HEARX LTD
Form 10-K/A
May 24, 2002

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-K/A
(AMENDMENT NO. 1)

FOR ANNUAL AND TRANSITION REPORTS

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

(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 29, 2001

or

o **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 0-16453

HEARx LTD.

Exact Name of Registrant as Specified in Its Charter

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

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

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

Title of each class	Name of each exchange on which registered
Common Stock, par value .10 per share	American Stock Exchange

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

None

Indicate by check þ 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 Incorporation or Organization) filing requirements for the past 90 days. Yes þ No o

Indicate by check þ 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. o

As of March 18, 2002, the aggregate market value of the Registrant s Common Stock held by non-affiliates (based upon the closing price of the Common Stockon the American Stock Exchange) was approximately $17,550,948.

On March 18, 2002, 14,040,759 shares of the Registrant s common stock were outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of Registrant s definitive Proxy Statement for the 2002 Annual Meeting of the Registrant s Stockholders (2002 Proxy Statement), to be filed with the Securities and Exchange Commission, are incorporated by reference in Part III hereof.

Item 8. *Financial Statements and Supplementary Data*

Report of Independent Certified Public Accountants

Board of Directors HEARx Ltd.
West Palm Beach, Florida

We have audited the accompanying consolidated balance sheets of HEARx Ltd. as of December 29, 2001 and 2000, and the related consolidated statements of operations, changes in stockholders equity and cash flows for each of the three years in the period ended December 29, 2001. We have also audited the schedule listed in the accompanying index. These financial statements and schedule are the responsibility of the Company s management. Our responsibility is to express an opinion on these financial statements and schedule based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements and schedule are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements and schedule. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements and schedule. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of HEARx Ltd. at December 29, 2001 and 2000, and the results of its operations and its cash flows for each of the three years in the period ended December 29, 2001 in conformity with accounting principles generally accepted in the United States of America.

Also in our opinion, the schedule presents fairly, in all material respects, the information set forth therein.

BDO Seidman, LLP

West Palm Beach, Florida
February 28, 2002

HEARx LTD.

CONSOLIDATED BALANCE SHEETS

	December 29, 2001	December 29, 2000
ASSETS		
Current assets:		
Cash and cash equivalents	$5,561,608	$4,250,413
Investment securities (Note 2)	150,000	993,224
Accounts and notes receivable, less allowance for doubtful accounts of $185,814 and $212,657	3,965,491	5,734,497
Inventories	504,762	500,582
Prepaid expenses and other	855,052	860,272
Total current assets	11,036,913	12,338,988
Property and equipment net (Notes 3 & 4)	6,835,643	7,595,991
Note receivable (Note 10)	700,000	
Deposits and other (Note 1)	2,768,966	1,937,144
	$21,341,522	$21,872,123
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable and accrued expenses	$6,871,124	$7,377,495
Accrued salaries and other compensation	890,985	1,071,208
Current maturities of long term debt (Note 3)	2,492,313	152,387

Dividends payable (Notes 5B, 5C, 5E and 5I)
1,521,053 1,387,066

Total current liabilities
11,775,475 9,988,156

Long term debt, less current maturities (Note 3)
8,750,999 175,887

Commitments and contingencies
(Notes 3,4,6,8, 10 & 11)

Stockholders equity:

Preferred stock: (Note 5)

(Aggregate liquidation preference $8,628,053 and $11,902,066) $1 par, 2,000,000 shares authorized

Series J (233 & 0 shares outstanding)
233
Series I Convertible (0 & 500 shares outstanding)
500
Series H Junior Participating (0 shares outstanding)

1998 Convertible (4,777 & 5,515 shares outstanding)
4,777 5,515

Total preferred stock
5,010 6,015
Common stock: $.10 par; 20,000,000 shares authorized; 14,559,403 and 12,364,139 shares issued (Notes 5 & 6)
1,455,940 1,236,414
Stock subscription (Note 5A)
(412,500)
Additional paid-in capital
91,438,475 92,695,792
Accumulated deficit
(89,188,436) (79,746,700)

Treasury stock, at cost:518,660 & 518,660 common shares	(2,483,441)	(2,483,441)
Total stockholders equity	815,048	11,708,080
	$21,341,522	$21,872,123

See accompanying notes to consolidated financial statements

HEARx LTD.

CONSOLIDATED STATEMENTS OF OPERATIONS

	Year Ended		
	December 29, 2001	**December 29, 2000**	**December 31, 1999**
Net Revenues	$48,796,110	$56,114,832	$47,476,764

Operating costs and expenses:

Cost of products sold
15,421,587 18,966,110 14,611,284
Center operating expenses
28,722,667 29,328,114 26,376,830
General and administrative expenses
10,441,046 8,830,546 8,601,723
Depreciation and amortization
2,410,160 2,572,048 2,420,891

Total operating costs and expenses
56,995,460 59,696,818 52,010,728

Loss from operations
(8,199,350) (3,581,986) (4,533,964)
Non-operating income (expense):

Interest income
222,349 294,132 210,104
Interest expense
(652,530) (28,723) (27,713)

Loss before minority interest
(8,629,531) (3,316,577) (4,351,573)
Minority Interest
- 347,677

Net loss	(8,629,531)	(3,316,577)	(4,003,896)
Dividends on preferred stock:			
Deemed dividends (Note 5C)		(571,241)	
Dividends	(812,205)	(775,631)	(821,387)
Total dividends on preferred stock	(812,205)	(1,346,872)	(821,387)
Net loss applicable to common stockholders	$(9,441,736)	$(4,663,449)	$(4,825,283)
Net loss per common share basic and diluted (Note 1)	$(.72)	$(.39)	$(.45)
Weighted average number of shares of common stock outstanding (Note 1)	13,120,137	11,834,388	10,775,006

See accompanying notes to consolidated financial statements

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HEARx LTD.

CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS EQUITY

	Year Ended December 29, 2001		Year Ended December 29, 2000		Year Ended December 31, 1999	
	Shares	**Amount**	**Shares**	**Amount**	**Shares**	**Amount**
Preferred Stock:						
Balance, beginning of year	6,015	$6,015	8,315	$8,315	12,709	$12,709
Exchange/redemption of preferred stock	(285)	(285)				
Issuance of preferred stock			500	500		
Conversion of preferred stock	(720)	(720)	(2,800)	(2,800)	(4,394)	(4,394)
Balance, end of year	5,010	$5,010	6,015	$6,015	8,315	$8,315
Common Stock:						
Balance, beginning of year	12,364,139	$1,236,414	11,547,337	$1,154,734	104,023,643	$10,402,364
Exchange/redemption of preferred stock	606,710	60,671				

Conversion of preferred stock
1,388,519 138,852 817,202 81,720 5,414,400 541,440
Exercise of employee stock options
35 3 1,600 160 13,600 1,360
Exercise of stock options by consultants
(2,000) (200)
Stock subscription
200,000 20,000
Reverse stock split
(97,904,306) (9,790,430)

Balance, end of year
14,559,403 $1,455,940 12,364,139 $1,236,414 11,547,337 $1,154,734

Treasury Stock:

