HANGER ORTHOPEDIC GROUP, INC.

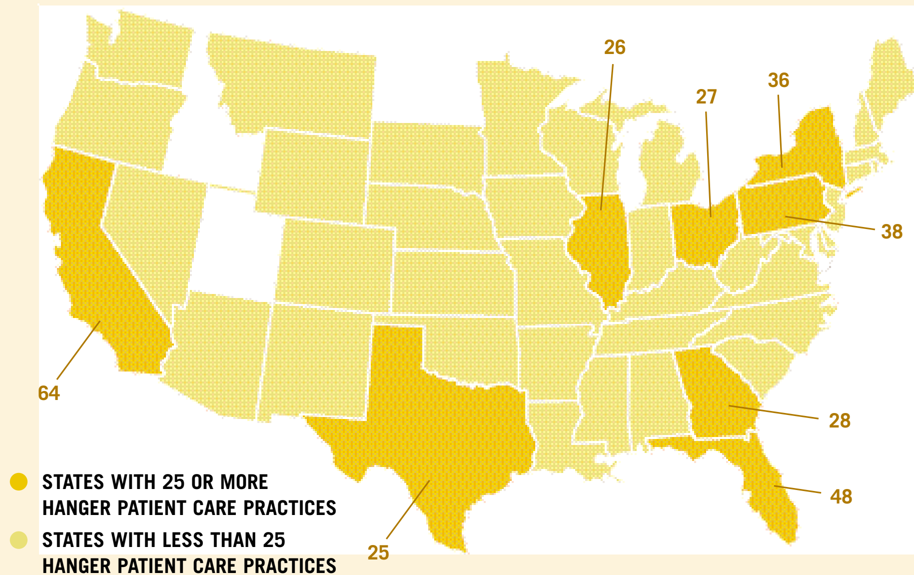
ANNUAL REPORT 2000

COMPANY PROFILE

Headquartered in Bethesda, Maryland, Hanger Orthopedic Group, Inc. is the oldest and largest, vertically integrated corporation in the prosthetics and orthotics industry in the United States. We are the market leader, owning and operating more than 600 patient care practices with 900 practitioners in 44 states and the District of Columbia.

Orthotics is the field of custom design, fabrication and fitting of braces and supports for treatment of musculoskeletal conditions resulting from illness, injury or congenital anomalies. Prosthetics is the field of custom design, fabrication and fitting of artificial limbs typically required by those who have suffered the loss of a limb at birth, from vascular disease, diabetes, cancer or trauma.

Hanger's revenues are generated from three operating segments: Patient Care which consists of nationwide prosthetic and orthotic practices; Distribution which consists of distribution centers delivering orthotic and prosthetic componentry; and the Manufacturing of pre- and custom-fabricated orthotic and prosthetic componentry. In addition, Hanger operates OPNET, which is the only prosthetics and orthotics managed care network in the country.



DEAR FELLOW SHAREHOLDER,

Last year I described for you the exciting opportunity for our company brought about by the milestone acquisition of NovaCare Orthotics & Prosthetics in July 1999. Bringing the NovaCare resources into our family more than doubled the number of patient care centers and tripled the number of practitioners. This expanded network of patient care facilities made Hanger the largest prosthetics and orthotics company in the world, with a market share of 25%.

In 2000, we embarked upon a transition with two major objectives: to achieve substantial financial improvement with the goal of enhancing shareholder value; and to strengthen our capabilities to provide prosthetics and orthotics to fulfill the unique health care needs of our patients. We recognized at the time of the acquisition that we were facing a series of intensive challenges, but we were and we remain committed to achieving our objectives.

Our earnings and cash generation in 2000 were disappointing and reflect the complexity and scope of combining two large companies. Because this level of performance is not acceptable, I have endorsed the re-engineering of our core processes, which will lower our cost structure and reduce our working capital requirements. Aided by representatives of a top management consulting firm, we are addressing the full range of these transitional process issues through a detailed 14-point plan. Implementation of this plan is being accomplished through several Profit Improvement Teams led and staffed by some of our best employees. The progress of each team is measured against specific goals and we have already begun to see the benefits of this arduous work. I anticipate this effort will continue throughout 2001 and into 2002. This is the most intense and dramatic effort undertaken by our company in its 140-year history, but when complete, management believes it will yield significant benefits. It will remove barriers and consolidate activities, thereby eliminating waste and distractions caused by fragmented work practices. Our employees will be able to focus their full knowledge and skills on the jobs they are most capable of performing. At the same time, job satisfaction will increase.

Enabling our professionals to provide health care second to none is the key to attaining our second objective. The lifeblood of Hanger is, and always has been, the exemplary care and dedication of our 900 individual practitioners who serve thousands of patients daily. We are determined to further enhance that care through continuing education, advancing technology, a national and convenient market presence, and a willing eagerness to serve when called. We are aligning the company's activities to support and sustain the ability of our practitioners to deliver distinctive service to our clients and our associates in the broader medical community.

The impetus for all of this is to rebuild shareholder value and to reinvigorate the business prospects of an enterprise that will endure and grow as a rewarding experience for all of our employees and shareholders. Financial success today is the foundation on which we will build the organizational self-confidence to deliver consistent and improving results. The satisfaction of our patients will demonstrate the wisdom of our undertaking. All of us at Hanger are committed to these objectives. I look forward to our bright future with much anticipation and on behalf of everyone at Hanger, I want to thank all of our patients, associates in the health community, and investors, whose confidence and support renews our faith in who we are and what we do.

Sincerely,

Ivan R. Sabel, CPO
Chairman of the Board and
Chief Executive Officer

HANGER PROSTHETICS & ORTHOTICS, INC.

Hanger Prosthetics & Orthotics is the foundation of its parent company, Hanger Orthopedic Group, Inc. It is our core business – treating patients with clinical excellence and superior customer service. The fact that Hanger Prosthetics & Orthotics has over 600 patient care practices in 44 states, allows us to keep and attract the best and the brightest health care practitioners from across the country. We employ 900 health care providers who, on a daily basis, administer expert care to 10,000 to 12,000 patients. Hanger practitioners, on average, have been with the company for 15 years.

ORTHOTICS

Certified orthotists are highly trained practitioners providing custom-fit or custom-made orthoses designed to increase the patient's mobility and decrease rehabilitation time. Orthotic care can positively influence recovery for the post-operative patient who suffered a stroke or the acutely-injured weekend warrior who overexerted themselves. Properly fitted orthoses offer patients a dramatically improved quality of life.

The goal of Hanger's orthotic programs is to provide a comprehensive rehabilitation process, including both products and services, to increase each patient's functional ability.

Older orthotic patients typically have ailments such as polio, diabetes, osteoporosis and conditions that limit their freedom of movement. Additional candidates for orthotic devices include people with neuromuscular and spinal conditions as well as basic sports injuries. Hanger orthotic products include devices for the head, neck, shoulders, arms, hands, spine, hips, legs, ankles and feet.

PROSTHETICS

Prosthetists are highly skilled practitioners who complete rigorous formal training and residency programs assisting prosthetic patients who have experienced congenital problems, vascular or diabetic complications, cancer or trauma that necessitated the loss of a limb. Hanger prosthetists have an industry reputation as being clinically superior practitioners offering evaluation and custom fitting of prosthetic limbs. This clinical excellence coupled with research and technology is the core of Hanger's commitment to our patients. Hanger's advanced and patented socket system, ComfortFlex™, allows patients more flexibility and ease of motion than ever before. The Hanger Upper Extremity Prosthetics Program, the only such program in the world, is staffed by highly trained and certified practitioner specialists available for consultation nationwide. In addition to the custom-fitted passive and conventional prostheses, many of our patients are excellent candidates for electrically powered prostheses. These prostheses are operated by the signals generated from contracting muscles that in turn make the arm move.

DANIEL COULTHURST

Missing both legs below the knees at birth, Daniel Coulthurst understands challenge. Despite primitive, uncomfortable prostheses that left him with daily sores and bruises, Daniel still fought hard to achieve his dream of becoming a competitive cyclist. Unfortunately, Daniel's antiquated prostheses continued to break and cause injury, setting severe physical limits on his racing abilities. In 1999, Hanger fitted Daniel with special high-activity prostheses made of a comfortable, lightweight carbon fiber that enabled him to compete at the Paralympic level.

To meet the expectations of our patients, we are dedicated to the innovative research and development of our technology. The Hanger Prosthetic & Research Center in Oklahoma City, Oklahoma and the Institute for the Advancement of Prosthetics in Lansing, Michigan are at the forefront of developing revolutionary devices such as the "Sense of Feel" and "Hot and Cold" sensory systems.

We also employ certified post-mastectomy fitters. These fitters are able to improve the quality of life for post-mastectomy patients when reconstructive surgery is not an option. Custom-fitted, easy-to-wear breast prostheses are oftentimes the best solution for patients who have had multiple surgeries, complications and infections.

SEATTLE ORTHOPEDIC GROUP, INC.

Seattle Orthopedic Group, Inc., (SOGI) is the manufacturing division of the Hanger Orthopedic Group, Inc. SOGI manufactures a full line of prefabricated and custom prosthetic and orthotic products and provides Central Fabrication services for the Patient Care division. Its products and services are available to the market under three trade names: (1) Seattle Limb Systems® (prosthetics), (2) Lenox Hill® (orthotics), and (3) Sea Fab® (Central Fabrication). In addition to offering its products and services to Hanger, SOGI maintains relationships with independent practitioners and all major P & O distributors in the United States. SOGI also sells to distributors in 45 countries worldwide. As an ISO (International Standard Organization) 9001 certified company, SOGI continually meets strict criteria throughout the research, development and manufacturing processes.

By doing so, SOGI maintains its reputation as a provider of quality merchandise and as a leader in the P & O industry in innovation and the use of new technology. SOGI also relies on the experience of Hanger Prosthetics & Orthotics' patients, who provide them with creative ideas for new products and critical input on functionality, comfort, and fit. Hanger practitioners and their patients are also very much involved in the testing and evaluation of all new product developments. SOGI is able to take advantage of daily feedback on Hanger products allowing for continuous improvements – an advantage that few manufacturers have.

PHYLLIS FROHLICH

In June 1996, Phyllis Frohlich lost her dominant arm in an automobile accident. During the nine months of surgeries, skin grafting, and healing, Phyllis thoroughly researched various prosthetic options, determined to find a prosthesis that would allow her to care for her first grandchild. Contrary to the evaluations of prosthetists from other companies, Hanger fitted Phyllis with the latest myo-electric arm and rotating wrist. Six months later, Phyllis was spending time with her granddaughter, cooking, gardening, and sewing with her myo-electric arm.

ELLS RAY HAMMETT

At the age of two, Ells Ray Hammett lost his right leg in an automobile accident. In 1926, Hanger fitted Ray with his very first prosthetic limb at the age of five. As his body grew and his needs changed, Ray turned to Hanger for new limbs to keep him active and comfortable. Today, at age 80, Ray still trusts the care and expertise of Hanger prosthetists: "15 limbs and 75 years later, I'm still with Hanger. They've been right there with me throughout my entire life."

SOUTHERN PROSTHETIC SUPPLY, INC.

SPS has transformed itself from a niche industry pioneer into a corporation that is the dominant leader in offering a comprehensive P & O product line. Their motto is to 'deliver the highest quality products at the lowest possible cost'. SPS does this by continually monitoring and addressing the changing needs of their growing internal and external customer base. SPS delivers 2,500 packages daily while reaching 98% of the United States market within one to two days of shipping. Though much of SPS' business is supporting the more than 600 Hanger patient care centers, nearly one-third of its efforts support an external customer population in North America and abroad. SPS has six distribution centers throughout the country and more than 85,000 square feet of distribution space.

