabilities that they may incur in connection with exercising their options.

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

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

- the company fails to maintain stockholder's equity of at least $2 million if the company has sustained losses from continuing operations or net losses in two of its three most recent fiscal years;
- the company fails to maintain stockholder's equity of $4 million if the company has sustained losses from continuing operations or net losses in three of its four most recent fiscal years;

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

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

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

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

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

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

Pursuant to the terms of the Investor Rights Agreement with Siemens, the Company is obligated to provide Siemens with a right of first refusal in the event the Company proposes a transaction that would constitute a change of control with, or primarily involving, a person in the hearing aid industry. The existence of this right may discourage a third party in the hearing aid industry from making a takeover offer which could be beneficial to HearUSA and its stockholders. In addition the term of our agreements with Siemens extend to February of 2015. The existence of these agreements could discourage a third party from making an offer to buy the Company that would be beneficial to the Company and its stockholders.

Item 1B. Unresolved Staff Comments

None

Item 2. Properties

HearUSA's corporate offices, network management office and national call center are located in West Palm Beach, Florida. The leases on these properties are for ten years and expire in 2016. As of December 25, 2010, the Company operated 41 centers in Florida, 13 in New Jersey, 28 in New York, 6 in Massachusetts, 8 in Ohio, 24 in Michigan, 7 in Missouri, 3 in Pennsylvania, 6 in North Carolina, 1 in South Carolina and 38 HEARx West centers in California. All of the locations are leased for one to ten year terms pursuant to generally non-cancelable leases (with renewal options in some cases). The Company believes these locations are suitable to serve its needs. The network is operated from the Company's corporate office in West Palm Beach. The Company has no interest or involvement in the network providers' properties or leases.

Item 3. Legal Proceedings

On February 4, 2011, the Company filed a complaint against Siemens Hearing Instruments, Inc. in the Supreme Court of the State of New York. The Company is seeking a declaratory judgment of the court concerning a claim by Siemens for an additional loan prepayment under the credit agreement of $2.3 million arising from the Company's sale of its Canadian assets in 2009. The Company believes it has satisfied the loan prepayment requirement related to the 2009 Canadian sale and that no additional amounts should be due. On March 17, 2011, before the matter had come before the court, Siemens issued to the Company a notice of default. The notice states that as a result of the Company's failure to pay the $2.3 million related to the Canadian asset sale, Siemens is declaring the Company in default under the Credit Agreement. Siemens also claims in the notice that it is entitled to accelerate all of the remaining payments under the Credit Agreement and demands the immediate payment of $32.7 million. The notice states that Siemens intends to pursue its rights and remedies to recover the total amount, including enforcing its security interests in the Company's assets. On March 17, 2011, the Company filed a motion for a temporary restraining order against Siemens to prevent Siemens from declaring the default, accelerating the full amount under the Credit Agreement and from employing self-help measures to enforce its rights under the Credit Agreement. The trial court denied the motion and HearUSA appealed.

On March 29, 2011, the Appellate Division of the New York State Supreme Court granted the motion by HearUSA for the temporary restraining order against Siemens Hearing Instruments, Inc.

As a result, Siemens is enjoined from declaring HearUSA to be in default under the credit agreement, from engaging in self help to collect under the credit agreement and from making any efforts to seize assets or take control of HearUSA's business pending a May 2, 2011 hearing on HearUSA's motion for a preliminary injunction on the condition that HearUSA make all other payments to Siemens under the Credit Agreement.

Due to the inherent uncertainties of litigation, the Company cannot predict the ultimate outcome of the proceeding. An unfavorable outcome would have a material adverse effect on our business, financial condition or results of operations.

On March 28, 2011, HearUSA amended its complaint to add an additional claim for a declaratory judgment that, in the event the court determines that HearUSA owes the $2.3 million, it may pay that amount within a reasonable time to avoid the default and acceleration of the $32.7 million. The court has scheduled a preliminary injunction hearing for May 2, 2011.

On April 4, 2011, Siemens filed a motion to dismiss this action. The court will hear this motion at the May 2, 2011 hearing.