Balance, beginning of year
(518,660) $(2,483,441) (388,760) $(2,070,380) (405,311) $(249,956)
Purchase of treasury stock
(129,900) (413,061) (1,921,239) (1,820,424)
Reverse Stock Split
1,937,790

Balance, end of year
(518,660) $(2,483,441) (518,660) $(2,483,441) (388,760) $(2,070,380)

Stock Subscription:

Balance, beginning of year
$ $ $
Stock Subscription
(412,500)

Balance, End of Year
$(412,500)

Additional Paid-in Capital:

Balance, beginning of year
$92,695,792 $87,307,886 $77,531,270
Exchange/redemption of preferred stock
(1,707,930)
Issuance of preferred stock
4,999,500
Cost of issuing preferred stock
(479,617)
Conversion of preferred stock
58,046 313,402 31,852
Stock subscription
392,500
Exercise of employee stock options
67 3,180 1,500
Exercise of stock options by consultants
(19,800)
Deemed dividend
571,241
Reverse stock split
9,743,264

Balance, end of year	$91,438,475	$92,695,792	$87,307,886

See accompanying notes to consolidated financial statements

HEARx LTD.

CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS EQUITY

	Year Ended December 29, 2001	Year Ended December 29, 2000	Year Ended December 31, 1999
	Amount	**Amount**	**Amount**
Accumulated Deficit:			
Balance, beginning of year	$(79,746,700)	$(75,083,251)	$(70,257,968)
Net loss for the year	(8,629,531)	(3,316,577)	(4,003,896)
Deemed dividends on preferred stock		(571,241)	
Preferred stock dividends	(812,205)	(775,631)	(821,387)
Balance, end of year	$(89,188,436)	$(79,746,700)	$(75,083,251)
Unamortized Deferred Compensation:			
Balance, beginning of year	$	$(37,813)	$(75,625)
Amortization		37,813	37,812
Balance, end of year	$	$	$(37,813)

Accumulated Other Comprehensive Income:

Balance, beginning of year
$ $ $58,263
Unrealized gains on securities net of reclassification adjustment (see disclosure)
(58,263)

Balance, end of year
$ $ $

Comprehensive Income (Loss):

Net loss for the year
$(8,629,531) $(3,316,577) $(4,003,896)
Other comprehensive income (loss)
(58,263)

Comprehensive income(loss)
$(8,629,531) $(3,316,577) $(4,062,159)

Disclosure of reclassification amount:

Unrealized holding losses arising during period
$ $ $(84,022)
Less: reclassification adjustment for gains included in net loss
25,759

Net unrealized losses on securities

$	$	$(58,263)

See notes to accompanying consolidated finanical statements

HEARx LTD.

CONSOLIDATED STATEMENTS OF CASH FLOWS

	Year Ended		
	December 29, 2001	**December 29, 2000**	**December 31, 1999**
Cash flows from operating activities:			
Net loss	$(8,629,531)	$(3,316,577)	$(4,003,896)
Adjustments to reconcile net loss to net cash used in operating activities:			
Depreciation and amortization	2,410,160	2,572,048	2,420,891
Provision for doubtful accounts	125,206	377,500	568,135
Loss on disposition of equipment	105,127	72,005	40,325
Minority Interest		(347,677)	
(Increase) decrease in:			
Accounts and notes receivable	1,643,800	(237,711)	(2,395,711)
Inventories	(4,180)	50,878	(21,265)
Prepaid expenses and other	35,005	(326,485)	(119,092)
Increase (decrease) in:			
Accounts payable and accrued expenses	(506,371)	463,470	1,372,605
Accrued salaries and other	(180,223)	(453,503)	(390,486)
Net cash used in operating activities	(5,001,007)	(798,375)	(2,876,171)
Cash flow from investing activities:			
Purchase of property and equipment	(1,640,464)	(1,519,764)	(1,450,107)

Proceeds from sale of equipment
600 2,979
Purchase of investments
(10,129,206) (10,375,928) (2,750,000)
Proceeds from maturities of investments
10,972,430 10,282,704 8,962,516
Issuance of note receivable
(700,000)
Cost of pending merger
(976,682)
Net cash from consolidating HEARx West
656,223

Net cash (used in) provided by investing activities
(2,473,322) (1,610,009) 5,418,632

Cash flows from financing activities:

Proceeds from issuance of:

Long-term debt
11,790,434 35,250
Principal payments: Long-term debt
(875,396) (289,051) (505,905)
Acquisition of treasury stock
(413,061) (1,820,424)
Exchange & redemption of capital stock
(2,129,584)
Proceeds from exercise of employee stock options
70
Proceeds from issuance of capital stock, net of offering costs
4,503,722 (44,306)

Net cash provided by (used in) financing activities
8,785,524 3,801,610 (2,335,385)

Net increase in cash and cash equivalents
1,311,195 1,393,226 207,076

Cash and cash equivalents at beginning of year	4,250,413	2,857,187	2,650,111
Cash and cash equivalents at end of year	$5,561,608	$4,250,413	$2,857,187

See accompanying notes to consolidated financial statements

HEARx LTD.

CONSOLIDATED STATEMENTS OF CASH FLOWS

	Year Ended		
	December 29, 2001	**December 29, 2000**	**December 31, 1999**

Supplemental disclosure of cash flow information:

Cash paid for interest
$414,516 $32,251 $7,419

Supplemental schedule of non-cash investing and financing activities

Preferred stock dividend paid upon conversion in kind by issuance of additional common stock
$196,178 $392,323 $568,898

Preferred stock dividend paid through exchange/ redemption by issuance of new preferred and common stock
451,093

Deemed dividends
571,241

Issuance of note payable and assumption of accounts payable in exchange for customer list and equipment
482,496

Issuance of Common Stock to employees
3,340 2,860

See accompanying notes to consolidated financial statements

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

1. Summary of Significant Accounting Policies

The Company

HEARx Ltd. (HEARx or the Company), a Delaware corporation, was organized for the purpose of creating a nationwide chain of retail centers to serve the needs of the hearing impaired. At the end of 2001, the Company operated a total of 82 centers, including 2 part-time centers. Those included 32 in Florida, 13 in New York, 15 in New Jersey and the 22 HEARx West centers in California.

Helix Transaction

On July 27, 2001, HEARx and Helix, signed a definitive merger agreement, which was subsequently amended and restated as of November 6, 2001. Helix owns or manages 128 hearing healthcare clinics located in Massachusetts, Pennsylvania, New York, Ohio, Michigan, Wisconsin, Minnesota, Washington and Missouri as well as in the Provinces of Ontario and Quebec. Pursuant to the merger agreement, HEARx has agreed, subject to stockholder, regulatory and other necessary approvals, to issue shares of HEARx common stock and common stock equivalents to the holders of Helix common shares in exchange for those shares. The transaction would result in Helix becoming an indirect wholly owned subsidiary of HEARx. At the effective time of the merger, each outstanding share of Helix common stock would be converted into the right to receive .3537 shares of HEARx common stock or ..3537 exchangeable shares of a newly formed wholly owned Canadian subsidiary of HEARx. The exchangeable shares are initially exchangeable into one share of HEARx common stock at the election of the holder. Based on the number of shares of Helix common stock outstanding at November 30, 2001, up to 14.61 million new shares of HEARx common stock or exchangeable shares will be issued to Helix stockholders in connection with the merger upon consummation assuming all approvals are obtained and there are no significant dissenting Helix shareholders. See Note 10, which describes certain significant transactions between HEARx and Helix.