SPS has analyzed best practices from other business models, such as the pharmaceutical industry, and has incorporated applicable efficiencies into the Hanger distribution formula. Add vertical integration into the mix and Hanger can offer significant cost savings to its customers through volume, efficiency and timeliness. Because of Hanger's leadership position in the P & O market, it also affords SPS the opportunity to form strategic partnerships with vendors to create a seamless supply chain. In addition, Hanger is in a unique position to enhance and stimulate new product development based largely on solicited patient feedback.

ORTHOTICS

George Mattingly, C.O. fits April, an orthotics patient, with an articulated AFO (ankle-foot-orthosis).

FINANCIAL RESULTS

SELECTED FINANCIAL DATA

(In thousands, except share and per share data)

Years Ended December 31,	1996	1997	1998	1999	2000
Statement of Operations Data:					
Net sales	$ 66,806	$ 145,598	$ 187,870	$ 346,826	$ 486,031
Gross profit	34,573	72,065	94,967	177,750	234,663
Selling, general & administrative	24,550	49,076	63,512	113,643	177,519
Depreciation and amortization	2,848	4,681	5,782	14,058	23,328
Integration costs [1]	2,480	---	---	5,035	1,710
Restructuring costs [1]	---	---	---	1,305	654
Income from operations	4,695	18,308	25,673	43,709	31,452
Interest expense, net	(2,547)	(4,933)	(1,902)	(22,177)	(47,072)
Income (loss) before taxes, extraordinary item	1,971	13,166	23,456	21,180	(15,493)
Provision (benefit) for income taxes	890	5,526	9,616	10,194	(1,497)
Income (loss) before extraordinary item	1,081	7,640	13,840	10,986	(13,996)
Extraordinary loss on early extinguishment of debt	(83)	(2,694)	---	---	---
Net income (loss)	$ 998	$ 4,946	$ 13,840	$ 10,986	$ (13,996)
Basic per common share data:					
Income (loss) before extraordinary item	$ 0.12	$ 0.65	$ 0.82	$ 0.47	$ (0.98)
Extraordinary loss on early extinguishment of debt	(0.01)	(0.23)	---	---	---
Net income (loss) per common share	$ 0.11	$ 0.42	$ 0.82	$ 0.47	$ (0.98)
Shares used to calculate basic per common share amounts	8,469,645	11,792,892	16,812,717	18,854,751	18,910,002
Diluted per common share data [2]:					
Income (loss) before extraordinary item	$ 0.12	$ 0.58	$ 0.75	$ 0.44	$ (0.98)
Extraordinary loss on early extinguishment of debt	(0.01)	(0.21)	---	---	---
Net income (loss) per common share	$ 0.11	$ 0.37	$ 0.75	$ 0.44	$ (0.98)
Shares used to calculate diluted per common share amounts	8,663,161	13,138,377	18,515,567	20,005,282	18,910,002

[1] The 1996 results include acquisition and integration costs of $2.5 million incurred in connection with the purchase of J. E. Hanger, Inc. of Georgia effective November 1, 1996. The 1999 and 2000 results include restructuring and integration costs of $6.3 million and $2.4 million, respectively, incurred in connection with the purchase of NovaCare O&P.

[2] For 1999 and 2000, excludes the effect of the conversion of the 7% Redeemable Convertible Preferred Stock into Common Stock as it is considered anti-dilutive. For 2000, excludes the effect of all dilutive options and warrants as a result of the Company's net loss for the year ended December 31, 2000.

BALANCE SHEET DATA:

December 31,	1996	1997	1998	1999	2000
Cash and cash equivalents	$ 6,572	$ 6,557	$ 9,683	$ 5,735	$ 20,669
Working capital	25,499	39,031	49,678	118,428	133,690
Total assets	134,941	157,983	205,948	750,081	761,818
Long-term debt	64,298	23,237	11,154	426,211	422,838
Shareholders' equity	39,734	106,320	162,553	172,914	154,380

1999

Quarter Ended	March 31	June 30	Sept. 30	Dec. 31
Net Sales	49,145	56,417	124,922	116,342
Gross Profit	24,256	28,862	65,344	59,288
Net Income (Loss)	3,121	4,875	3,449	(459)
Diluted Per Common Share Data Net Income [1]	$ 0.15	$ 0.24	$ 0 .12	$ (0.08)

2000

Quarter Ended	March 31	June 30	Sept. 30	Dec. 31
Net Sales	114,868	125,872	125,252	120,039
Gross Profit	57,684	65,562	64,430	46,987
Net Income (Loss) [2]	(279)	2,407	1,596	(17,720)
Diluted Per Common Share Data Net Income [1]	$ (0.07)	$ 0.06	$ 0.02	$ (0.99)

[1] For 1999 and 2000, excludes the effect of the conversion of the 7% Redeemable Convertible Preferred Stock into Common Stock as it is considered anti-dilutive. For 2000, excludes the effect of all dilutive options and warrants as a result of the Company's net loss for the year ended December 31, 2000.

[2] During the fourth quarter of 2000, the Company recorded charges of approximately $9.6 million and $9.0 million related to an inventory adjustment and an increase in the allowance for doubtful accounts respectively. Management considers these charges to be changes in estimates in accordance with the provisions of Accounts Principles Board Opinion No. 20.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

OVERVIEW

The significant growth in our net sales has resulted from an aggressive program of acquiring and developing O&P patient-care centers. Similarly, growth in our O&P distribution and manufacturing net sales is attributable primarily to acquisitions. At December 31, 2000, the Company operated 620 patient-care centers, six distribution facilities and seven manufacturing facilities.

EXPANSION

The following table sets forth the number of patient-care centers, certified practitioners and states (including the District of Columbia) in which we operated at the end of each of the past three years:

For the Years Ended December 31,	1998	1999	2000
Number of patient-care centers	256	617	620
Number of certified practitioners	321	962	888
Number of states (including D.C.)	31	42	45

RECENT ACQUISITIONS

During 2000, we acquired five O&P companies for an aggregate consideration, excluding earn out provisions, of approximately $4.5 million, consisting of approximately $2.4 million of cash and $2.1 million of promissory notes. These O&P companies, which operated seven patient-care centers at December 31, 2000, had combined net sales of approximately $2.3 million in the year ended December 31, 2000. Additional amounts aggregating approximately $13.9 million may be paid in connection with earnout provisions contained in acquisition agreements.

On July 1, 1999, we acquired NovaCare O&P for an aggregate consideration of $445.0 million. NovaCare O&P, which operated 395 O&P patient care centers at June 30, 1999, had net sales of approximately $278.8 million in the twelve months ended June 30, 1999. We acquired five other O&P companies during 1999 for an aggregate consideration, excluding potential earn-out provisions, of approximately $11.9 million. These O&P companies, which operated five patient-care centers at December 31, 1999, had combined net sales of approximately $10.5 million in the year ended December 31, 1998.

SOURCES OF NET SALES

The majority of our net sales continue to be derived from operating patient-care centers. The following table sets forth the percent contributed to net sales in each of the periods indicated by the principal sources of our net sales. The decrease in the percentage of net sales contributed by distribution activities and decrease in the percentage of net sales attributable to manufacturing in 1999 and 2000 is primarily a result of the NovaCare O&P acquisition which consisted entirely of patient-care services.

For the Years Ended December 31,	1998	1999	2000
Source of net sales:			
Patient-care services	81.1%	88.6%	92.0%
Manufacturing	4.5	3.0	2.0
Distribution	14.4	8.4	6.0
	100.0%	100.0%	100.0%

PAYOR MIX

We receive payments for O&P services rendered to patients from private insurers, HMOs, PPOs, the patients directly and governmental payors, including Medicare, Medicaid and the VA. The sources and amounts of our net sales derived from patient-care centers are determined by a number of factors, including the number and nature of O&P services rendered and the rates of reimbursement among payor categories. Generally, private insurance and other third-party reimbursement levels are greater than managed care (HMO/PPO), Medicare, Medicaid and VA reimbursement levels. Changes in our payor mix can affect our profitability. The following table sets forth the percent contributed to net sales in each of the following periods by the principal categories of payors:

For the Years Ended December 31,	1998	1999	2000
Payor mix (1):			
Private pay and other	46.3%	59.0%	61.6%
Medicare/Medicaid/VA/state Agencies	53.7	41.0	38.4
	100.0%	100.0%	100.0%

(1) Payor mix data is based on a sampling of approximately 41% of the patient-care centers in 1998, approximately 79% of the patient care centers in 1999 and approximately 84% of the patient care centers in 2000.

ADJUSTED EBITDA AND OPERATING MARGIN TRENDS

Adjusted EBITDA and operating margins in 2000 were lower than 1999, primarily as a result of (i) higher material cost of goods sold, (ii) increased provision for bad debt expense and (iii) higher general and administrative costs. In 1999, margins were higher than 1998, primarily as a result of (i) the acquisition of NovaCare O&P which was entirely patient care services, which historically have experienced higher margins than distribution and manufacturing operations; and (ii) the elimination of duplicative overhead and corporate field personnel. The following table sets forth our Adjusted EBITDA and operating margins during each of the past three years:

For the Years Ended December 31,	1998	1999	2000
Adjusted EBITDA margin [1]	16.7%	18.5%	11.8%
Operating margin [2]	13.7	12.6	6.5

[1] Adjusted "EBITDA" is defined as net income (loss) before interest expense (net), taxes, depreciation and amortization, discontinued operations, restructuring and integration costs, other expense (net), extraordinary items and accounting change. Adjusted EBITDA is not a measure of performance under GAAP. While Adjusted EBITDA should not be considered in isolation or as a substitute for net income, cash flows from operating activities and other income or cash flow statement data prepared in accordance with GAAP, or as a measure of profitability or liquidity, management understands that Adjusted EBITDA is customarily used as a criteria in evaluating health care companies and is a common metric used by lenders in debt covenants.

[2] "Operating" is defined as net income (loss) before interest expense, taxes and discontinued operations.

SEASONALITY

Our results of operations are affected by seasonal considerations. The adverse weather conditions often experienced in certain geographical areas of the United States during the first quarter of each year, together with a greater degree of patients' sole responsibility for their insurance deductible payment obligations during the beginning of each calendar year, have contributed to lower net sales during that quarter.

RESULTS OF OPERATIONS

The following table sets forth for the periods indicated certain items of our statements of operations as a percentage of our net sales:

For the Years Ended December 31,	1998	1999	2000
Net sales	100.0%	100.0%	100.0%
Cost of products & services sold	49.5	48.7	51.7
Gross profit	50.5	51.3	48.3
Selling, general and administrative	33.8	32.8	36.5
Depreciation and amortization	1.7	1.9	2.3
Amortization of excess cost over net Assets acquired	1.3	2.2	2.5
Integration and restructuring costs	---	1.8	.5
Income (loss) from operations	13.7	12.6	6.5
Interest expense, net	1.0	6.4	9.7
Income (loss) before taxes and extraordinary Item	12.5	6.1	(3.2)
Income taxes	5.1	2.9	(0.3)
Net income	7.4	3.2	(2.9)

YEAR ENDED DECEMBER 31, 2000 COMPARED TO THE YEAR ENDED DECEMBER 31, 1999

Net Sales. Net sales for the year ended December 31, 2000, were approximately $486.0 million, an increase of approximately $139.2 million, or 40.1%, over net sales of approximately $346.8 million for the year ended December 31, 1999. The increase was principally attributable to the acquisition of NovaCare O&P on July 1, 1999.