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

Item 4. Reserved

EXECUTIVE OFFICERS OF THE COMPANY

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

Name and Position	Age	First Served as Executive Officer
Stephen J. Hansbrough Chairman and Chief Executive Officer Director	64	1993
Gino Chouinard President and Chief Operating Officer	42	2002
Francisco Puñal Senior Vice President and Chief Financial Officer	52	2008

Messrs. Hansbrough, Chouinard and Puñal are serving pursuant to employment agreements with 3-year terms expiring in 2012, which will be renewed for successive one-year terms unless a party provides notice of non-renewal.

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

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

Francisco (Frank) Puñal, Senior Vice President and Chief Financial Officer from March 2009 to present, was Senior Vice President and Chief Accounting Officer of the Company from April 2008 to February 2009. Mr. Puñal served as the Chief Financial Officer of International Bedding Group, Inc., a privately held company based in Pompano Beach, Florida, from June of 2007 to April 2008. Mr. Puñal also served for over six years as Vice President and Controller of Jacuzzi Brands, Inc., a NYSE-listed company. Earlier in his career, Mr. Puñal was a Senior Audit Manager for Ernst & Young LLP.

PART II

Item 5. Market for Registrant’s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities.

The common stock of the Company is traded on the NYSE Amex under the symbol “EAR”. As of April 6, 2011, the Company had 45,006,218 shares of common stock outstanding. The closing price of the common stock on April 6, 2011 was $0.49. The following table sets forth the high and low sales prices for the common stock as reported by the NYSE Amex for the fiscal quarters indicated:

Fiscal Quarter	Common Stock	
	High	Low
2010		
Fourth	$1.09	$0.80
Third	$1.05	$0.78
Second	$1.70	$0.85
First	$1.77	$1.29
2009		
Fourth	$1.69	$1.20
Third	$1.39	$0.56
Second	$0.95	$0.36
First	$0.75	$0.38

As of April 6, 2011, there were 1,037 holders of record of the common stock.

Dividend Policy

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

The following table sets forth certain information regarding the Company’s equity compensation plans as of December 25, 2010:

Equity Compensation Plan Information

Plan Category	Number of Securities to be issued upon exercise of outstanding options, warrants and rights (a)		Weighted-average exercise price of outstanding options, warrants and rights (b)	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a))
Equity compensation plans approved by security holders	6,652,510		$ 1.15	2,479,008
Equity compensation plans not approved by security holders	100,000	(1)	$ 0.35	-
Total equity compensation plans approved and not approved by security holders	6,752,510		$ 1.14	2,479,008

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

Item 6. Selected Financial Data

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

CONSOLIDATED STATEMENT OF OPERATIONS DATA:

	Year Ended				
Dollars in thousands	December 25 2010	December 26 2009	December 27 2008	December 29 2007	December 30 2006
Total net revenues	$ 83,502	$ 88,934	$ 95,297	$ 89,095	$ 79,081
Income (loss) from operations (1 and 2)	(2,623)	5,087	390	3,874	2,345
Non-operating income:					
Gain (loss) on foreign exchange (3)	(9)	585	-	-	-
Gain from insurance settlement (4)	-	68	-	-	203
Gain on settlement of intangible asset (5)	-	-	981	-	-
Interest income	42	27	42	164	152
Interest expense (6)	(3,561)	(4,791)	(5,678)	(7,929)	(5,955)
Income tax expense	(723)	(880)	(832)	(595)	(308)
Income (loss) from continuing operations	(6,874)	96	(5,097)	(4,486)	(3,563)
Income from discontinued operations	-	1,031	3,156	2,682	1,022
Gain on sale of assets, net of income tax	-	931	-	-	-
Net income (loss)	(6,874)	2,058	(1,941)	(1,804)	(2,541)
Income from noncontrolling interest	(863)	(544)	(1,260)	(1,478)	(633)
Net income (loss) attributable to HearUSA, Inc	(7,737)	1,514	(3,201)	(3,282)	(3,174)
Net income (loss) attributable to HearUSA, Inc. common stockholders	(7,876)	1,378	(3,340)	(3,419)	(3,312)
Income (loss) per common share attributable to HearUSA, Inc. common stockholders:					
Basic and diluted, loss from continuing operations	(0.18)	(0.01)	(0.17)	(0.17)	(0.13)
Basic and diluted, income from discontinued operations	(0.18)	0.04	0.08	0.08	0.03
Basic and diluted, income (loss)	-	0.03	(0.09)	(0.09)	(0.10)