The boards of directors of both companies have approved the transaction. The transaction is now subject to approval by the stockholders of both HEARx and Helix and by the Canadian courts. HEARx has filed a registration statement/proxy statement on Form S-4 with the U.S. Securities and Exchange Commission relating to the Helix transaction and the Form S-4 is currently undergoing the SEC review process. The transaction is expected to close before the end of the second quarter of 2002. After the transaction, the Company intends to change its name to Hear USA, Inc. As of December 29, 2001, the Company had incurred legal and professional fees of approximately $976,000 in connection with the pending merger, which are included in Deposits and other in the accompanying consolidated balance sheet.

Segments

The Company s operations are organized by centers into three geographic regions, the Northeast, Florida and California. These regions comprise one operating segment. Net revenues and income (loss) from operations at center level by region are as follows:

	Northeast	Florida	California	Corporate	Total
Net Revenues					
2001	$11,900,000	$20,000,000	$16,900,000		$48,800,000

2000					
	14,200,000	24,000,000	17,900,000		56,100,000
1999					
	10,100,000	25,000,000	12,400,000		47,500,000
Income (Loss) from Operations					
2001					
	(228,000)	2,985,000	1,894,000	(12,850,000)	(8,199,000)
2000					
	861,000	4,529,000	2,430,000	(11,402,000)	(3,582,000)
1999					
	(680,000)	5,199,000	1,970,000	(11,023,000)	(4,534,000)

Income (loss) from operations at the center level are computed before general and administrative expenses and depreciation/amortization. Center operations depreciation amounted to $1,666,000, $1,863,000 and $1,793,000 in 2001, 2000 and 1999 respectively. Center operations capital expenditures amounted to $870,000, $952,000 and $1,450,000 in 2001, 2000 and 1999, respectively. Aggregate identifiable assets of center operations at December 29, 2001 and December 29, 2000 were $ 6,172,000 and $7,159,000, respectively.

Consolidation and change in reporting entity

On August 10, 1998, HEARx formed a joint venture, HEARx West LLC, with the Permanente Federation LLC to create and operate a network of retail hearing care centers (HEARx West Centers). The joint venture agreement provides for a 50/50 ownership by HEARx and the Permanente Federation, with centers bearing the HEARx name. The agreement provides for net income and losses, tax credits and tax preference items to be allocated according to the members percentage interests.

Prior to March 1999, HEARx Ltd. accounted for its investment in HEARx West using the equity method because HEARx did not control HEARx West due to certain provisions in the joint venture agreement. In March 1999, as a result of amendments to the agreement, HEARx obtained control of HEARx West. Accordingly, HEARx has included the financial position and results of operations of HEARx West in the accompanying consolidated financial statements.

Fiscal year

The Company s fiscal year ends on the last Saturday in December and customarily consists of four 13-week quarters for a total of 52 weeks. Every sixth year includes 53 weeks.

Investment securities

Marketable securities are classified available for sale and are carried at estimated market value. Unrealized holding gains and losses are reported as a net amount in a separate component of stockholders equity until realized. Gains and losses realized from the sales are computed by the specific identification method.

Inventories

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

Property and equipment

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

Intangible assets

Intangible assets, included in deposits and other, primarily represent customer lists acquired from acquisitions of hearing businesses. These customer lists are being amortized on a straight-line basis over periods ranging from nine to fifteen years. Intangible assets also include the excess purchase price of acquisitions over the fair value of assets acquired. Such excess costs are being amortized over fifteen years. Total costs of intangible assets were approximately $1,567,000 at both December 29, 2001 and 2000, and accumulated amortization at December 29, 2001 and 2000 was approximately $575,000 and $463,000, respectively.

Pre-opening costs

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

Long-lived assets impairments and disposals

The Company reviews the carrying values of its long-lived and identifiable intangible assets for possible impairment whenever events or changes in circumstances indicate that the carrying amounts of the assets may not be recoverable through the estimated undiscounted future cash flows resulting from the use of these assets. At December 29, 2001, no long-lived assets were held for disposal.

Advertising Costs

Costs for newspaper, television, and other media advertising are expensed as incurred and were $6,781,000, $7,757,000 and $5,470,000 in 2001, 2000, and 1999, respectively.

Sales return policy

The Company provides to all patients purchasing hearing aids a specific return period, a minimum of 30 days, if the patient is dissatisfied with the product. The Company provides an allowance in accrued expenses for returns. The return period can be extended to 60 days if the patient attends the Company s H.E.L.P. program.

Warranties

Hearing aids sold by the Company are covered by manufacturers warranties.

Revenue Recognition

Revenues from the sale of audiological products are recognized at the time of delivery. Revenues from hearing care services are recognized at the time those services are performed.

The Company has capitation contracts with certain health care organizations under which the Company is paid an amount for each enrollee of the health maintenance organization to provide to the enrollee a once every three years discount on certain hearing products and services. The amount paid to the Company by the healthcare organization is calculated on a per-capita basis and is referred to as capitation revenue. Capitation revenue is deferred until the earlier of the actual utilization by the member populations or the end of the contract term.

Income taxes

Deferred taxes are provided for temporary differences arising from the differences between financial statement and income tax bases of assets and liabilities. A valuation allowance is provided for the amount of deferred tax assets which are not considered more likely than not to be realized.

Net loss per common share

Net loss per common share is calculated in accordance with Statement of Financial Accounting Standards (SFAS) No. 128 Earnings Per Share which requires companies to present basic and diluted earnings per share. Net loss per share Basic is based on the weighted average number of common shares outstanding during the year. Net loss per common share Diluted is based on the weighted average number of common shares and dilutive potential common shares outstanding during the year. Convertible preferred stock, stock options and stock warrants are excluded from the computations of net loss per share because the effect of their inclusion would be anti-dilutive.

Excluded from the computation of net loss per common share diluted at December 29, 2001, December 29, 2000 and December 31, 1999 were convertible preferred stock, outstanding options and warrants to purchase 6,613,368, 3,457,296 and 2,693,885 shares, respectively, of the Company s Common Stock at exercise prices less than average market price because to not do so would be anti-dilutive. In addition, outstanding options and warrants to purchase 1,615,045, 1,568,560 and 889,941 shares of common stock were excluded because the options and warrants exercise prices were greater than the average market price of the common shares.

Statements of Cash Flows

For the purposes of the Statements of Cash Flows, temporary cash investments which have an original maturity of ninety days or less are considered cash equivalents.

Reclassifications

Certain amounts in the 2000 and 1999 financial statements have been reclassified in order to conform to the 2001 presentation.