Gross Profit. Gross profit in the year ended December 31, 2000 was approximately $234.7 million, an increase of approximately $56.9 million, or 32.0%, from gross profit of approximately $177.8 million for the year ended December 31, 1999. Gross profit as a percentage of net sales decreased to 48.3% in 2000 from 51.3% in 1999. This decrease in the gross profit margin is primarily attributable to higher material costs and changes in product mix.

Selling, General and Administrative. Selling, general and administrative expenses in the year ended December 31, 2000 increased by approximately $63.9 million, or 56.2%, compared to the year ended December 31, 1999. Selling, general and administrative expenses as a percentage of net sales increased to 36.5% in 2000 compared to 32.8% in 1999. The increase in selling, general and administrative expenses was primarily due to the NovaCare O&P acquisition on July 1, 1999 and primarily occurred in payroll, rent and bad debt expense.

Integration and Restructuring Costs. During the year ended December 31, 2000, we recognized approximately $2.4 million of one-time integration costs in connection with our acquisition on July 1, 1999 of NovaCare O&P, a substantial decrease from the $6.3 million of integration and restructuring costs recognized in the prior year. Additional information relating to integration and restructuring costs is set forth below under "Integration and Restructuring Costs."

Income from Operations. Principally as a result of the above, income from operations in 2000 was approximately $31.5 million, a decrease of $12.2 million, or 27.9%, from the prior year. Income from operations as a percentage of net sales decreased to 6.5% in 2000 from 12.6% for the prior year.

Interest Expense, Net. Net interest expense for the year ended December 31, 2000 was approximately $47.1 million, an increase of approximately $24.9 million over approximately $22.2 million incurred in 1999. Interest expense as a percentage of net sales in 2000 increased to 9.7% from 6.4% for 1999. The increase in interest expense was primarily attributable to $255.0 million borrowed under a bank credit facility and $150 million in senior subordinated notes issued to acquire NovaCare O&P, as well as an increase in variable borrowing rates.

Income Taxes. Our effective tax rate benefit was 9.7% in 2000 versus a provision of 48% in 1999. The decrease in the effective tax rate in 2000 was a result of the operating and taxable losses incurred during the year. The benefit from income taxes for the year ended December 31, 2000 was approximately $1.5 million compared to provision for income taxes of approximately $10.2 million for the year ended December 31, 1999.

Net Income/Loss. As a result of the above, we reported a net loss of approximately $14.0 million, or $.98 per common dilutive share (loss), for the year ended December 31, 2000, as compared to net income of $11.0 million, or $.44 per common dilutive share, for the year ended December 31, 1999.

YEAR ENDED DECEMBER 31, 1999 COMPARED TO THE YEAR ENDED DECEMBER 31, 1998

Net Sales. Net sales for the year ended December 31, 1999 were approximately $346.8 million, an increase of approximately $159.0 million, or 84.6%, over net sales of approximately $187.9 million for the year ended December 31, 1998. Contributing to the increase was the acquisition of NovaCare O&P on July 1, 1999.

Gross Profit. Gross profit for the year ended December 31, 1999, was approximately $177.8 million, an increase of approximately $82.8 million, or 87.2%, over gross profit of approximately $95.0 million for the year ended December 31, 1998. The increase was primarily attributable to the increase in net sales. Gross profit as a percentage of net sales increased to 51.3% in 1999 from 50.5% in 1998. The increase in the gross profit margin is primarily a result of the NovaCare O&P acquisition which was entirely patient care services. Patient care services historically have experienced higher gross profit margins than distribution and manufacturing operations.

Selling, General and Administrative Expenses. Selling, general and administrative expenses in the year ended December 31, 1999 increased by approximately $50.1 million, or 78.9%, compared to the year ended December 31, 1998. Selling, general and administrative expenses as a percentage of net sales in 1999 decreased to 32.8% from 33.8% in 1998.

Integration and Restructuring Costs. As stated above, we recognized approximately $6.3 million of integration and restructuring costs during 1999 in connection with our acquisition on July 1, 1999 of NovaCare O&P. Additional information relating to the integration and restructuring costs is set forth below under "Integration and Restructuring Costs."

Income from Operations. Principally as a result of the above, income from operations in the year ended December 31, 1999 was approximately $43.7 million, an increase of approximately $18.0 million, or 70.3%, over the prior year's comparable period. Income from operations as a percentage of net sales decreased to 12.6% in 1999 from 13.7% in 1998.

Interest Expense, Net. Interest expense, net for the year ended December 31, 1999 was approximately $22.2 million, an increase of approximately $20.3 million over approximately $1.9 million incurred in the year ended December 31, 1998. Interest expense as a percentage of net sales increased to 6.4% from 1.0% for the prior year. The increase in interest expense was primarily attributable to $255.0 million borrowed under a bank credit facility and $150.0 million in senior subordinated notes issued to acquire NovaCare O&P.

Income Taxes. Our effective tax rate was 48% in 1999 versus 41% in 1998. The increase in 1999 is a result of the disproportionate impact of the amortization of the excess costs over net assets acquired in relation to taxable income, primarily attributable to the acquisition of NovaCare O&P. The provision for income taxes for the year ended December 31, 1999 was approximately $10.2 million compared to approximately $9.6 million for the year ended December 31, 1998.

Net Income/Loss. As a result of the above, we recorded net income of approximately $11.0 million, or $.44 per dilutive common share, in the year ended December 31, 1999, compared to net income of approximately $13.8 million, or $.75 per dilutive common share, in 1998. Net income for 1999, excluding the integration and restructuring costs, would have been $14.8 million, or $.63 per dilutive common share.

LIQUIDITY AND CAPITAL RESOURCES

Cash flow generated from operating activities during 2000 approximated $3.6 million, an increase of $3.8 million from the 1999 level of cash flow used for operating activities of $224.0. The increase resulted from a reduction in the rate of working capital investment growth (i.e., although working capital increased in absolute terms during 2000, it did so at a considerably lower rate than experienced in 1999), offset by lower cash earnings. Cash earnings, defined as Adjusted EBITDA less interest expense, restructuring and integration costs and current income tax expense, decreased approximately $20 million from $26.1 million in 1999 to $6 million in 2000. Cash flow used for operating activities during 1999 of $224,000 represented a decrease in operating cash flows of approximately $18.8 million from the 1998 level of cash flow generated by operating activities of $18.5 million. This decrease principally resulted from an increase in the investment of working capital during 1999, offset by an increase in cash earnings of approximately $6.7 million during 1999.

The comparability of cash flows used for investing and financing activities for each of the years in the three year period ended December 31, 2000 is largely impacted by the Company's acquisition of the NovaCare O&P from NovaCare, Inc on July 1, 1999 (the "Acquisition").

Under the terms of the Acquisition agreement, the aggregate purchase price consideration totaled $445.0 million, which consisted of the assumption of liabilities and other obligations of $38.4 million and the balance in cash. Of the cash portion, $15.0 million was placed in escrow pending the determination of any potential post closing adjustments relating to working capital. During 2000, the Company received $24.7 million from NovaCare, Inc. pursuant to the post closing purchase price adjustment. Reference is made to the discussion under "Arbitration of Dispute Regarding Adjusted Working Capital of NovaCare O&P and Subsequent Litigation" below for information regarding post-closing adjustments.

Hanger required approximately $430.2 million in cash to close the acquisition, to pay approximately $20.0 million of related fees and expenses, including debt issue costs of approximately $16.0 million, and to refinance existing debt of approximately $2.5 million. The funds were raised by Hanger through (i) borrowing approximately $230.0 million of revolving credit and term loans under a new bank facility; (ii) selling $150.0 million principal amount of 11.25% Senior Subordinated Notes due 2009; and (iii) selling $60.0 million of 7% Redeemable Preferred Stock. The new bank credit facility consists of a $100.0 million revolving credit facility, of which $30.0 million was drawn on in connection with the acquisition of NovaCare O&P, a $100 million Tranche A term facility and a $100 million Tranche B term facility.

The Company's consolidated liquidity position (comprised of cash and cash equivalents and unused credit facilities) approximated $36 million at December 31, 2000 compared to approximately $50.7 million at December 31, 1999. Consolidated working capital at December 31, 2000 of approximately $133.7 million is up $15.3 million from the December 31, 1999 level of $118.4 million.

The Company's total long term debt at December 31, 2000, including a current portion of approximately $37.6 million, was approximately $460.4 million. Such indebtedness included: (i) $150.0 million of 11.25% million Senior Subordinated Notes due 2009; (ii) $84.7 million for the Revolving Credit Facility; (iii) $92.5 million for Tranche A Term Facility; (iv) $99.3 million for Tranche B Term Facility; and (v) a total of $33.9 million of other indebtedness. The Revolving Credit Facility, and the Tranche A and B Term Facilities (the "Credit Facility") were entered into with The Chase Manhattan Bank, Bankers Trust Company, Paribas and certain other banks (the "Banks") in connection with the Acquisition. The Revolving Credit Facility matures on July 1, 2005; the Tranche A Term Facility is payable in quarterly installments of $5.0 million through July 1, 2005; and the Tranche B Term Facility is payable in quarterly installments of $250,000 through December 31, 2004 and in quarterly installments of $15.8 million through January 1, 2007.

The Credit Facility contains certain affirmative and negative covenants customary in an agreement of this nature. At December 31, 1999, the Company was not in compliance with financial covenants under the Credit Facility for capital expenditure and adjusted interest coverage ratio. In consideration for the Banks' waiver of the Company's non-compliance with these covenants, an amendment to the Credit Agreement effective March 29, 2000 was entered into which provided for an increase in the interest rates of the Credit Facility borrowings by 25 basis points. Certain of the financial covenants were eased with respect to 2000 and 2001 under the terms of the amendment to the Credit Agreement. In addition at December 31, 2000, the Company was not in compliance with the financial covenants under the Credit Agreement for interest coverage and leverage coverage. In consideration for the bank's waiver of the Company's non-

compliance with these covenants, an amendment to the amended and restated Credit Agreement dated as of March 16, 2001 was entered into which provides for an increase in the interest rates of the Credit Facility borrowings by 50 basis points. Certain of the financial covenants were eased with respect to 2001 and 2002 under the terms of the amendment to the Credit Agreement.

Matters critical to the Company's compliance with the Credit Facility's covenants, and ultimately its immediate term liquidity (to the extent alternative sources of liquidity are not readily available), include improving operating results, through revenue growth and cost control, and reducing the Company's investment in working capital. As further discussed below, the Company has retained the services of Jay Alix & Associates to assist in identifying programs aimed at achieving these objectives. The Company's ability to continue to comply with the Credit Facility covenants is dependent on certain factors, including (a) the ability of the Company to effectuate the restructuring initiatives referred to above, and (b) the Company's ability to continue to attract and retain experienced management and O&P practitioners. Unexpected increases in the LIBOR rate could also adversely impact the Company's ability to comply with the Credit Facility's covenants. Management believes that the Company will continue to comply with the terms of the Credit Facility and that the Company's consolidated liquidity position is adequate to meet its short term and long term obligations.

The Credit Facility is collateralized by substantially all of the Company's assets, restricts the payment of dividends and restricts the Company from pursuing acquisition opportunities for the calendar year 2001.

All or any portion of outstanding loans under the Credit Facility may be repaid at any time and commitments may be terminated in whole or in part at our option without premium or penalty, except that LIBOR-based loans may only be repaid at the end of the applicable interest period. Mandatory prepayments will be required in the event of certain sales of assets, debt or equity financings and under certain other circumstances.