(1) Income from operations in 2010, 2009, 2008, 2007 and 2006 includes approximately $1.1 million, $981,000, $849,000, $606,000 and $976,000, respectively of non-cash stock-based compensation expense.
(2) Income from operations includes approximately $851,000, $801,000, $1.1 million, $896,000 and $815,000, in 2010, 2009, 2008, 2007 and 2006, respectively, of intangible assets amortization.
(3) Gain on foreign exchange is a result of the Canadian asset sale in April 2009. The Company plans to repatriate its remaining investment in its Canadian operations. Therefore, gains and losses on foreign currency exchange related to the Company's net investment remaining in its Canadian operations after the asset sale will be recognized in continuing operations.
(4) The gain from insurance settlement is from insurance proceeds and final payment resulting from property damages and business interruption claims sustained by a California hearing care center in 2009, and hurricane damages and

business interruption claims sustained by Florida hearing care centers in 2005.

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(5) The gain on settlement of intangible asset is the result of the December 22, 2008 amendment to the license agreement with AARP, which restructured the payment terms, eliminating the $7.6 million annual license payment.
(6) Interest expense includes approximately $177,000, $314,000, $380,000 and $117,000 of non-cash interest expense on discounted notes payable in 2010, 2009, 2008 and 2007, $222,000 of decrease and $170,000 of increase in non-cash interest expense related to recording warrants at their fair market value in 2010 and 2009, $763,000 of non-cash interest expense on long-term contractual commitment in 2008, $122,000, $3.5 million and $2.7 million in 2008, 2007 and 2006, respectively, of non-cash debt discount amortization (including $1.4 million in 2007 due to the reduction in the price of warrants related to the 2003 convertible subordinated notes) and approximately $319,000 in 2006 of decreases in non-cash interest expense related to a decrease in the fair market value of the warrant liability.

BALANCE SHEET DATA:

			As of		
Dollars in thousands	December 25 2010	December 26 2009	December 27 2008	December 29 2007	December 30 2006
Total assets	$ 81,026	$ 91,313	$ 100,601	$ 100,542	$ 83,276
Working capital deficit (1 and 2)	(39,877)	(1,830)	(5,773)	(14,791)	(14,263)
Long-term debt:					
Long-term debt, net of current maturities	1,134	36,139	49,099	36,499	28,599
Convertible subordinated notes and subordinated notes, net of debt discount of $278,000 in 2006	-	-	-	-	3,762

(1) Includes approximately $32.2 million, $2.5 million, $2.7 million, $2.6 million and $3.5 million in 2010, 2009, 2008, 2007 and 2006, respectively, representing the current maturities of the long-term debt to Siemens which may be repaid through rebate credits and approximately $2.5 million, net of debt discount, in 2006 related to the $7.5 million convertible subordinated notes.

(2) Included in the negative working capital amounts as of December 25, 2010, is the entire principal outstanding under the Siemens notes payable of $32.2 million, which has been classified in current liabilities, as a result of the Siemens' claim under its notice of default issued on March 17, 2011, that is entitled to accelerate all remaining payments due under the credit agreement, as described in "Legal Proceedings", above.

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

GENERAL

The Company has over 400 provider agreements with health insurance companies and managed care organizations. Some of our contracted insurance companies and managed care organizations decided to limit, change or eliminate hearing care benefits beginning in 2010 what the Company believes was a response to unclear implications of healthcare reform and the overall downturn in the economy.

As a result, the Company’s revenues decreased in 2010 compared to 2009, primarily in the first quarter of the year. The Company implemented a number of plans and strategies to replace the revenues lost, which included increased marketing to its existing insurance base and private pay customers.

Several of these companies have now expanded or reinstated hearing benefits for their members, effective January 1, 2011. These companies included Preferred Care Partners (Florida), BCBS Horizon Medicare Blue (New Jersey), and BCBS Medicare Blue HMO (Florida). Similarly, Humana, Inc. reinstated hearing benefits in its 2011 Senior HMO product in Florida. Management believes these developments signal a shift away from insurance and managed care organizations limiting, changing or eliminating hearing care benefits. Accordingly, the Company expects revenues from insurance plans to increase during 2011 over 2010 levels.