Estimates

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

Stock-based compensation

The Company has elected to follow Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees (APB 25) and related interpretations in accounting for its employee stock options. Under APB 25, because the exercise price of employee stock options equals the market price of the underlying stock on the date of grant, no compensation expense is recorded. The Company has adopted the disclosure only provisions of SFAS No. 123 (SFAS 123) Accounting for Stock-Based Compensation.

2. Investment Securities

Investment securities available for sale consist of the following:

	Amortized Cost	Gross Unrealized Gains/(Losses)	Estimated Market Value
December 29, 2001			
Certificate of Deposit $150,000 $ $150,000			

December 29, 2000

Asset-Backed Securities	$750,000	$ $750,000
Certificates of Deposit	243,224	243,224
Total	$993,224	$ $993,224

At December 29, 2001, the $150,000 certificate of deposit had a contractual maturity of one year.

The asset-backed securities were Taxable Student Loan Asset-Backed Notes, with a floating interest rate, which was reset every 28 days. The fair market value was estimated using the quoted market price, based on the most recent auction, which occurred on the 28-day interest reset date. The market price generally approximated amortized cost due to the floating interest rate. The 20-year contractual maturity was the maturity of the underlying assets.

3. Debt

Long term debt consists of the following:

	December 29 2001	**December 29 2000**
Note payable to supplier, see (a) below	$ 10,875,000	$
Note payable collateralized by customer list, see (b) & (c) below	162,500	291,144
Other	205,812	37,130
	11,243,312	328,274
Less current maturities	(2,492,313)	(152,387)
	$8,750,999	$175,887

The approximate aggregate maturities on long term debt obligations in years subsequent to 2001 are as follows: 2002 $2,492,000; 2003 $2,471,000; 2004 $2,305,000; 2005 $2,300,000 and 2006 $1,675,000.

(a) On April 23, 2001, the Company and Siemens Hearing Instruments, Inc. (Siemens) signed a letter of intent pursuant to which the parties intended to form a marketing and promotional alliance in the United States. As part of this letter of intent, Siemens agreed to provide HEARx with a five-year $7.5 million line of credit with interest at 12%, payable quarterly. These terms of the letter of intent relating to $7.5 million line of credit became binding on April 27, 2001, when HEARx first drew on the line of credit. Under the letter of intent, HEARx agreed to purchase from Siemens a certain percentage of HEARx s total hearing aid requirements over the next five years. The letter of intent provided that as HEARx purchased products from Siemens, Siemens would pay to HEARx certain rebates that would then be used to pay the quarterly installments of principal and interest under the five-year line of credit. On December 7, 2001, HEARx and Siemens entered into the credit agreement and supply agreement described below, which superseded the letter of intent.

imposes certain financial and other covenants on HEARx. If HEARx cannot maintain compliance with these requirements, Siemens may decline to make funds available to HEARx. Furthermore, if HEARx and Helix do not complete the merger, approximately $6.7 million of the credit facility may not be accessible to HEARx at all.

The Tranche A, B and C Loans are payable quarterly over five years with the outstanding principal and interest at 10% due and payable on the final maturity date. Principal and interest, at prime rate (as defined) plus 1%, on the Tranche D Loan is payable on the final maturity date. Quarterly principal and interest payments on Tranche A, B and C Loans will be paid through rebates received from Siemens by HEARx as long as HEARx purchases certain minimum percentages of its requirements of hearing aids from Siemens pursuant to the supply agreement discussed below. HEARx will record a rebate receivable and reduce cost of goods sold for the rebates earned as it meets minimum purchase percentages from Siemens. During 2001, approximately $1,665,000 of earned rebates were recorded as a reduction of cost of goods sold, and $390,000 of interest and $625,000 of principal has been repaid upon receipt of such rebates. The loans may be prepaid in whole or in part at any time without penalty. The credit facility is secured by a first priority security interest in substantially all of the assets of HEARx.

In connection with the credit facility, HEARx and Siemens entered into a supply agreement dated as of December 7, 2001, pursuant to which HEARx agreed to purchase from Siemens certain minimum percentages of HEARx s hearing aid purchases for a period of ten years (an initial five year term and a five year renewal term) at specified prices.

Pursuant to the agreements with Siemens, in the event of a change of control of the Company (as defined), and the surviving entity of such change of control does not assume the Company s obligations under the agreements, the entire outstanding amount under the credit facility will be immediately due and payable and the supply arrangements may be terminated upon payment to Siemens of a $50 million breakup fee.

(b) In January 1996, the Company acquired the customer list and selected assets of Suffolk County Hearing Aid Center, Inc. in New York for $150,000 in cash, 150,000 shares of Common Stock, and a five year note in the amount of $250,000 including interest. The note payable included interest at 5.5% was payable in five annual installments of $50,000 including interest beginning January 22, 1997 and was repaid in January 2001.

(c) During July 1999, the Company issued a $325,000 promissory note payable bearing 8.75% interest to an individual in connection with a purchase of an audiological practice in California, (See Note 8). The note is payable in four annual installments of $81,250 plus accrued interest, beginning July 1, 2000 and is collateralized by the equipment and customer list purchased.

4. Property and Equipment and Leases

Property and equipment consists of the following:

	Range of Useful Lives	December 29, 2001	December 29, 2000
Equipment, furniture and fixtures	5 -10 years	$8,567,807	$7,922,131
Leasehold Improvements	5 -10 years	6,892,273	6,554,421
Computer systems	3 years	3,720,120	3,363,613
Leasehold improvements in progress	N/A	223,855	147,050
		19,404,055	17,987,215
Less accumulated depreciation and amortization		12,568,412	10,391,224
		$6,835,643	$7,595,991

Approximate future minimum rental commitments under operating leases are as follows: $4,336,000 in 2002; $3,857,000 in 2003; $3,095,000 in 2004; $2,742,000 in 2005; $884,000 in 2006 and $449,000 thereafter. These leases are primarily for hearing centers and are located in retail shopping areas.

Equipment and building rent expense for the years ended December 29, 2001, December 29, 2000 and December 31, 1999 was $3,759,000, $3,181,000 and $2,956,000, respectively.

5. Stockholders Equity

A. Stock Subscription

On April 1, 2001 the Company sold 200,000 shares of the Company s common stock, par value $.10 per share (Common Stock) to an investment banker, for $2.0625 per share, and received a secured, nonrecourse promissory note for the principal amount of $412,500. The secured, nonrecourse promissory note is collateralized by the Common Stock purchased which is held in escrow. The principal amount of the note and accrued interest is payable on April 1, 2006. The note bears interest at the prime rate published by the Wall Street Journal adjusted annually. At December 29, 2001, the interest rate of the note was 8%. The $412,500 note has been recorded as Stock Subscription in stockholders equity in the accompanying balance sheet.

Under the terms of a consulting agreement with the investment banker, beginning December 1, 2000 the Company paid the investment banker approximately $188,000 for financial consulting services, which was recorded as consulting expense of approximately $38,000 and $150,000 during 2000 and 2001, respectively. The agreement was terminated in August 2001.