The $60.0 million outstanding shares of 7% Redeemable Preferred Stock are convertible into shares of our non-voting common stock at a price of $16.50 per share, subject to adjustment. The Company is entitled to require that the 7% Redeemable Preferred Stock be converted into non-voting common stock on and after July 2, 2002, if the average closing price of the common stock for 20 consecutive trading days is equal to or greater than 175% of the conversion price. The 7% Redeemable Preferred Stock will be mandatorily redeemable on July 1, 2010 at a redemption price equal to the liquidation preference plus all accrued and unpaid dividends. In the event of a change in control, the Company must offer to redeem all of the outstanding 7% Redeemable Preferred Stock at a redemption price equal to 101% of the sum of the per share liquidation preference thereof plus all accrued and unpaid dividends through the date of payment. The 7% Redeemable Preferred Stock accrues annual dividends, compounded quarterly, equal to 7%, is subject to put rights and will not require principal payments prior to maturity on July 1, 2010.

AGREEMENT WITH JAY ALIX & ASSOCIATES

On December 11, 2000, the Company retained the services of JA&A to assist in identifying areas for cash generation and profit improvement. Subsequent to the completion of this diagnostic phase, the Company modified and extended the retention agreement on January 23, 2001 to include the implementation of certain restructuring activities. Among the targeted plans are spending reductions, improving the utilization and effectiveness of support services, including claims processing, the refinement of materials purchasing and inventory management and the consolidation of distribution services. In addition, the Company will seek to enhance revenues through revised marketing efforts and more efficient billing procedures.

The terms of this engagement provide for payment of JA&A's normal hourly fees plus a success fee if certain defined benefits are achieved. Management has elected to pay one-half of any earned success fees in cash, with the remaining one-half of the success fee paid through a grant of options to purchase the Company's stock. All the options will be granted with an exercise price of $1.40 per share, which was the average closing price of the Company's common stock for all trading days during the period from December 23, 2000 – January 23, 2001. The number of options will be determined by multiplying the non-cash half of each success fee invoice of JA&A by 1.5 and dividing the product by $1.40. The options are to be granted within 30 days of each invoice, shall be exercisable beginning with the sixth month following each award and shall expire five years from the termination of JA&A's engagement. The number of options that will be granted cannot be determined at this time.

INTEGRATION AND RESTRUCTURING COSTS

In December of 2000, management and the Board of Directors determined that major performance improvement initiatives needed to be adopted. Two hundred and thirty-four (234) employees were severed, resulting in a charge of approximately $1.0 million (the amount is offset by approximately $381,000 restructuring benefit described below), and in December 2000 the Company retained JA&A to do an assessment of the opportunities available for improved financial and operating performance. JA&A was retained to develop a comprehensive performance improvement program. The plan developed by JA&A and the Company calls for a $30.0 million reduction in operating expenses over a two year period, significant increases in patient revenue and reductions in inventory and accounts receivable levels. The plan calls for the incurrence of one-time, non-recurring costs of nearly $9.0 million during 2001. The performance improvement plan was provided to the secured lenders on February 23, 2001 and calls for formal quarterly status reports to the Hanger Board and lenders. As of December 31, 2000, the Company recorded approximately $693,000 in restructuring liabilities. Those amounts were paid in January of 2001, thus completing the plan of restructuring.

The above restructuring charges and the related cost savings represent our best estimate, but necessarily make numerous assumptions with respect to industry performance, general business and economic conditions, raw materials and product pricing levels, government legislation, the timing of implementation of the restructuring and related employee reductions and patient-care center closings and other matters, many of which are outside of our control. Our estimate of cost savings is not necessarily indicative of future performance, which may be significantly more or less favorable than as set forth and is subject to the considerations relating to forward-looking statements that are set forth below under the caption "Forward Looking Statements."

The Company has implemented a plan of restructuring relating to our acquisition of NovaCare O&P on July 1, 1999. The plan contemplated lease termination and severance costs associated with the closure of certain redundant patient-care centers and corporate functions. The Company has transitioned patients being cared for at a closed patient-care center to another patient-care center generally located within proximity to the closed branch. During 1999 we recorded approximately $5.6 million in restructuring liabilities for the costs associated with the restructuring of the NovaCare O&P operations and allocated such costs to the purchase price of NovaCare O&P in accordance with purchase accounting requirements. Also during 1999 and 2000, The Company accrued approximately $1.3 million and $0.7 million respectively, for the costs associated with the restructuring of our operations.

The 1999 restructuring plan provided for the closure of 54 patient-care centers, consisting of 29 Hanger and 25 NovaCare O&P locations, and the termination of the employment of 225 employees. As of December 31, 2000, all of the reduction in force had been completed. Management decided to amend the original restructuring plan which called for the closure of 54 patient care centers. As of December 31, 2000, 44 of the patient care centers were closed and management reversed approximately $672,000 of the restructuring reserve providing an approximate restructuring benefit during fourth quarter 2000 of $381,000 and a reduction of goodwill of approximately $291,000.

We also have expensed integration costs relating to the integration of the acquired NovaCare O&P patient-care centers. During 1999 and 2000, we expensed approximately $5.0 million and $1.7 million, respectively, of integration costs. Such integration costs include costs of changing patient-care center names, payroll and related benefits conversion costs, stay-paid bonuses and related benefits for transitional employees and certain other costs relating to the acquisition. Integration costs are expensed as incurred.

ARBITRATION OF DISPUTE REGARDING ADJUSTED WORKING CAPITAL OF NOVACARE O&P AND SUBSEQUENT LITIGATION

As stated above, on July 1, 1999, we acquired all of the outstanding capital stock of NovaCare O&P from NovaCare, Inc. pursuant to a Stock Purchase Agreement, dated April 2, 1999 and amended on May 19, 1999 and June 30, 1999, by and among NovaCare, NC Resources, Inc., Hanger and HPO Acquisition Corporation. The purchase price paid by us was $445.0 million, subject to adjustment to the extent that NovaCare O&P's adjusted working capital at June 30, 1999 was less or greater than $92.0 million. Of the purchase price paid by us, $15.0 million was placed in escrow with U.S. Bank Trust National Association, as exchange agent, pending the determination of such amount of adjusted working capital. We and NovaCare disagreed regarding the determination of the amount of NovaCare O&P adjusted working capital and on February 25, 2000, we and NovaCare submitted the matter to the independent arbitrator in accordance with the dispute resolution arbitration mechanism provided under the Stock Purchase Agreement. The agreement provided that such arbitrator's determination would be conclusive and binding upon the parties.

On May 22, 2000, the independent arbitrator issued its report concluding that NovaCare O&P's adjusted working capital at June 30, 1999 was approximately $68.9 million and that we were entitled to the working capital deficiency of approximately $25.1 million, representing the required decrease in the purchase price previously paid by us for NovaCare O&P. On May 25, 2000, the escrow agent released the $15.0 million of escrowed funds to us. Pursuant to the Stock Purchase Agreement, we were entitled to receive the approximately $10.1 million balance of the working capital deficiency on or before June 21, 2000, which was 30 days after the date of the independent arbitrator determination.

On June 5, 2000, NovaCare (the name of which was changed to NAHC, Inc.) filed a Complaint in the Court of Chancery of the State of Delaware in and for New Castle County against us, our subsidiary, HPO Acquisition Corp., and the escrow agent alleging the wrongful release of the escrowed funds and seeking the return of such escrowed funds to the Escrow Agent. On June 9, 2000, we filed an answer and counterclaim requesting the Court to dismiss the Complaint and confirm the entire independent arbitrator award.

On June 30, 2000, we entered into a Settlement Agreement with NovaCare providing for dismissal of the litigation and execution of a mutual release relating to currently unknown matters arising from the acquisition. In addition, the Settlement Agreement provided that of the $10.1 million owed by NovaCare to us, $6.0 million would be paid immediately by NovaCare and NovaCare would execute a collateralized promissory note in the principal amount of $3.7 million, plus 7% annual interest, payable monthly over the following six months. Actual payment of the $6.0 million was received by us on July 3, 2000. In connection with the settlement, we were confident that we would have prevailed in the litigation. However, in view of the time that would have been involved in obtaining a favorable result and NovaCare's inability to pay the full $10.1 million at the time the Settlement Agreement was entered into, we determined it would be prudent to enter into such agreement, under which we gave NovaCare a $0.4 million discount in exchange for the immediate payment of $6.0 million and the greater certainty of receiving $3.7 million under the promissory note. The $3.7 million was received in a timely manner with some minor deductions relating to certain other outstanding accounts payable between the parties.

CLASS ACTION

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

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

We believe that the allegations have absolutely no merit and plan to vigorously defend the lawsuit.

NEW ACCOUNTING STANDARDS

In June 1998, the Financial Accounting Standard Board issued SFAS 133, “Accounting for Derivative Instruments and Hedging Activities,” which is effective for fiscal years beginning after June 15, 2000. SFAS 133 requires that an entity recognize all derivative instruments as either assets or liabilities on its balance sheet at their fair value. Changes in the fair value of derivatives are recorded each period in current earnings or other comprehensive income, depending on whether a derivative is designated as part of a hedge transaction, and, if it is, the type of hedge transaction. The Company has adopted SFAS 133 as of January 1, 2001. As the Company does not use derivative instruments SFAS 133 did not have a material effect on the financial position or results of operation of the Company at January 1, 2001.

In December 1999, the of the Securities and Exchange Commission released Staff Accounting Bulletin No. 101 (“SAB 101”). “Revenue Recognition,” to provide guidance on the recognition, presentation and disclosure of revenue in financial statements. The Company believes that its revenue recognition practices are in conformity with the guidelines in SAB 101, as revised, and that this pronouncement will have no material impact on its financial statements.

In March 2000, the Financial Accounting Standards Board (“FASB”) released Interpretation No. 44, “Accounting for Certain Transactions involving Stock Compensation: an interpretation of APB Opinion No. 25.” Interpretation No. 44 provided clarification of certain issues, such as determination of who is an employee, the criteria for determining whether a plan qualifies as a non-compensatory plan, the accounting consequence of various modifications to the terms of a previously fixed stock option or award and the accounting for an exchange of stock compensation awards in a business combination. The Company believes that its practices are in conformity with this guidance, and therefore Interpretation No. 44 has no impact on its financial statements.

In 2000, the FASB issued SFAS No. 137, “Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities” (which was amended by SFAS 140). This statement replaces SFAS No. 125 (of the same name). SFAS No. 140 carries over the main provisions of SFAS No. 125 concerning and servicing of Financial Assets. At December 31, 2000, this standard would not have impacted the Company’s financial statements.

OTHER

Inflation has not had a significant effect on our operations, as increased costs to us generally have been offset by increased prices of products and services sold.

We primarily provide services and customized devices throughout the United States and are reimbursed, in large part, by the patients’ third-party insurers or governmentally funded health insurance programs. The ability of our debtors to meet their obligations is principally dependent upon the financial stability of the insurers of our patients and future legislation and regulatory actions.