RESULTS OF OPERATIONS

2010 Compared to 2009 (in thousands of dollars)

Revenues

Dollars in thousands

	2010	2009	Change	% Change
Hearing aids and other products	$77,184	$81,086	$(3,902)	(4.8)%
Services	6,318	7,848	(1,530)	(19.5)%
Total net revenues	$83,502	$88,934	$(5,432)	(6.1)%

The $5.4 million, or 6.1%, decrease in net revenue in 2010 compared to 2009 was principally a result of the loss of revenue related to a number of insurance plans eliminating, changing or limiting their hearing care benefits during 2010. These changes adversely affected both hearing aids and services revenue.

The Company expects revenues from provider contracts to increase in 2011 over 2010 levels. While there can be no assurance, it appears that the cancellations and reductions in benefits seen at the end of 2009 is not continuing into 2011. In late 2010, the Company reached agreement with several managed care plans to provide new or expanded hearing care benefits to an additional 400,000 members beginning January 1, 2011.

Cost of Products Sold and Services

Dollars in thousands

	2010	2009	Change	%
Hearing aids and other products	$20,706	$20,224	$482	2.4 %
Services	1,687	1,733	(46)	(2.7)%

Total cost of products sold and services	$22,393	$21,957	$436	2.0 %
Percent of total net revenues	26.8 %	24.7 %	2.1 %	8.5 %

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The cost of products sold includes the effect of rebate credits earned under our supply agreement with Siemens. (See Note 8 – Long-term Debt, Notes to Consolidated Financial Statements included herein.)

The following table reflects the components of the Siemens' rebate credits which are included in cost of products sold for hearing aids (see Note 8 – Long-term Debt, Notes to Consolidated Financial Statements included herein):

Dollars in thousands

	2010		2009		Change		%	
Rebates offsetting base required payments on Tranche C	$2,000		$2,000		$-		-	
Volume rebates used to reduce Tranche C principal	788		821		(33	)	(4.0	)%
Rebates offsetting required payments on Tranche B for purchases made by acquired centers	425		599		(174	)	(29.0	)%
Rebates offsetting interest on Tranches B and C	3,234		3,815		(581	)	(15.2	)%
Total rebate credits	$6,447		$7,235		$(788	)	(10.9	)%
Percent of total net revenues	7.7	%	8.1	%	(0.4	)%	(4.9	)%

The $174,000 reduction in rebates earned on Tranche B was due to the 2009 negotiated decrease in the per unit rebates from $65 to $50 and a decline in the number of Siemens units purchased. The rebates per unit were decreased in exchange for better overall pricing. The $581,000 decrease in interest forgiven is due to the lower level of Siemens indebtedness primarily resulting from the repayment of approximately $8.1 million from the proceeds of the sale of the Canadian operations in 2009. Cost of products sold as a percent of total net revenues before the impact of the Siemens rebate credits was 34.5% in 2010 compared to 32.8% in 2009. The increase in cost of sales as a percentage of revenue is primarily the result of the lost insurance business and product mix, as the lost insurance business traditionally generates higher margins.

Expenses

Dollars in thousands

	2010		2009		Change		%	
Center operating expenses	$47,000		$44,152		$2,848		6.5	%
Percent of total net revenues	56.3	%	49.6	%	6.7	%	13.3	%
General and administrative expenses	$14,606		$15,421		$(815	)	(5.3	)%
Percent of total net revenues	17.5	%	17.3	%	0.2	%	1.2	%
Depreciation and amortization	$2,126		$2,317		$(191	)	(8.2	)%
Percent of total net revenues	2.5	%	2.6	%	(0.1	)%	(3.8	)%

The $2.8 million increase in center operating expenses in 2010 as compared with 2009 is attributable to a $2.2 million increase in marketing expense, and a $816,000 increase in compensation due to reinstatement of the 2009 5% salary reductions and changes in the commission payment methodology that were mostly offset by lower base pay. The Company spent approximately $3.7 million marketing the AARP program during 2010. AARP advertising and program costs totaled $4.0 million in 2010 compared to $583,000 in 2009.

The Company believes that it will not be necessary to separately fund its new marketing initiatives and the AARP program going forward. Marketing expenditures are expected to decline to traditional levels in 2011. The increasing role AARP has begun to play in educating its members on the program will allow the Company to combine its AARP initiatives with its other marketing programs.