B. Series J Preferred Stock

On December 13, 2001, the Company completed an exchange and redemption of all of the 418 shares of outstanding Series I Convertible Preferred Stock (see Note 5C below) and 203,390 associated common stock purchase warrants for $1,951,000 in cash, 233 shares of newly created Series J Preferred Stock, and 470,530 shares of Common Stock. The cost of the transaction included legal and broker fees of approximately $47,500 in cash and 136,180 shares of Common Stock issued to the broker. The fair value of the cash, shares of Series J Preferred Stock, and Common Stock transferred to the holders of the Series I Convertible Preferred Stock approximated the carrying value of the Series I Convertible Preferred Stock and the related dividends payable of approximately $4.7 million.

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

At any time the Company has the right to redeem all or a portion of the Series J Preferred Stock for a redemption price equal to the stated value plus accrued and unpaid dividends. If there is a change in control of the Company, only upon or after the approval thereof by the Company s Board of Directors, the holders of the Series J Preferred Stock have the right to require the Company to redeem the Series J Preferred Stock at a price of 120% of the stated value plus any accrued and unpaid dividends. The parties have agreed that the transaction pending with of Helix shall not be deemed to be a change in control for this purpose.

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

In connection with this transaction, the Company also entered into a Registration Rights Agreement with the holder under which the Company is required to file a registration statement on Form S-3 covering the resale of the 470,530 shares of Common Stock issued in this transaction no later than 180 days from December 13, 2001. The 470,530 shares of Common Stock issued in the transaction, together with 129,470 shares of Common Stock currently held by the same holder, have been placed in escrow and are subject to resale restrictions based on the trading price of the common stock and appropriate resale registration. During 2001, approximately $5,000 of the 6% dividend is included in the caption Dividends under Dividends on Preferred Stock in the accompanying consolidated statements of operations.

C. Series I Convertible Preferred Stock

On May 9, 2000, the Company completed a private placement of 500 shares of the Company s 7% Series I Convertible Preferred Stock, par value $1.00 per share (the Series I Preferred Stock) and warrants to acquire 203,390 shares Common Stock, for an aggregate purchase price of $5.0 million. The net proceeds to the Company after payment of finders fees, placement fees, legal and accounting expenses was approximately $4.5 million. In connection with the placement of the Series I Preferred Stock, the Company also issued finders warrants to purchase an aggregate of 131,695 shares of Common Stock at an exercise price equal to $4.46.

The Series I Preferred Stock was convertible into Common Stock after August 6, 2000. Upon conversion, holders were entitled to receive a number of shares of Common Stock determined by dividing the sum of the stated value of the Series I Preferred Stock ($10,000 per share), plus accrued and unpaid dividends (unless the Company elected to pay dividends in cash) by $4.46 (subject to adjustments upon occurrence of certain dilutive events). The dividends payable upon conversion were equal to 7% of the stated value of the Series I Preferred Stock per annum in cash or by accretion to the Stated Value, at the Company s discretion subject to limited exceptions. The Series I Preferred Stock could not be converted until after August 6, 2000 and then at the fixed conversion price of $4.46 per share until January 2001. From January 2001 until May 2001, the holders could request redemption of the shares of preferred stock at 110% of the stated value plus accrued dividends. If the Company elected not to redeem the shares, the conversion price converted to the lesser of $4.46 or the market price (defined as the average of the 5 lowest closing prices for the 30 trading days preceding the conversion date) at the time of conversion. The Series I Preferred Stock could be converted by holders in accordance with these terms any time prior to May 9, 2003, and would automatically convert on such date. In the event of liquidation, dissolution or winding up of the Company prior to the conversion of the Series I Preferred Stock, holders of the Series I Preferred Stock would be entitled to receive an amount equal to the stated value per share before any distribution could be made to the holders of any junior securities but after any distribution was made to holders of senior securities. During 2001, 82 shares of the Series I Convertible Preferred Stock were converted into 689,106 shares of

Common Stock, prior to the exchange and redemption of the remaining 418 shares in December 2001. During 2001 and 2000, approximately $283,000 and $224,000, respectively, of the 7% dividends payable upon conversion had been accreted and is included in the caption Dividends under Dividends on Preferred Stock in the accompanying consolidated statements of operations.

The related common stock purchase warrants issued to the investor in connection with the Series I Preferred Stock private placement, were exercisable for shares of Common Stock for an exercise price of $4.46 per share. The warrants would have expired on May 9, 2005.

During the year ended December 29, 2000, the Company recorded a deemed dividend of approximately $571,000 for the intrinsic value of the beneficial conversion option under the terms of the Series I Preferred Stock. The deemed dividend includes an allocation of the proceeds to the relative fair value of the warrants of approximately $285,500, and the intrinsic value of the beneficial conversion of approximately $285,500.

All of the shares of the Series I Convertible Preferred Stock and the related common stock purchase warrants were redeemed and exchanged on December 13, 2001 as described above, and no shares of the series remain outstanding.

D. Reverse Stock Split

On June 30, 1999 the Company effectuated a one for ten reverse common stock split. The reverse stock split and a reduction in the authorized shares of common stock to twenty million were approved at the June 7, 1999 Annual Meeting of Stockholders. Each stockholder of ten shares of common stock on June 30, 1999 was entitled to one share of common stock in connection with the reverse split. A cash payment was paid in lieu of fractional shares. Accordingly, except for the presentation in the accompanying consolidated balance sheets and statements of changes in stockholders equity, the Company has restated all share and per share data for all periods presented to reflect the change in capital structure.

E. 1998 Convertible Preferred Stock

On August 27, 1998, the Company completed a private placement of 7,500 units of $1 par, 1998 Convertible Preferred Stock and related common stock purchase warrants. Net proceeds to the Company after the payment of placement fees, legal and accounting expenses was $6,975,000. The additional capital was primarily raised to fund construction and start-up costs of the HEARx West centers.

The 1998 Convertible Preferred Stock ranks prior to all of the Company s Common Stock, prior to any class or series of capital stock of the Company thereafter created specifically ranking by its terms junior to 1998 Convertible Preferred, junior to the Company s 1997 Convertible Preferred Stock (none of which remains outstanding) and after any class or series of capital stock of the Company thereafter created and specifically ranking by its terms senior to the 1998 Convertible Preferred. Upon conversion the 1998 Convertible Preferred holders are entitled to receive a number of shares of Common Stock determined by dividing the sum of the stated value of the 1998 Convertible Preferred ($1,000 per share) so converted plus a premium (unless the Company elects to pay that premium in cash), by a conversion price equal to the lesser of the average closing bid prices for the Common Stock five of twenty days prior to conversion, and $18.00 (the closing bid price at the date of issuance, subject to adjustment upon occurrence of certain dilutive events including the reverse split described above). The premium payable upon conversion is equal to 8% of the stated value of 1998 Convertible Preferred from the date of issuance until one year following such date, and increased by 0.5% each year, commencing on the date which was one year following the date of issuance. The 1998 Convertible Preferred may be converted by holders in accordance with these terms at any time prior to August 27, 2003, and automatically converts on such date. In the event of liquidation, dissolution or winding up of the Company prior to conversion of the 1998 Convertible Preferred, holders of 1998 Convertible Preferred will be entitled to share ratably in all assets available for distribution prior to distributions to holders of Common Stock. In addition, no distributions may be made to holders of Common

Stock until holders of 1998 Convertible Preferred shall have received a liquidation preference equal to the sum of the stated value of the 1998 Preferred Stock ($1,000 per share) plus an amount equal to ten percent (10%) per annum of such stated value for the period from the date of issuance until the date of final distribution. During 2001, 2000 and 1999, 638, 1,800 and 185 shares of the 1998 Convertible Preferred, respectively, plus accrued dividends of $ 140,255, $216,926 and $16,156, respectively, were converted into 699,413, 517,989 and 44,712 shares of the Company s Common Stock, respectively. In addition, during 2001, 100 shares of the 1998 Convertible Preferred plus accrued dividends of $30,947 was redeemed for cash of approximately $139,000. During 2001, 2000 and 1999 approximately $524,000, $543,000 and $655,000, respectively, of the conversion premium has been accreted and is included in the caption Dividends under Dividends on Preferred Stock in the accompanying consolidated statements of operations.