FORWARD LOOKING STATEMENTS

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

CONSOLIDATED BALANCE SHEETS

(Dollars in thousands, except share and per share amounts)

ASSETS

December 31,	1999	2000
CURRENT ASSETS		
Cash and cash equivalents	$ 5,735	$ 20,669
Accounts receivable, less allowances for doubtful accounts of $17,866 and $23,005 in 1999 and 2000, respectively	103,125	111,210
Inventories	59,915	61,223
Prepaid expenses and other assets	5,222	4,262
Income tax	3,644	6,325
Deferred income taxes	11,778	20,038
Total current assets	189,419	223,727
PROPERTY, PLANT AND EQUIPMENT		
Land	4,177	4,177
Buildings	8,886	8,876
Machinery and equipment	26,677	31,393
Furniture and fixtures	8,629	9,968
Leasehold improvements	13,004	16,925
	61,373	71,339
Less accumulated depreciation and amortization	15,269	24,345
	46,104	46,994
INTANGIBLE ASSETS		
Excess cost over net assets acquired	498,612	490,724
Non-compete agreements	2,019	1,426
Patents	9,768	9,924
Assembled work force	7,000	7,000
Other intangible assets	15,833	17,082
	533,232	526,156
Less accumulated amortization	20,412	36,533
	512,820	489,623
OTHER ASSETS	1,738	1,474
TOTAL ASSETS	$ 750,081	$ 761,818

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

CONSOLIDATED BALANCE SHEETS

(Dollars in thousands, except share and per share amounts)

LIABILITIES, REDEEMABLE PREFERRED STOCK SHAREHOLDERS' EQUITY

December 31,	**1999**	**2000**
CURRENT LIABILITIES		
Current portion of long-term debt	$ 25,406	$ 37,595
Accounts payable	16,714	17,809
Accrued expenses	5,445	9,380
Accrued interest payable	4,768	7,559
Accrued compensation related cost	18,658	17,385
Deferred revenue	---	309
Total current liabilities	70,991	90,037
Long-term debt	426,211	422,838
Deferred income taxes	13,481	26,026
Other liabilities	5,141	2,656
Total Liabilities	515,824	541,557
7% Redeemable Convertible Preferred stock, liquidation preference $1,000 per share	61,343	65,881
Commitments and contingent liabilities (See Note K)		
SHAREHOLDERS' EQUITY		
Common stock, $.01 par value; 60,000,000 shares authorized,19,043,497 shares and 18,910,002 shares issued and outstanding in 1999 and 2000	190	190
Additional paid-in capital	146,498	146,498
Retained earnings	26,882	8,348
	173,570	155,036
Treasury stock, cost -- (133,495 shares)	(656)	(656)
	172,914	154,380
TOTAL LIABILITIES, REDEEMABLE PREFERRED STOCK AND SHAREHOLDERS' EQUITY	$ 750,081	$ 761,818

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

CONSOLIDATED STATEMENTS OF OPERATIONS

(Dollars in thousands, except share and per share amounts)

For the Years Ended December 31,	1998	1999	2000
Net sales	$ 187,870	$ 346,826	$ 486,031
Cost of products and services sold	92,903	169,076	251,368
Gross profit	94,967	177,750	234,663
Selling, general and administrative	63,512	113,643	177,519
Depreciation and amortization	3,294	6,538	11,178
Amortization of excess cost over net assets acquired	2,488	7,520	12,150
Restructuring costs	---	1,305	654
Integration costs	---	5,035	1,710
Income from operations	25,673	43,709	31,452
Interest expense, net	(1,902)	(22,177)	(47,072)
Other expense, net	(315)	(352)	127
Income (loss) before taxes	23,456	21,180	(15,493)
Provision (benefit) for income taxes	9,616	10,194	(1,497)
Net income (loss)	$ 13,840	$ 10,986	$ (13,996)
Net income (loss) applicable to common stock	$ 13,818	$ 8,831	$ (18,534)
Basic Per Common Share Data			
Net income (loss)	$ 0.82	$ 0.47	$ (0.98)
Shares used to compute basic per common share amounts	16,812,717	18,854,751	18,910,002
Diluted Per Common Share Data			
Net income (loss) *	$ 0.75	$ 0.44	$ (0.98)
Shares used to compute diluted per common share amounts *	18,515,567	20,005,282	18,910,002

* For 1999 and 2000, excludes the effect of the conversion 7% Redeemable Convertible Preferred Stock into Common Stock as it is considered anti-dilutive.

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

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

For the Years Ended December 31, 1998, 1999 and 2000

(In thousands)

	Common Shares	Common Stock	Additional Paid in Capital	Retained Earnings (Accumulated Deficit)	Treasury Stock	Total
Balance, December 31, 1997	15,537	$ 157	$ 102,586	$ 4,233	$ (656)	$ 106,320
Preferred dividends declared				(22)		(22)
Net Income				13,840		13,840
Issuance of Common Stock in connection with the exercise of stock options	338	3	2,252			2,255
Issuance of Common Stock in connection with the exercise of stock warrants	276	3	(3)			
Issuance of Common Stock in connection with acquisitions	141	1	2,399			2,400
Issuance of Common Stock in Public Offering	2,400	24	37,736			37,760
Balance, December 31, 1998	18,692	188	144,970	18,051	(656)	162,553
Preferred dividends declared				(2,118)		(2,118)
Accretion of Preferred Stock				(37)		(37)
Net Income				10,986		10,986
Issuance of Common Stock in connection with the exercise of stock options	184	2	861			863
Issuance of Common Stock in connection with acquisitions	23		500			500
Conversion of Seller Notes into Shares of Common Stock	11		167			167
Balance, December 31, 1999	18,910	190	146,498	26,882	(656)	172,914
Preferred dividends declared				(4,464)		(4,464)
Accretion of Preferred Stock				(74)		(74)
Net Loss				(13,996)		(13,996)
Balance, December 31, 2000	18,910	$ 190	$ 146,498	$ 8,348	$ (656)	$ 154,380

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

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Dollars in thousands)

For the Years Ended December 31,	1998	1999	2000
Cash flows from operating activities:			
Net income (loss)	$ 13,840	$ 10,986	$ (13,996)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:			
Loss on disposal of assets	---	37	---
Provision for bad debt	7,510	15,046	23,620
Provision for inventory reserves	2,202	---	120
Depreciation and amortization	3,294	6,538	11,178
Amortization of excess cost over net assets acquired	2,488	7,520	12,150
Amortization of debt discount and debt issue costs	---	1,059	2,436
Deferred taxes (benefit)	(554)	662	(3,200)
Restructuring costs	---	1,305	654
Changes in assets and liabilities, net of effects from acquired companies:			
Accounts receivable	(10,773)	(19,367)	(31,089)
Inventories	256	(10,372)	(1,113)
Prepaid and other assets	611	(2,493)	259
Other assets	(87)	1,156	273
Accounts payable	(586)	2,896	982
Accrued expenses	(67)	(4,638)	4,794
Accrued wages & payroll taxes	247	(6,127)	(1,287)
Deferred revenue	---	---	309
Other liabilities	150	(4,432)	(2,483)
Net cash provided by (used in) operating activities	18,531	(224)	3,607
Cash flows from investing activities:			
Purchase of fixed assets	(2,859)	(12,598)	(9,845)
Acquisitions, net of cash acquired	(30,333)	(432,291)	(9,958)
Cash received pursuant to purchase price adjustment`	---	---	24,700
Proceeds from sale of certain assets, net of cash	---	397	---
Purchase of non-compete agreements	(398)	(294)	(87)
Purchase of customer list	---	---	(30)
Other	(60)	(209)	(156)
Net cash provided by (used in) investing activities	(33,650)	(444,995)	4,624
Cash flows from financing activities:			
Net borrowings under revolving credit agreement	---	55,000	29,700
Repayment of term loans	---	---	(8,250)
Proceeds from issuance of preferred stock, net	---	59,188	---
Redemption of preferred stock	(326)	---	---
Proceeds from issuance of Common Stock	40,016	863	---
Proceeds from long-term debt	6,000	350,000	---
Repayment of long-term debt	(27,445)	(9,089)	(13,521)
Increase in financing costs	---	(14,691)	(1,226)
Net cash provided by financing activities	18,245	441,271	6,703
Increase (decrease) in cash and cash equivalents	3,126	(3,948)	14,934
Cash and cash equivalents at beginning of year	6,557	9,683	5,735
Cash and cash equivalents at end of year	$ 9,683	$ 5,735	$ 20,669

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands, except share and per share amounts)

NOTE A - THE COMPANY

Hanger Orthopedic Group, Inc. is the nation's largest professional practice management company in the orthotics & prosthetics ("O&P") rehabilitation industry. In addition to providing O&P patient-care services through its operating subsidiaries, the Company also manufactures and distributes components and finished patient-care products to the O&P industry primarily in the United States. Hanger's subsidiary, Hanger Prosthetics & Orthotics, Inc. formerly known as J.E. Hanger, Inc., was founded in 1861 by a Civil War amputee and is the oldest company in the O&P industry in the United States. Orthotics is the design, fabrication, fitting and supervised use of custom-made braces and other devices that provide external support to treat musculoskeletal disorders. Prosthetics is the design, fabrication and fitting of custom-made artificial limbs.

The Company has obtained financing from various sources to provide the necessary funding for acquisitions and working capital requirements. As discussed in Note H, the Company was not in compliance with the financial covenants of its Credit Agreement as of December 31, 1999 and 2000. The Company's Credit Agreement was amended on March 29, 2000 and March 16, 2001 to provide waivers of non-compliance as well as to ease the restriction of certain financial covenants with respect to 2001 and 2002.

NOTE B - SIGNIFICANT ACCOUNTING POLICIES

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

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

Cash and Cash Equivalents: The Company considers all highly liquid investments with original maturities of three months or less at the date of purchase to be cash equivalents. At various times throughout the year, the Company maintains cash balances in excess of FDIC limits.

Fair Value of Financial Instruments: The carrying value of the Company's short-term financial instruments, such as receivables and payables, approximate their fair values, based on the short-term maturities of these instruments. The carrying value of the Company's long-term debt approximates fair value based on using rates currently available to the Company for debt with similar terms and remaining maturities.

Inventories: Inventories, which consist principally of purchased parts, are stated at the lower of cost or market using the first-in, first-out (FIFO) method. The Company calculates cost of goods sold in accordance with the gross profit method. The Company bases the estimates used in applying the gross profit method on the actual results of the most recently completed fiscal year and other factors affecting cost of goods sold during the current reporting periods. Estimated cost of goods sold during the period is adjusted when the annual physical inventory is taken. In the fourth quarter of 2000, the Company recorded a book-to-physical adjustment of approximately $9.6 million. The Company treated this adjustment as a change in accounting estimate in accordance with the provisions of Accounting Principles Board Opinion No. 20.

Long-Lived Asset Impairment: The Company reviews its long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amount of the assets may not be recoverable through future cash flows such as: a significant decrease in the market value of the Company's assets; or a significant adverse change in legal factors or in the business climate that could affect the value of an asset or an adverse action or assessment by a regulator; or a significant adverse change in third-party reimbursement requirements. If it is determined that an impairment loss has occurred based on expected cash flows undiscounted, before interest and taxes, then the extent of the impairment is calculated, based on net cash flows and the loss is recognized in the statement of operations. Management's review of future cash flows associated with long-lived assets has not indicated an impairment of those assets during the periods presented.

Property, Plant and Equipment: Property, plant and equipment are recorded at cost. The cost and related accumulated depreciation of assets sold, retired or otherwise disposed of are removed from the respective accounts, and any resulting gains or losses are included in the statement of operations. Depreciation is computed for financial reporting purposes using the straight-line method over the estimated useful lives of the related assets as follows: machinery and equipment and furniture and fixtures - 5 years; leasehold improvements - shorter of the asset life or term of lease; and buildings - 10-20 years. Depreciation expense was approximately $2,806 and $5,251 and $9,009 for the years ended December 31, 1998, 1999 and 2000, respectively.