General and administrative expenses decreased by approximately $815,000 in 2010 as compared to 2009. This decrease is primarily the result of a $394,000 decrease in communication expenses, a $127,000 decrease in compensation expenses due to reductions in staffing, and a $101,000 decrease in shareholder relation costs.

Gain (loss) on Foreign Exchange

As a result of the sale of its Canadian operations in April 2009, the Company repatriated its remaining investment in its Canadian operations. Therefore, gains and losses on foreign currency exchange related to the Company's net investment remaining in its Canadian operations after the asset sale were recognized in continuing operations. The Company recognized a $9,000 foreign currency loss in 2010 and $585,000 foreign currency gain in 2009.

Interest Expense

Dollars in thousands

	2010	2009	Change	%
Notes payable from business acquisitions and others (1)	$327	$976	$(649)	(66.5)%
Siemens Tranches B and C – interest forgiven (2)	3,234	3,815	(581)	(15.2)%
Total interest expense	$3,561	$4,791	$(1,230)	(25.7)%

	2010	2009	Change	%
Total cash interest expense (3)	$372	$492	$(120)	(24.4)%
Total non-cash interest expense (4)	3,189	4,299	(1,110)	(25.8)%
Total interest expense	$3,561	$4,791	$(1,230)	(25.7)%

(1) Includes $177,000 and $314,000 in 2010 and 2009, respectively, of non-cash interest expense related to recording of notes at their present value by discounting future payments to market rate of interest (see Note 8 – Long-term Debt, Notes to Consolidated Financial Statements included herein) and $(222,000) and $170,000 of non-cash interest (income) expense in 2010 and 2009, respectively, related to recording warrants at their fair market value.

(2) The interest expense on Tranches B and C is forgiven by Siemens as long as the minimum purchase requirements are met. A corresponding rebate credit is recorded as a reduction of the cost of products sold (see Note 8 – Long-term Debt, Notes to Consolidated Financial Statements included herein and Liquidity and Capital Resources, below).

(3) Represents the sum of the cash interest portion paid on the notes payable for business acquisitions and others.

(4) Represents the non-cash interest expense related to recording the notes payable for business acquisitions at their present value by discounting future payments to the market rate of interest, interest on Siemens Tranches B and C offset by rebates, net of the reduction of non-cash interest expense in 2010 related to recording warrants at their estimated fair value.

Income Taxes

The Company has net operating loss carryforwards of approximately $53.1 million for U.S. income tax purposes. The Company has temporary differences between the financial statement and tax reporting arising primarily from differences in the amortization of intangible assets and goodwill and depreciation of fixed assets. The deferred tax assets for U.S. income tax purposes have been offset by a valuation allowance because it was determined that these assets were not likely to be realized.

During 2010 and 2009, the Company recorded a deferred tax expense of approximately $880,000 related to the estimated deduction of tax deductible goodwill from its U.S. operations. The deferred income tax expense was recorded because it cannot be offset by temporary differences as it relates to infinite-lived assets and the timing of reversing the liability is unknown. Deferred income tax expense will continue to be recorded until the tax deductible goodwill is fully amortized.

In 2010, income tax benefits totaling $157,000 related to the 2009 tax expense were recorded based on the finalization of the Canadian tax return.

Net Income Attributable to Noncontrolling Interest

During 2010 and 2009, the Company's 50% owned joint venture, HEARx West, generated net income of approximately $1.7 million and $1.1 million, respectively. The Company records 50% of the venture's net income as net income attributable to noncontrolling interest in the income of a joint venture in the Company's consolidated statements of operations. The net income attributable to noncontrolling interest for 2010 and 2009 was approximately $863,000 and $544,000, respectively.

Discontinued Operations

On April 27, 2009, the Company sold the assets of Helix Hearing Care of America Corp. and the stock of 3371727 Canada Inc., both indirect wholly owned subsidiaries of the Company, for cash consideration of approximately 23.1 million U.S. dollars, which resulted in a gain on sale of approximately $931,000, net of applicable tax, for the year ended December 26, 2009.

During 2009, income from discontinued operations, net of income taxes, was approximately $1.0 million representing the results of our Canadian operations during the approximately four month period prior to the sale in April 2009.