For each unit of 1998 Convertible Preferred purchased, each investor received warrants to acquire 7.5 shares of Common Stock of the Company. Upon exercise, holders will be entitled to receive shares of Common Stock for an exercise price of $18.00 per share. The warrants will expire on August 27, 2003. In connection with this transaction, the Company issued an additional 56,250 warrants with an exercise price of $18.00 to certain individuals as finder s fees for the placement of the 1998 Convertible Preferred with investors. All related warrants remain outstanding as of December 29, 2001.

F. 1997 Convertible Preferred Stock

The 1997 Convertible Preferred Stock ranked prior to all of the Company s Common Stock, prior to any class or series of capital stock of the Company thereafter created specifically ranking by its terms junior to 1997 Convertible Preferred, and after any class or series of capital stock of the Company thereafter created and specifically ranking by its terms senior to the 1997 Convertible Preferred. The 1997 Convertible Preferred Stock bore a cumulative premium of 6%, payable in kind or cash upon conversion at the option of the Company. Upon conversion of the Preferred Stock, holders were entitled to receive a number of shares of Common Stock determined by dividing the stated value of the Preferred Stock ($1,000 per share), plus a premium in the amount of 6% per annum of the stated value from the date of issuance (unless the Company chose to redeem the shares otherwise issuable in respect of that premium) by a conversion price equal to the lesser of (i) $50.00, or (ii) 85% of the average of the closing bid prices for shares of Common Stock for the ten day trading period immediately prior to conversion. The 1997 Convertible Preferred Stock was convertible by holders beginning August 15, 1997 and at any time prior to March 17, 2000 and must have been converted on that date. During 2000 and 1999 1,000 and 4,209, shares of the 1997 Convertible Preferred Stock plus accrued dividends of $175,397 and $552,743, were converted into 299,214 and 1,098,906, shares of the Company s Common Stock, respectively. All shares of the 1997 Convertible Preferred Stock had been converted before December 29, 2000. During 2000 and 1999 approximately $9,000 and $166,000, respectively, of the 6% conversion premium had been accreted and is included in the caption Dividends under Dividends on Preferred Stock in the accompanying consolidated statements of operations.

In connection with the 1997 Convertible Preferred Stock, the Company issued 85,000 warrants with an exercise price of $50.00 and 75,000 five-year warrants with an exercise price of $20.00 to purchase shares of the Company s Common Stock. These warrants were issued to certain individuals as finder s fees for the placement of the preferred shares with investors. As of December 29, 2001 59,500 warrants remain outstanding.

G. Shareholder Rights Plan

On December 14, 1999, the Board of Directors approved the adoption of a Shareholder Rights Plan, in which a dividend of one preferred share purchase right (a Right) for each outstanding share of Common Stock was declared, and payable to the stockholders of record on December 31, 1999. The Rights will be exercisable only if a person or group acquires 15% or more of the Company s Common Stock or announces a tender offer which would result in ownership of 15% or more of the Common Stock. The Rights entitle the holder to purchase one one-hundredth of a

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share of Series H Junior Participating Preferred Stock at an exercise price of $28.00 and will expire on December 31, 2009.

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

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

H. Warrants

No warrants were exercised in 2001.

The aggregate number of common shares reserved for issuance upon the exercise of warrants is 462,383 as of December 29, 2001. The expiration date and exercise prices of the outstanding warrants are as follows:

Outstanding Warrants	Expiration Date	Ex
59,500	2002	$
2	2003	12.50
30,000	2001	6.30
65,975	2003	20.00
112,501	2003	18.00
5,000	2002	30.00
131,695	2005	2.46
462,383		

I. Aggregate and Per Share Cumulative Preferred Dividends

As of December 29, 2001 and 2000, the aggregate and per share amount of arrearages in cumulative preferred dividends/premiums were $1,521,000 and $1,387,000 and $.11/share and $.12/share, respectively.

6. Stock Plans

The Company has the following stock plans:

A. Employee Stock Option Plans

In 1987, the Company established the 1987 Stock Option Plan. It is administered by the Company s Board of Directors. A maximum of 250,000 shares of Common Stock were authorized for issuance under this plan. All employees of the Company, other than its then principal stockholder (Dr. Paul A. Brown) were eligible to receive options under this plan at the sole discretion of the Board of Directors. Both incentive and non-incentive stock options could be granted. This plan expired June 2, 1997 and no further option grants can be made under this plan. The expiration of the plan did not affect the outstanding options which shall remain in full force as if the plan had not expired.

In 1995, the Company established the 1995 Flexible Stock Plan. It is also administered by the Company s Board of Directors. An original maximum of 250,000 shares of the Company s Common Stock were authorized for issuance under this plan. On June 6, 2000 the shareholders approved an increase of 500,000 shares of the Company s stock available under this plan. The plan authorizes an annual increase in authorized shares equal to 10% of the number of shares authorized as of the prior year. Currently an aggregate of 4,895 shares remain as authorized but not yet subject to a plan grant under the plan. All employees of the Company are eligible to receive incentive stock options, non-qualified stock options, stock appreciation rights, restricted shares, performance shares, and other stock-based awards under this plan at the sole discretion of the Board of Directors.

On October 24, 2001 and December 14, 1999 the Board of Directors approved the issuance of non-qualified stock options to purchase 300,000 and 213,246 shares of the Company s Common Stock for $.77 and $3.88 per share, respectively, to certain officers of the Company. These grants are independent of the Company s 1987 and 1995 stock option plans and are to be funded on exercise from shares of treasury stock.

As of December 29, 2001, 338 employees of the Company held options permitting them to purchase an aggregate of 1,574,222 shares of Common Stock at prices ranging from $.77 to $30.00 per share. Options are exercisable for periods ranging from four to nine years commencing one year following the date of grant and are generally exercisable in cumulative annual installments of 25 percent per year.