Intangible Assets: Non-compete agreements are recorded based on agreements entered into by the Company and are amortized over their estimated useful lives ranging from 5 to 7 years using the straight-line method. Other intangible assets are recorded at cost and are amortized over their estimated useful lives of up to 16 years using the straight-line method. Excess cost over net assets acquired represents the excess of purchase price over the value assigned to net identifiable assets of purchased businesses and is amortized using the straight-line method over 40 years.

Revenue Recognition: Revenue on the sale of orthotic and prosthetic devices is recorded when the device is accepted by the patient. Revenues from referral service contracts is recognized over the term of the contract. Deferred revenue represents billings made prior to the final fitting and acceptance by the patient and unearned service contract revenue. Revenue is recorded at its net realizable value taking into consideration all governmental and contractual discounts.

Credit Risk: The Company primarily provides services and customized devices throughout the United States and is reimbursed by the patients' third-party insurers or governmentally funded health insurance programs. The Company performs ongoing credit evaluations of its distribution customers. Accounts receivable are not collateralized. The ability of the Company's debtors to meet their obligations is dependent upon the financial stability of the insurers of the Company's customers and future legislation and regulatory actions. Additionally, the Company maintains reserves for potential losses from these receivables that historically have been within management's expectations.

Income Taxes: Income taxes are determined in accordance with Statement of Financial Accounting Standards ("SFAS") 109, which requires recognition of deferred income tax liabilities and assets for the expected future tax consequences of events that have been included in the financial statements or tax returns. Under this method, deferred income tax liabilities and assets are determined based on the difference between financial statement and tax bases of assets and liabilities using enacted tax rates in effect for the year in which the differences are expected to reverse. SFAS 109 also provides for the recognition of deferred tax assets if it is more likely than not that the assets will be realized in future years.

Stock-Based Compensation: Compensation costs attributable to stock option and similar plans are recognized based on any difference between the quoted market price of the stock on the date of the grant over the amount the employee is required to pay to acquire the stock (the intrinsic value method under Accounting Principles Board Opinion 25). SFAS 123, "Accounting for Stock-Based Compensation," requires companies electing to continue to use the intrinsic value method to make pro forma disclosures of net income and earnings per share as if the fair value based method of accounting had been applied. The Company has adopted the disclosure only provisions of SFAS 123.

Comprehensive Income: Effective January 1, 1998 the Company adopted the provisions of SFAS 130, "Reporting Comprehensive Income." SFAS 130 establishes standards for reporting and display of comprehensive income and its components in the financial statements. The adoption of SFAS 130 had no effect on the Company's consolidated financial statements.

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

New Accounting Standards: In June 1998, the Financial Accounting Standard Board issued SFAS 133, "Accounting for Derivative Instruments and Hedging Activities," which is effective for fiscal years beginning after June 15, 2000. SFAS 133 requires that an entity recognize all derivative instruments as either assets or liabilities on its balance sheet at their fair value. Changes in the fair value of derivatives are recorded each period in current earnings or other comprehensive income, depending on whether a derivative is designated as part of a hedge transaction, and, if it is, the type of hedge transaction. The Company has adopted SFAS 133 as of January 1, 2001. As the Company does not use derivative instruments, SFAS 133 did not have a material effect on the financial position or results of operations of the Company at January 1, 2001.

In December 1999, the of the Securities and Exchange Commission released Staff Accounting Bulletin No. 101 ("SAB 101"). "Revenue Recognition," to provide guidance on the recognition, presentation and disclosure of revenue in financial statements. The Company believes that its revenue recognition practices are in conformity with the guidelines in SAB 101, as revised, and that this pronouncement will have no material impact on its financial statements.

In March 2000, the FASB released Interpretation No. 44, "Accounting for Certain Transactions involving Stock Compensation: an interpretation of APB Opinion No. 25." Interpretation No. 44 provided clarification of certain issues, such as determination of who is an employee, the criteria for determining whether a plan qualifies as a non-compensatory plan, the accounting consequence of various modifications to the terms of a previously fixed stock option or award and the accounting for an exchange of stock compensation awards in a business combination. The Company believes that its practices are in conformity with this guidance, and therefore No. 44 has no impact on its financial statements.

In 2000, the FASB issues SFAS No. 137, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities" (which was amended by SFAS 140). This statement replaces SFAS No. 125 (of the same name). SFAS No. 140 carries over the main provisions of SFAS No. 125 concerning and servicing of Financial Assets. At December 31, 2000, this standard would not have impacted the Company's financial statements.

NOTE C - SUPPLEMENTAL CASH FLOW FINANCIAL INFORMATION

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

For the Years Ended December 31,	**1998**	**1999**	**2000**
Cash paid during the period for:			
Interest	$ 2,099	$ 18,261	$ 42,645
Income taxes	8,307	12,400	2,666
Non-cash financing and investing activities:			
Preferred stock dividends declared and accretion	22	2,155	4,538
Issuance of notes in connection with acquisitions	7,934	3,006	2,874
Issuance of Common Stock in connection with acquisitions	2,400	500	---
Conversion of seller notes into shares of Common Stock	---	167	---

NOTE D - ACQUISITIONS

During 1998, the Company acquired seventeen orthotic and prosthetic companies and one prosthetic component manufacturing company. The aggregate purchase price, excluding potential earn-out provisions, was $39,125, comprised of $28,791 in cash, $7,934 in promissory notes and 141,417 shares of common stock of the Company valued at $2,400. The notes are payable over one to five years with interest rates ranging from 6.0000% to 7.6875%. The cash portion of the purchase price for these acquisitions was borrowed under the Company's revolving and acquisition loan commitment.

During 1998, the Company paid approximately $591 to the former owners of ACOR Orthopaedic, Inc. - Retail Division and Montana Orthotics and Prosthetics, Inc., pursuant to earnout provisions contained in the 1997 acquisition agreements. In addition, the Company paid approximately $1,528 to the former owners of Seattle Limb Systems, Inc., Fort Walton Orthopedic Inc. and Mobile Limb and Brace, Inc., Morgan Prosthetics – Orthotics, Inc. and Eugene Teufel & Sons, Inc., pursuant to working capital provisions contained in the respective acquisition agreements. The Company has accounted for these additional payments as additional purchase price resulting in an increase to excess of cost over net assets acquired in the amount of $2,119.

Following the acquisition of NovaCare O&P in 1999, the Company and NovaCare disagreed regarding the determination of the amount of NovaCare O&P adjusted working capital and on February 25, 2000, the Company and NovaCare submitted the matter to the independent arbitrator in accordance with the dispute resolution arbitration mechanism provided under the Stock Purchase Agreement. The agreement provided that such arbitrator's determination would be conclusive and binding upon the parties. On May 22, 2000, an independent arbitrator issued its report concluding that the Company was entitled to the working capital deficiency of approximately $25.1 million, representing the required decrease in the purchase price previously paid by the Company for NovaCare O&P. On May 25, 2000, the escrow agent released the $15.0 million of escrowed funds to the Company. Pursuant to the Stock Purchase Agreement, the Company was entitled to receive the approximately $10.1 million balance of the working capital deficiency on or before June 21, 2000, which was 30 days after the date of the independent arbitrator determination.

On June 5, 2000, NovaCare (the name of which was changed to NAHC, Inc.) filed a Complaint in the Court of Chancery of the State of Delaware in and for New Castle County against the Company, our subsidiary, HPO Acquisition Corp., and the escrow agent alleging the wrongful release of the escrowed funds and seeking the return of such escrowed funds to the Escrow Agent. On June 9, 2000, we filed an answer and counterclaim requesting the Court to dismiss the Complaint and confirm the entire independent arbitrator award.

On June 30, 2000, the Company entered into a Settlement Agreement with NovaCare providing for dismissal of the litigation and execution of a mutual release relating to currently unknown matters arising from the acquisition. In addition, the Settlement Agreement provided that of the $10.1 million owed by NovaCare to the Company, $6.0 million would be paid immediately by NovaCare and NovaCare would execute a collateralized promissory note in the principal amount of $3.7 million, plus 7% annual interest, payable monthly over the following six months. Actual payment of the $6.0 million was received by the Company on July 3, 2000. The Company determined it would be prudent to enter into an agreement, under which the Company gave NovaCare a $0.4 million discount in exchange for the immediate payment of $6.0 million and the greater certainty of receiving $3.7 million under the promissory note. The $3.7 million was received in a timely manner with some minor deductions relating to certain other outstanding accounts payable between the parties.

Included in liabilities assumed are restructure provisions which are more fully described in Note E. Additionally, certain contingent liabilities, more fully described in Note K, exist which, when resolved may result in adjustment of the purchase price cost allocation.

During 1999, the Company acquired five other orthotic and prosthetic companies. The aggregate purchase price, excluding potential earn-out provisions, was $12.1 million, comprised of $8.6 million, in cash, $2.9 million in promissory notes and 23,000 shares of Common Stock of the Company valued at $500.

Hanger required approximately $430.2 million in cash to close the acquisition of NovaCare O&P, to pay approximately $20.0 million of related fees and expenses, including debt issue costs of approximately $16.0 million, and to refinance existing debt of approximately $2.5 million. The funds were raised by Hanger through (i) borrowing approximately $230.0 million of revolving credit and term loans under a new bank facility; (ii) selling $150.0 million principal amount of 11.25% Senior Subordinated Notes due 2009; and (iii) selling $60.0 million of 7% Redeemable Preferred Stock. The new bank credit facility consists of a $100.0 million revolving credit facility, of which $30.0 million was drawn on in connection with the acquisition of NovaCare O&P, a Tranche A term facility and a Tranche B term facility.

The acquisition of NovaCare O&P has been accounted for as a business combination in accordance with the purchase method. The results of operations for this acquisition have been included in the Company's results since July 1, 1999. Excess cost over net assets acquired includes goodwill and other intangible assets. Goodwill is amortized using the straight-line method over 40 years. Other intangible assets of $15.0 million, primarily patents, are amortized over periods of between 8 and 11 years.

Additionally, the Company paid during 1999, approximately $9.9 million and issued $126.0 in notes related to seven orthotic and prosthetic companies acquire in years prior to 1999. The payments were primarily made pursuant to earnout and working capital provisions contained in the respective acquisition agreements. The Company has accounted for these amounts as additional purchase price resulting in an increase to excess of cost over net assets acquired in the amount of $10.0 million.

During 2000, the Company acquired five orthotic and prosthetic companies. The aggregate purchase price, excluding potential earn-out provisions, was $4.5 million, comprised of $2.4 million in cash and $2.1 million in promissory notes. The notes are payable over two to five years with interest rates ranging from 6% to 8%. The cash portion of the purchase price for these acquisitions was borrowed under the Company's revolving credit facility.

All of the above acquisitions have been accounted for as business combinations in accordance with the purchase method. The results of operations for these acquisitions are included in the Company's results of operations from their date of acquisition. Excess cost over net assets acquired in these acquisitions amounting to approximately $32.9 million, $374.6 million and $3.6 million in 1998, 1999 and 2000, respectively, are amortized using the straight-line method over 40 years.

The following table summarizes the unaudited consolidated pro forma information, assuming the NovaCare O&P acquisition had occurred at the beginning of each of the following periods:

	1998	1999
Net sales	$ 492,417	$ 482,502
Net income (loss)	2,497	(1,609)
Diluted loss per common share [1]	$ (.10)	$ (.31)

[1] Excludes potentially dilutive Common Stock and includes an adjustment to net loss for Preferred Stock Dividends.