LIQUIDITY AND CAPITAL RESOURCES

The accompanying financial statements are presented on a going concern basis. Due to the economy our sources of revenues have not been sufficient to cover our operating costs. Management has implemented plans to reduce costs and cash needs. The Company is in a dispute with its principal lender, Siemens Hearing Instruments, Inc. (“Siemens”) in regard to the amount of the cash prepayment due to Siemens on the credit facility from the net proceeds of the sale of the Canadian operations in 2009. The credit facility requires prepayment of the loan balance totaling 50% of the net proceeds from sales of assets. As noted in “Legal Proceedings above”, the Company has requested adjudication of the dispute. The amount in dispute is $2.3 million. On March 17, 2011, before the matter had come before the court, Siemens issued to the Company a notice of default. The notice states that as a result of the Company’s failure to pay the $2.3 million, Siemens is declaring the Company in default under the Credit Agreement. Siemens also claims in the notice that it is entitled to accelerate all of the remaining payments under the Credit Agreement and demands the immediate payment of $32.7 million. The notice states that Siemens intends to pursue its rights and remedies to recover the total amount, including enforcing its security interests in the Company’s assets.

On March 29, 2011, the Appellate Division of the New York State Supreme Court granted the motion by HearUSA for the temporary restraining order against Siemens Hearing Instruments, Inc.

As a result, Siemens is enjoined from declaring HearUSA to be in default under the credit agreement, from engaging in self help to collect under the credit agreement and from making any efforts to seize assets or take control of HearUSA's business pending a May 2, 2011 hearing on HearUSA's motion for a preliminary injunction on the condition that the Company make all other payments to Siemens under the credit agreement. The Company has made all other payments under the credit agreement and under the supply agreement with Siemens. The Company has reflected the entire $32.2 million due under the credit agreement in the current portion of the long-term debt in its consolidated balance sheet as of December 25, 2010, pending the resolution of the dispute.

Because the Company may not be able to reduce its costs to offset cash shortfalls or to raise debt financing to meet its cash needs and pay any amounts due on the Siemens credit agreement, management believes that the Company’s current cash will not be sufficient to cover the expenses the Company will incur during the next twelve months, which may include the monthly payments due to Siemens under the supply agreement.

The Company completed a number of cost cutting initiatives during later part of 2010 and the first quarter to 2011. The cost savings from these initiatives will not be sufficient to meet its cash needs over the next 12 months at current revenue and margin levels. The Company is in discussions with a number of parties to obtain additional financing but there can be no assurance that the Company will obtain the necessary financing.

Agreements with Siemens

The Company has entered into credit, supply, investor rights and security agreements with Siemens. The term of the current agreements extends to February 2015.

Pursuant to these agreements, Siemens has extended to the Company a $50 million credit facility and the Company has agreed to purchase at least 90% of its hearing aid purchases from Siemens and its affiliates. If the 90% minimum purchase requirement is met, the Company earns rebates which are then used to liquidate principal and interest payments due under the credit agreement.

Credit Agreement

The credit agreement includes a revolving credit facility of $50 million that bears interest at 9.5%, matures in February 2015 and is secured by substantially all of the Company's assets. As of December 25, 2010, there was approximately $32.2 million outstanding under the credit agreement. Amounts available to be borrowed under the credit facility are to be used solely for acquisitions unless otherwise approved by Siemens. The Company may not borrow further under their line for acquisitions until such time as it is generating cash from operations. Borrowings under the credit facility are accessed through Tranche B and Tranche C. Borrowing for acquisitions under Tranche B is generally based upon a formula equal to 1/3 of 70% of the acquisition target's trailing 12 months revenues, and any amount greater than that may be borrowed under Tranche C with Siemens' approval. Principal borrowed under Tranche B was repaid quarterly at a rate of $65 per Siemens unit purchased by the acquired businesses through September 2009. In October 2009, the parties agreed to reduce the rebate to a rate of $50 per Siemens unit purchased by the acquired businesses in exchange for more favorable pricing. Principal borrowed under Tranche C is repaid at $500,000 per quarter. The required quarterly principal and interest payments on Tranches B and C are forgiven by Siemens through rebate credits of similar amounts as long as 90% of hearing aid units purchased by the Company are from Siemens. Amounts not forgiven through rebate credits are payable in cash each quarter. The Company has met the minimum purchase requirements of the arrangement since inception of the arrangement with Siemens.