The following table summarizes the transactions of the Company s employee stock option plans:

	Year Ended					
	December 29, 2001		December 29, 2000		December 31, 1999	
	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price
Outstanding at beginning of year	873,957	$5.42	764,194	$5.78	464,718	$7.19
Granted	758,830	$1.04	152,360	$4.12	342,256	$4.17
Exercised	35	$2.00	1,600	$2.09	1,360	$2.10
Forfeited and cancelled	58,530	$5.17	40,997	$7.42	41,420	$8.45
Outstanding at end of year	1,574,222	$3.32	873,957	$5.42	764,194	$5.78
Exercisable at end of year	862,388		452,214		345,921	

Weighted average fair value of options granted during year
$0.80 $3.43 $2.96

The following table summarizes information about fixed employee stock options outstanding at December 29, 2001:

Range of Exercise Price	Options Outstanding	Weighted Average Remaining Contractual Life	Weighted Average Exercise Price	Options Exercisable At December 29, 2001	Weighted Average Exercise Price
$ .77 $ 2.00	794,880	7.4	$ 1.09	346,230	$ .93
$2.10 $ 5.40	442,171	5.2	$4.00	208,950	$4.10
$5.41 $ 8.75	320,491	4.8	$7.27	291,448	$7.38
$8.75 $30.00	16,680	5.0	$15.69	15,760	$15.70
	1,574,222			862,388	

The stock options are exercisable in the following years:

2002	1,095,831
2003	222,110
2004	144,370
2005	111,911
	1,574,222

SFAS 123, Accounting for Stock-Based Compensation, requires the Company to provide pro forma information regarding net loss and loss per share as if compensation cost for the Company s employee stock option plans had been determined in accordance with the fair value based method prescribed in SFAS 123. The Company estimates the fair value of each option at the grant date by using the Black-Scholes option pricing model with the following weighted-average assumptions used for grants in 2001, 2000, and 1999, respectively, no dividends, expected volatility of 93%, 89% and 89%; risk-free interest rates of 4.66%, 5.12% and 6.65% and expected lives ranging from 5 to 10 years.

Under accounting provisions of SFAS 123, the Company s net loss and loss per share would have been increased to pro forma amounts indicated below:

	2001	2000	1999
Net Loss applicable to Common Stockholders			
As reported	$(9,441,736)	$(4,663,449)	$(4,825,283)
Pro forma	$(10,200,000)	$(5,591,000)	$(5,896,000)
Loss per share basic and diluted			
As reported	$(0.72)	$(0.39)	$(0.45)
Pro forma	$(0.78)	$(0.47)	$(0.55)

B. Non-Employee Director Plan

In April 1993, the stockholders of the Company approved the adoption of the HEARx Ltd. Non-qualified Stock Option Plan for Non-Employee Directors (Directors Plan). The purpose of the Directors Plan is to increase the proprietary interest of non-employee directors and promote long-term stockholder value by granting stock options to non-employee directors. Grants cannot exceed 50,000 shares of Common Stock in the aggregate and may be granted until the Annual Meeting of Stockholders in 2003. Under the plan, each non-employee director may be granted 1,500 options each year. The option price is the fair market value of the Company s shares at the date of grant.

As of December 29, 2001, three directors hold options as follows: 3,000 shares at $ 3.40, 4,500 at $4.00, 4,500 shares at $5.00, 4,500 shares at $ 6.875, 16,500 at $7.50, and 4,500 shares at prices ranging from $12.50 to $58.75 per share.

C. Stock Bonus Plan

The Board of Directors adopted a Stock Bonus Plan (Bonus Plan). The number of shares of Common Stock which can be issued under the Bonus Plan cannot exceed 50,000. It is administered by the Board of Directors. The purpose of the Bonus Plan is to provide an incentive to senior management to achieve the Company s strategic objectives. At present there are nine senior management personnel eligible to participate. No shares were issued in 2001, 2000, or 1999.

7. Major Customers and Suppliers

During 2001 and 1999, the Company did not have sales totaling 10% or more of the total net sales to a single customer. In 2000, the Company had sales totaling $ 5.7 million or 10.2% of net sales to a single customer, Kaiser Permanente Health Plan.

During 2001, 2000 and 1999, the Company purchased approximately 94.9%, 79.2%, and 70.8% of all hearing aids sold by HEARx from Siemens. As described in Note 3, on December 7, 2001, the Company entered into a supply agreement with Siemens with an initial five year term, whereby, the Company agreed to minimum purchase levels from Siemens. Although there are a limited number of manufacturers of hearing aids, management believes that other suppliers could provide similar hearing aids on comparable terms. In the event of a disruption of supply from Siemens, the Company could obtain comparable products from other manufacturers. Few manufacturers offer dramatic product differentiation. The Company has not experienced any significant disruptions in supply in the past.

8. Related Party Transactions

On January 6, 1999 HEARx West entered into a capitation contract with an affiliate (the Kaiser Plan) of its minority owner, the Permanente Federation LLC. Under the terms of the contract, HEARx West is paid an amount per enrollee of the Kaiser Plan, to provide a once every three years benefit on certain hearing products and services. During 2001, 2000 and 1999 approximately $1,943,000, $5,722,000 and $4,308,000 of capitation revenue from this contract is included in net revenue in the accompanying consolidated statements of operations.

On July 31, 1999, the Company entered into an asset purchase agreement with an individual who is employed as the Company s California Division Manager. Under the terms of this agreement, the Company purchased equipment for consideration of approximately $100,000 and a customer list for consideration of approximately $382,000. Consideration included cash of $75,000, a $325,000 promissory note payable to the individual, and assumed trade payables of approximately $82,000.

9. Income Taxes

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

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

	December	
	2001	**2000**
Depreciation	$422,000	$37,000
Allowance for doubtful accounts	93,000	103,000
Joint venture	(931,000)	(207,000)
Other	269,000	370,000
Net operating loss carryforward	26,463,000	25,112,000
	26,316,000	25,415,000
Less valuation allowance	(26,316,000)	(25,415,000)
Net deferred tax asset	$	$

At December 29, 2001 the Company had net operating loss carryforwards of approximately $ 70,000,000 for tax reporting purposes. The losses are available for carryforward for fifteen and twenty year periods and will expire beginning in 2002. Any future significant changes in ownership of the Company may limit the annual utilization of the tax net operating loss carryforwards.

10. Note Receivable and Subsequent Events

On November 16, 2001, HEARx loaned $700,000 to Helix for use by Helix as part of the $3.5 million acquisition of substantially all of the capital stock of Auxiliary Benefits Corporation, a Colorado corporation doing business as National Ear Care Plan (NECP). The note is secured by substantially all of the assets of NECP, bears interest at a rate of 12% per annum and matures on November 16, 2002. On January 10, 2002, HEARx loaned to Helix an additional $2 million to complete the NECP transaction. On January 14, 2002 HEARx and Helix entered into a subscription agreement pursuant to which HEARx purchased 4,853,932 common shares of Helix for an aggregate purchase price of $2.7 million. The purchase price was paid using the $2.7 million in loans to Helix. Upon consummation of the purchase of the 4,853,932 Helix common shares, HEARx became a greater than 10% owner of Helix common shares. HEARx is accounting for this investment using the equity method.