The unaudited consolidated pro forma results do not necessarily represent results which would have occurred if the acquisitions had taken place at the beginning of each period, nor are they indicative of the results of future combined operations or trends.

Adjustments made in arriving at the unaudited consolidated pro forma results include increased interest expense on acquisition debt, amortization of goodwill, adjustments to the fair value of assets acquired and depreciable lives, preferred stock dividends, and related tax adjustments.

Additionally during 2000, the Company paid, approximately $7.6 million and issued $750.0 in notes related to 15 orthotic and prosthetic companies acquired in years prior to 2000. The payments were primarily made pursuant to earnout and working capital provisions contained in the respective acquisition agreements. The Company has accounted for these amounts as additional purchase price resulting in an increase to excess of cost over net assets acquired in the amount of $8.4 million. Additional amounts aggregating approximately $13.9 million may be paid in connection with earnout provisions contained in acquisition agreements.

NOTE E - INTEGRATION & RESTRUCTURING COSTS

The Company has made an assessment of the restructuring costs to be incurred relative to the acquisition of NovaCare O&P. Affected by the plan of restructuring are approximately 54 patient care centers to be closed, including approximately 29 Hanger and 25 NovaCare O&P locations. The Company began formulating, and commenced, a plan of restructuring on July 1, 1999, which is now complete. Since commencement of the plan of restructuring, the Company has transitioned patients being cared for at closed patient care centers to other patient care centers generally within proximity to a closed branch. During 1999, the Company recorded approximately $5.6 million in restructuring liabilities for the costs associated with the restructuring of the NovaCare O&P operations and allocated such costs to the purchase price of NovaCare O&P in accordance with purchase accounting requirements. The Company also accrued approximately $1.3 million ($796.0 after tax) for the costs associated with the restructuring of the existing Hanger operations in conjunction with the NovaCare O&P acquisition and the Company has recorded such charges in the statement of operations.

The above-referenced restructuring costs primarily include severance pay benefits and lease termination costs. The cost of providing severance pay and benefits for the reduction of approximately 225 employees is estimated at approximately $3.4 million and is primarily a cash expense. Total employee terminations included approximately 70 acquired corporate and 155 patient-care center employees. Employees terminated at patient-care centers include most, if not all, employees at each patient care center closed. During 1999, approximately 195 employees were terminated including approximately 53 acquired corporate employees and 142 patient care center employees. Lease termination costs, for patient care centers closed, are estimated at $3.5 million, are cash expenses and are expected to be paid through 2003. During 1999, 54 patient care centers were identified for closure. As of December 31, 2000, all of the reduction in force had been completed. Management decided to amend the original restructuring plan which called for the closure of 54 patient care centers. As of December 31, 2000, 44 of the patient care centers were closed and management reversed approximately $672.0 of the restructuring reserve providing an approximate restructuring benefit during the fourth quarter 2000 of $381.0 and a reduction of goodwill of approximately $291.0.

Additionally, in relation to the acquisition of NovaCare O&P, the Company recorded integration costs of approximately $5.0 million, including costs of changing patient care center names, payroll and related benefits, conversion, stay-bonuses and related benefits for transitional employees and certain other costs related to the acquisition. These costs were expensed as incurred and recorded against operations during 1999.

In December of 2000, management and the Board of Directors determined that major performance improvement initiatives needed to be adopted. Two hundred and thirty-four (234) employees were severed and the Company retained Jay Alix & Associates ("JA&A") to do an assessment of the opportunities available for improved financial and operating performance. JA&A was retained to develop a comprehensive performance improvement program.

During the fourth quarter of 2000, management implemented a plan to sever two-hundred thirty-four (234) employees in an effort to reduce general and administrative expenses. The Company recorded approximately $1.0 million in restructuring expense (this amount is offset by approximately $381.0 restructuring benefit described above). As of December 31, 2000, the Company recorded approximately $0.7 million in restructuring liabilities. Those amounts were paid in January of 2001, thus completing the plan of restructuring. Additionally, the Company recorded approximately $1.7 million in integration expenses during the period.

Components of the restructuring reserves for 1999 and 2000, spending during the periods, and remaining reserve balances are as follows:

	Employee Severance Costs	Lease Termination and other Exit Costs	Total Restructuring Reserve
Balance at December 31, 1998	$ ---	$ ---	$ ---
Provision for existing Hanger Business	223	1,082	1,305
Provision for existing NovaCare O&P Business	3,145	2,570	5,715
Spending	(1,768)	(660)	(2,428)
Balance at December 31, 1999	1,600	2,992	4,592
Provision	1,035	---	1,035
Spending	(1,942)	(913)	(2,855)
Amendment to Plan	---	(672)	(672)
Balance at December 31, 2000	$ 693	$ 1,407	$ 2,100

NOTE F - NET INCOME PER COMMON SHARE

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

Earnings per share are computed as follows:

Years Ended December 31,	**1998**	**1999**	**2000**
Net income (loss)	$ 13,840	$ 10,986	$ (13,996)
Less preferred stock dividends declared and accretion	(22)	(2,155)	(4,538)
Income (loss) available to common stockholders used to compute basic per common share amounts	$ 13,818	$ 8,831	$ (18,534)
Add back interest expense on convertible note payable, net of tax	$ 44	$ 51	$ ---
Income (loss) available to common stockholders plus assumed conversions to compute diluted per common share amounts	$ 13,862	$ 8,882	$ (18,534)
Shares of common stock outstanding used to compute basic per common share amounts	16,812,717	18,854,751	18,910,002
Effect of convertible note payable	87,501	92,573	---
Effect of dilutive options	836,126	541,834	---
Effect of dilutive warrants	779,223	516,124	---
Shares used to compute dilutive per common share amounts [1]	18,515,567	20,005,282	18,910,002
Basic income per common share	$ .82	$ .47	$ (.98)
Diluted income per common share	$ .75	$ .44	$ (.98)

[1] For 1999 and 2000, excludes the effect of the conversion of the 7% Redeemable Convertible Preferred Stock into Common Stock as it is considered anti-dilutive. For 2000, excludes the effect of all dilutive options and warrants as a result of the Company's net loss for the year ended December 31, 2000.

Options to purchase 3,345,693 shares of common stock and warrants to purchase 830,650 shares of common stock were outstanding at December 31, 2000, and not included in the computation of diluted income per share due to the Company's net loss for the year ended December 31, 2000.

Options to purchase 234,250 and 665,333 shares of common stock were outstanding at December 31, 1998 and 1999, respectively, but were not included in the computation of diluted income per share for 1998 and 1999 because the options' prices were greater that the average market price of the common shares.

NOTE G - INVENTORY

Inventories at December 31, 1999 and 2000 consist of the following:

	1999	2000
Raw materials	$ 31,715	$ 29,482
Work in-process	17,172	19,885
Finished goods	11,028	11,856
	$ 59,915	$ 61,223

NOTE H - LONG-TERM DEBT

Long-term debt consists of the following at December 31, 1999 and 2000:

	1999	2000
A Term Loan Commitment	$ 100,000	$ 92,500
B Term Loan Commitment	100,000	99,250
Senior subordinated notes	150,000	150,000
Revolving credit facility	55,000	84,700
Subordinated seller notes, non-collateralized net of unamortized discount of $195.5 and $141.5 at December 31, 1999 and 2000, respectively, with principal and interest payable in either monthly, quarterly or annual installments at effective interest rates ranging from 6% to 11.572%, maturing through January 2009.	$ 46,617	$ 33,983
	451,617	460,433
Less current portion	25,406	37,595
	$ 426,211	$ 422,838

On July 29, 1998, 3,300,000 shares of Common Stock of the Company were sold in an underwritten public offering at $17.00 per share. Of that amount, 2,400,000 shares were sold by the Company and 900,000 were sold by certain stockholders of the Company. Of the approximately $37.8 million of net proceeds of the offering received by the Company, the Company applied $24.7 million to the repayment of the A-Term Loan, B-Term Loan and other indebtedness.

On June 16, 1999, the Company issued $150.0 million of Senior Subordinated Notes, bearing interest of 11.25%, and maturing on June 15, 2009. Interest is payable on June 15 and December 15, commencing on December 15, 1999.

On July 1, 1999, the Company replaced its bank credit facility with a new facility (the "Credit Agreement") which consists of a $100.0 million Revolving Credit Facility, a $100.0 million Tranche A Term Facility and $100.0 million Tranche B Term Facility. The Revolving Credit Facility matures on July 1, 2005; the Tranche A Term Facility is payable in quarterly installments of $5.0 million through July 1, 2005; and the Tranche B Term Facility is payable in quarterly installments of $250.0 through December 31, 2004 and in quarterly installments of $15.8 million through January 1, 2007. The Credit Agreement, as initially entered into, provided that the Tranche A Term Facility and the Revolving Credit Facility would carry an annual interest rate of adjusted LIBOR plus 2.50% or ABR plus 1.50%, and that the Tranche B Term Facility would carry an annual interest rate of adjusted LIBOR plus 3.50% or ABR plus 2.50%. At December 31, 1999, the Company was not in compliance with financial covenants under the Credit Agreement for capital expenditure and adjusted interest coverage ratio. In consideration for the Banks' waiver of the Company's non-compliance with these covenants, an amendment to the Credit Agreement effective March 29, 2000 was entered into which provides for an increase in the Tranche A Term Facility and the Revolving Credit Facility annual interest rate to adjusted LIBOR plus 3.00% or ABR plus 2.00%, and an increase in the Tranche B Term Facility annual interest rate to adjusted LIBOR plus 4.00% or ABR plus 3.00%. Certain of the financial covenants were eased with respect to 2000 and 2001 under the terms of the amendment to the Credit Agreement.

In addition at December 31, 2000, the Company was not in compliance with the financial covenants under the Credit Agreement for interest coverage and leverage coverage. In consideration for the bank's waiver of the Company's non-compliance with these covenants, an amendment to the amended and restated Credit Agreement dated as of March 16, 2001 was entered into which provides for an increase in the Tranche A Term Facility and the Revolving Credit Facility annual interest rate to adjusted LIBOR plus 3.50% or ABR plus 2.50%, and an increase in the Tranche B Term Facility annual interest rate to adjusted LIBOR plus 4.50% or ABR plus 3.50%. Certain of the financial covenants were eased with respect to 2001 and 2002 under the terms of the amendment to the Credit Agreement.

Matters critical to the Company's compliance with the Credit Facility's covenants, and ultimately its immediate term liquidity (to the extent alternative sources of liquidity are not readily available), include improving operating results, through revenue growth and cost control, and reducing the Company's investment in working capital. The Company has retained the services of Jay Alix & Associates to assist in identifying programs aimed at achieving these objectives. The Company's ability to continue to comply with the Credit Facility covenants is dependent on certain factors, including (a) the ability of the Company to effectuate the restructuring initiatives referred to above, and (b) the Company's ability to continue to attract and retain experienced management and O&P practitioners. Unexpected increases in the LIBOR rate could also adversely impact the Company's ability to comply with the Credit Facility's covenants

The Credit Facility with the Banks is collateralized by substantially all the assets of the Company, restricts the payment of dividends, and contains certain affirmative and negative covenants customary in an agreement of this nature.

Maturities of long-term debt at December 31, 2000 are as follows:

2001	$ 37,595
2002	32,477
2003	26,402
2004	107,196
2005	42,571
Thereafter	214,192
	$ 460,433

As of December 31, 2000, the Company had available borrowings under its Revolving Credit Facility of $15.3 million.