The credit agreement requires that the Company reduce the principal balance by making annual payments in an amount equal to 20% of Excess Cash Flow (as defined in the credit agreement), and by paying Siemens 50% of the proceeds of any net asset sales (as defined) and 25% of proceeds from any equity offerings the Company may complete. The Company did not have any Excess Cash Flow (as defined) in fiscal 2010 or 2009. In 2009 the Company paid Siemens approximately $8.1 million of the proceeds received from the sale of the Company's Canadian operations in 2009.

The Company is in a dispute with Siemens concerning the amount of the cash prepayment due to Siemens on the credit facility from the net cash proceeds of the sale of the Canadian operations in 2009.

On March 17, 2011, before the matter had come before the court, Siemens issued to the Company a notice of default. The notice stated that as a result of the Company's failure to pay the disputed $2.3 million, Siemens is declaring the Company in default under the Credit Agreement. Siemens also claims in the notice that it is entitled to accelerate all of the remaining payments under the Credit Agreement and demands the immediate payment of $32.7 million. The notice states that Siemens intends to pursue its rights and remedies to recover the total amount, including enforcing its security interests in the Company's assets.

On March 29, 2011, the Appellate Division of the New York State Supreme Court granted a motion by HearUSA for a temporary restraining order against Siemens Hearing Instruments, Inc.

Siemens is enjoined from declaring HearUSA to be in default under the credit agreement, from engaging in self help to collect under the credit agreement and from making any efforts to seize assets or take control of HearUSA's business pending a May 2, 2011 hearing on HearUSA's motion for a preliminary injunction on the condition that the Company make all other payments due Siemens under the Credit Agreement.

The Company has reflected the entire outstanding balance of the credit facility in the current portion of long-term debt in its consolidated balance sheet as of December 25, 2010, pending the resolution of the dispute.

The credit facility also imposes certain financial and other covenants on the Company which are customary for loans of this size and nature, including restrictions on the conduct of the Company's business, the incurrence of indebtedness, merger or sale of assets, the modification of material agreements, changes in capital structure and making certain payments. If the Company cannot maintain compliance with the covenants, Siemens may terminate future funding under the credit agreement and declare all then outstanding amounts under the agreement immediately due and payable. At December 25, 2010 the Company believes it was in compliance with the Siemens loan covenants. For a description of the dispute with Siemens, see Legal Proceedings, above.

Supply Agreement

The supply agreement requires the Company to purchase at least 90% of its hearing aid purchases from Siemens and its affiliates. The 90% requirement is computed on a cumulative four consecutive quarters. The Company has met the minimum purchase requirements of the supply agreement since inception of the arrangement with Siemens. If the minimum purchase requirement is met, the Company earns rebates used to liquidate principal and interest under the credit agreement. Approximately $47.3 million has been rebated since the Company entered into this arrangement in December 2001.

Additional quarterly volume rebates of $156,250, $312,500 or $468,750 can be earned by meeting certain quarterly volume tests. These rebates reduce the principal due on the credit facility. Additional volume rebates of $788,000 and $821,250 were recorded in 2010 and 2009, respectively.

All rebates earned are accounted for as a reduction of cost of products sold.

The following table summarizes the rebate structure:

	Calculation of Pro forma Rebates to HearUSA when at least 90% of Units Purchased are from Siemens (1) Quarterly Siemens Unit Sales Compared to Prior Years' Comparable Quarters			
	90% but < 95%	95% to 100%	> 100% < 125%	125% and >
Acquisition rebate (2)	$50/ unit	$50/ unit	$50/ unit	$50/ unit
	Plus	Plus	Plus	Plus
Notes payable rebate	$ 500,000	$ 500,000	$ 500,000	$ 500,000
Additional volume rebate	-	156,250	312,500	468,750
Interest forgiveness rebate (3)	1,187,500	1,187,500	1,187,500	1,187,500
	$ 1,687,500	$ 1,843,750	$ 2,000,000	$ 2,156,250

(1) Calculated using trailing twelve month units purchased by the Company
(2) Siemens units purchased from acquired businesses ($65 per unit through September 2009 and $50 per unit thereafter)
(3) Assuming the $50 million line of credit is fully utilized

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

	Years Ended	
(Dollars in thousands)	December 25, 2010	December 26, 2009