11. Commitments and Contingencies

The Company established the HEARx Ltd. 401(k) plan in October 1998. All employees who have attained age 21 with at least three months of service are eligible to participate in the plan. The Company s contribution to the plan is determined from year to year by the Board of Directors. The Company s contributions to the plan were approximately $45,800, $45,400 and $42,400 for the years ended December 29, 2001, December 29, 2000 and December 31, 1999, respectively.

Effective December 14, 1999 the Company entered into five year employment agreements with certain of its executive officers that provide for annual salaries, severance payments, and accelerated vesting of stock options upon termination of employment under certain circumstances or a change in control, as defined.

12. Quarterly Financial Data (Unaudited)

Year Ended December 29, 2001	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
Net Revenues (a)	$12,488,191	$11,341,188	$12,370,798	$12,595,933
Operating Expenses	15,436,835	14,037,415	13,100,630	14,420,580
Loss from Operations	(2,948,644)	(2,696,227)	(729,832)	(1,824,647)
Interest Income (a)	46,574	54,290	73,919	47,566
Net Loss applicable to Common stockholders	(3,113,224)	(2,995,535)	(1,157,723)	(2,175,254)
Earnings per share	(.25)	(.23)	(.09)	(.15)

Year Ended December 29, 2000	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
Net Revenues (a)	$13,081,825	$15,101,443	$13,242,307	$14,689,257
Operating Expenses	13,797,022	15,596,502	14,306,798	15,996,496
Loss from Operations	(715,197)	(495,059)	(1,064,491)	(1,307,239)
Interest Income (a)	39,942	72,973	104,725	76,492
Net Loss applicable to Common stockholders (b)	(819,495)	(596,898)	(1,227,839)	(2,019,217)
Earnings per share	(.07)	(.05)	(.10)	(.17)

(a) Net revenues for the first, second, and third quarters of both 2001 and 2000 differ from net revenues reported in the corresponding quarterly financial statements in Form 10-Q due to the reclassification of interest income from net revenues to non-operating income.

(b) Net loss applicable to common stockholders for the fourth quarter of 2000 includes a deemed dividend of approximately $571,000 recorded as a result of implementing EITF 00-27 Application of Issue 98-5 to Certain Convertible Instruments.

13. Fair Value of Financial Instruments

SFAS 107 requires the disclosure of fair value of financial instruments. The estimated fair value amounts have been determined by the Company s management using available market information and other valuation methods. However, considerable judgment is required to interpret market data in developing the estimates of fair value. Accordingly, the estimates presented herein are not necessarily indicative of the amounts the Company could realize in a current market exchange. The use of different market assumptions and/or estimation methods may have a material effect on the estimated fair value amounts. Furthermore, the Company does not intend to dispose of a significant portion of its financial instruments and thus, any aggregate unrealized gains or losses should not be interpreted as a forecast of future earnings and cash flows. SFAS 107 excludes certain financial instruments from its disclosure requirements, such as leases. In addition, disclosure of fair value estimates are not required for nonfinancial assets and liabilities, such as fixed assets, intangibles and anticipated future business. As a result, the following fair values are not comprehensive and therefore do not reflect the underlying value of the Company.

The following methods and assumptions were used in estimating fair value disclosure for financial instruments:

Cash and Cash Equivalents the carrying amounts reported in the consolidated balance sheets approximate those assets fair value due to the short term nature of these assets.

Investment Securities the carrying amounts reported in the consolidated balance sheets approximate those assets fair value (Note 2).

Accounts and Notes Receivable the carrying amounts reported in the consolidated balance sheets approximate those assets fair value due primarily to the short term nature of these assets.

Accounts Payable and Accrued Expenses the carrying amounts reported in the consolidated balance sheets approximate those liabilities fair value, due primarily to the short term nature of these liabilities.

Long-Term Debt the carrying amounts reported in the consolidated balance sheets approximate those liabilities, fair value, as current borrowing rates approximate the actual fixed interest rates of these liabilities.

14. Recent Accounting Pronouncements

In June 2001, the FASB finalized FASB Statements No. 141, *Business Combinations* (SFAS 141), and No. 142, *Goodwill and Other Intangible Assets* (SFAS 142). SFAS 141 requires the use of the purchase method of accounting and prohibits the use of the pooling-of-interest method of accounting for business combinations initiated after June 30, 2001. SFAS 141 also requires that the Company recognize acquired intangible assets apart from goodwill if the acquired intangible assets meet certain criteria. SFAS 141 applies to all business combinations initiated after June 30, 2001 and for purchase business combinations completed on or after July 1, 2001. It also requires, upon adoption of SFAS 142, that the Company reclassify the carrying amounts of intangible assets and goodwill based on the criteria in SFAS 141.

SFAS 142 requires, among other things, that companies no longer amortize goodwill, but instead test goodwill for impairment at least annually. In addition, SFAS 142 requires that the Company identify reporting units for the purpose of assessing potential future impairments of goodwill, reassess the useful lives of other existing recognized intangible assets, and cease amortization of intangibles assets with an indefinite useful life. An intangible asset with an indefinite useful life should be tested for impairment in accordance with the guidance in SFAS 142. SFAS 142 is required to be applied in fiscal years beginning after December 15, 2001 to all goodwill and other intangible assets recognized at that date, regardless of when those assets were initially recognized. SFAS 142 requires the Company to complete transitional goodwill impairment test six months from the date of adoption. The Company is also required to reassess the useful lives of other intangible assets within the first interim quarter after adoption of SFAS 142. The Company s previous business combinations were accounted for using the purchase method. The impact of the adoption of SFAS 141 and SFAS 142 on the Company s financial position and results of operations is not expected to be material.

In October 2001, the FASB issued SFAS No. 144 *Accounting for the Impairment or Disposal of Long-Lived Assets* which resolves significant implementation issues related to FASB Statement No. 121, *Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be*

Disposed Of, and supersedes the accounting and reporting provisions of APB Opinion No. 30, *Reporting the Results of Operations Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions,* for the disposal of a business segment. SFAS 144 is effective for fiscal years beginning after December 15, 2001, and interim periods within those fiscal years, with early application encouraged. The impact of adoption of SFAS 144 on the Company s financial position and results of operations is not expected to be material.

HEARx Ltd.

Schedule II Valuation and Qualifying Accounts

	Balance at Beginning Of Period	Additions	Deductions	Balance at End Of Period
December 29, 2001				
Allowance for doubtful accounts	$212,657	$125,206	$(152,049)(1)	$185,814
Allowance for sales returns	$772,976		$(272,196)	$500,780
December 29, 2000				
Allowance for doubtful accounts	$535,609	$377,500	$(700,452)(1)	$212,657
Allowance for sales returns	$497,412	$275,564		$772,976
December 31, 1999				
Allowance for doubtful accounts	$588,509	$568,135	$(621,035)(1)	$535,609
Allowance for sales returns	$300,708	$196,704		$497,412

(1) Uncollectible accounts written off, net of recoveries.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

HEARX LTD.
(Registrant)

By: /s/ PAUL A. BROWN, M.D.

Paul A. Brown, M.D.
Chairman of the Board

Date: May 22, 2002

EXHIBIT INDEX

The following Exhibits are filed as part of this report.

Exhibit Number	Description
23	Consent of BDO Seidman, LLP