NOTE I - INCOME TAXES

The provisions (benefit) for income taxes for the years ended December 31, 1998, 1999 and 2000 consisted of the following:

	1998	**1999**	**2000**
Current:			
Federal	$ 8,683	$ 7,844	$ (194)
State	1,486	1,688	1,897
Total	10,169	9,532	1,703
Deferred:			
Federal and State	(553)	662	(3,200)
Provision (benefit) for income taxes	$ 9,616	$ 10,194	$ (1,497)

A reconciliation of the federal statutory tax rate to the effective tax rate for the years ended December 31, 1998, 1999 and 2000 is as follows:

	1998	**1999**	**2000**
Federal statutory tax rate	$ 8,210	$7,413	$ (5,423)
Increase in taxes resulting from:			
State income taxes (net of federal effect)	985	1,196	1,058
Amortization of the excess cost over net assets acquired	159	1,733	2,477
Other, net	262	(148)	391
Provision for income taxes	$ 9,616	$ 10,194	$ (1,497)

Temporary differences and carryforwards which give rise to deferred tax assets and liabilities as of December 31, 1999 and 2000 are as follows:

	1999	2000
Deferred Tax Liabilities:		
Book basis in excess of tax	$ 903	$ 903
Depreciation and amortization	12,407	24,685
Debt issue costs	732	640
Other	---	300
	14,042	26,528
Deferred Tax Assets:		
Net operating loss	284	1,979
Accrued expenses	5,090	7,370
Reserve for bad debts	5,055	9,098
Inventory capitalization and reserves	1,633	2,093
Acquisition costs	277	---
	12,339	20,540
Net deferred tax liabilities	$ (1,703)	$ (5,988)

For Federal tax purposes at December 31, 2000, the Company has available approximately $5.6 million of net operating loss carryforwards expiring in the year 2020.

NOTE J - DEFERRED COMPENSATION

In conjunction with the acquisition of J.E. Hanger, Inc. of Georgia ("JEH") in 1996, the Company assumed the unfunded deferred compensation plan that had been established for certain key JEH officers. The plan accrues benefits ratably over the period of active employment from the time the contract is entered into to the time the participant retires. Participation had been determined by JEH's Board of Directors. The Company has purchased individual life insurance contracts with respect to each employee covered by this plan. The Company is the owner and beneficiary of the insurance contracts. The accrual related to the deferred compensation arrangements amounted to approximately $2.1 million and $2.0 million at December 31, 1999 and 2000, respectively.

NOTE K - COMMITMENTS AND CONTINGENT LIABILITIES

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

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

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

We believe that the allegations have absolutely no merit and plan to vigorously defend the lawsuit.

NOTE L - OPERATING LEASES

The Company leases office space under noncancellable operating leases. Future minimum rental payments, by year and in the aggregate, under operating leases with terms of one year or more consist of the following at December 31, 2000:

2001	$ 24,284
2002	17,959
2003	14,061
2004	10,120
2005	7,005
Thereafter	10,994
	$ 84,423

Rent expense was approximately $6,283, $14,821 and $23,716 for the years ended December 31, 1998, 1999 and 2000, respectively.

NOTE M - PENSION AND PROFIT SHARING PLANS

Previously the Company had a separate defined contribution profit sharing and 401(k) plan ("JEH Plan") covering all the employees of JEH, a wholly-owned subsidiary of the Company acquired November 1, 1996. On this date, the Company froze the JEH Plan such that no new employees of JEH were able to participate. On January 1, 1998 the JEH Plan was merged into the Company's 401(k) Savings and Retirement Plan.

Hanger acquired NovaCare O&P in July 1999. The NovaCare O&P employees were allowed to participate in a 401(k) plan with NovaCare, Inc.

The NovaCare O&P employee assets were transferred to Hanger's 401(k) fund manager in August 1999. The funds were transferred by executing a partial plan merger. The NovaCare O&P employees were able to continue making 401(k) contributions and were able to change their investment allocations.

The Company maintains a 401(k) Savings and Retirement plan to cover all of the employees of the Company. The Company may make discretionary contributions. Under this 401(k) plan, employees may defer such amounts of their compensation up to the levels permitted by the Internal Revenue Service. During 1999 and 2000, the Company made contributions of $923.0 and $1.4 million to this plan, respectively.

NOTE N - REDEEMABLE PREFERRED STOCK

The Company has 10.0 million authorized shares of preferred stock, par value $.01 per share, which may be issued in various classes with different characteristics.

During 1999, the Mandatorily Redeemable Preferred Stock Class F, of which no shares had been issued, was retired. The Company issued $60.0 million of 7% Redeemable Preferred Stock on July 1, 1999 in connection with our acquisition of NovaCare O&P. The 60.0 million outstanding shares of 7% Redeemable Preferred Stock are convertible into shares of our non-voting common stock at a price of $16.50 per share, subject to adjustment. The Company is entitled to require that the 7% Redeemable Preferred Stock be converted into non-voting common stock on and after July 2, 2002, if the average closing price of the common stock for 20 consecutive trading days is equal to or greater than 175% of the conversion price. The 7% Redeemable Preferred Stock will be mandatorily redeemable on July 1, 2010 at a redemption price equal to the liquidation preference plus all accrued and unpaid dividends. In the event of a change in control of our company, we must offer to redeem all of the outstanding 7% Redeemable Preferred Stock at a redemption price equal to 101% of the sum of the per share liquidation preference thereof plus all accrued and unpaid dividends through the date of payment. The 7% Redeemable Preferred Stock accrues annual dividends, compounded quarterly, equal to 7%, is subject to put rights and will not require principal payments prior to maturity on July 1, 2010.

NOTE O - WARRANTS AND OPTIONS

Warrants

In November 1996, the Company issued warrants for 1.6 million shares of Common Stock to the holders of certain notes. In August 1997, the Company repaid these notes with the proceeds from a public offering. In accordance with the note agreement, warrants for 880,000 shares were terminated. The remaining warrants for 720,000 shares provide that the noteholders may purchase 418,400 shares and 301,600 shares for $4.01 and $6.375, respectively. The warrants are exercisable through November 1, 2004. In November 1998, 150,800 warrants were exercised which resulted in the issuance of 105,800 shares. Also, in November 1998, warrants for 209,200 shares were exercised which resulted in the issuance of 169,900 shares.

At December 31, 2000, warrants to purchase 830,650 shares at prices ranging from $2.44 to $7.65 per share were outstanding.

Options

Under the Company's 1991 Stock Option Plan ("SOP"), 8.0 million shares of Common Stock are authorized for issuance under options that may be granted to employees. The number of shares available for grant at December 31, 1999 and 2000 was 4.5 million and 3.1 million, respectively. Under the SOP, options may be granted at an exercise price not less than the fair market value of the Common Stock on the date of grant. Vesting and expiration periods are established by the Compensation Committee of the Board of Directors and generally vest three years following grant and generally expire eight to ten years after grant.

Under the Company's 1993 Non-Employee Director Stock Option Plan, 250,000 shares of Common Stock are authorized for issuance to directors of the Compan who are not employed by the Company or any affiliate of the Company. Under this plan, an option to purchase 5,000 shares of Common Stock is granted automatically on an annual basis to each eligible director on the third business day following the date of each Annual Meeting of Stockholders of the Company at which the eligible director is elected. The exercise price of each option is equal to 100% of the fair market value of the Common Stock on the date of grant. Each option vests at the rate of 25% each year for the first four years after the date of grant of the option and each such option expires ten years from the date of grant; provided, however, that in the event of termination of a director's service other than by reason of total and permanent disability or death, then the outstanding options of such holder expire three months after such termination. Outstanding options remain exercisable for one year after termination of service by reason of total and permanent disability or death. The number of shares that remain available for grant at December 31, 1999 and 2000 were 76.3 and 49.5, respectively.

In addition to the SOP, non-qualified options may be granted with exercise prices that are less than the current market value. Accordingly, compensation expense for the difference between current market value and exercise price is recorded over the vesting period.

The following is a summary of option transactions and exercise prices:

	STOCK OPTION PLAN			NON-EMPLOYEE DIRECTOR STOCK OPTION PLAN		
	Shares	Price Per Share	Weighted Average	Shares	Price Per Share	Weighted Average
Outstanding at December 31, 1997	1,556,383	$ 2.75 to $ 13.25	7.42	200,625	$ 3.00 to $ 12.00	7.27
Granted	258,750	$ 13.31 to $ 22.50	19.78	35,000	$ 18.63	18.63
Terminated	(57,424)	$ 4.13 to $ 17.38	10.32	(9,000)	$ 3.00 to $ 8.75	6.28
Exercised	(302,476)	$ 2.75 to $ 12.25	5.68	(57,750)	$ 4.38 to $ 12.00	11.05
Outstanding at December 31, 1998	1,455,233	$ 2.75 to $ 22.50	9.88	168,875	$ 3.00 to $ 18.63	8.38
Granted	1,225,000	$ 10.25 to $ 20.81	14.72	35,000	$10.25 to $ 20.81	14.70
Terminated	(28,424)	$ 4.13 to $ 22.50	13.01	(42,500)	$ 3.00 to $ 18.63	6.92
Exercised	(229,621)	$ 2.75 to $ 13.25	6.94	(625)	$ 6.52	6.52
Outstanding at December 31, 1999	2,422,188	$ 2.75 to $ 22.50	12.57	160,750	$ 3.00 to $ 20.81	10.00
Granted	1,304,497	$ 4.63 to $ 5.19	4.63	35,000	$ 5.19	5.19
Terminated	(568,492)	$ 4.13 to $ 22.50	8.26	(8,250)	$ 6.00	6.00
Outstanding at December 31, 2000	3,158,193	$ 2.75 to $ 22.00	9.54	187,500	$ 3.00 to $ 18.63	9.40
Vested at December 31, 2000	1,188,951			105,000		

The Company applies APB Opinion 25 "Accounting for Stock Issued to Employees", and related Interpretations in accounting for its plans. Historically, the Company granted stock options at exercise prices equal to the fair market value of the stock on the date of grant for fixed stock options. Accordingly, no compensation cost has been recognized for its fixed stock option plans. Had compensation cost for the Company's stock-based compensation plans been determined based on the fair value at the grant dates for awards under those plans consistent with the method set forth in SFAS 123, "Accounting for Stock-Based Compensations," the Company's net income and earnings per share would have been reduced to the unaudited pro forma amounts indicated below:

		1998	1999	2000
Net Income:	As reported	$ 13,840	$ 10,986	$ (13,996)
	Pro Forma	12,433	7,731	(19,558)
Diluted Income Per Common Share:				
	As reported	0.75	$ 0.44	$ (0.98)
	Pro Forma	$ 0.67	$ 0.28	$ (1.27)

The fair value for these options was estimated at the date of grant using a Black-Scholes option pricing model with the following weighted average assumptions for 1998, 1999 and 2000:

	1998	1999	2000
Expected term	5	5	5
Volatility factor	59%	46%	58%
Risk free interest rate	5.1%	5.7%	6.7%
Dividend yield	0%	0%	0%
Fair value	$ 10.87	$ 7.00	$ 2.64

The following table summarizes information concerning outstanding and exercisable options as of December 31, 2000:

	OPTIONS OUTSTANDING			OPTIONS EXERCISABLE	
Range of Exercise Prices	**Number of Options and Awards**	**Weighted Average Remaining Life (Years)**	**Weighted Average Exercise Price**	**Number of Options and Awards**	**Weighted Average Exercise Price**
$ 2.810 to $ 3.500	59,908	4.85	$ 3.24	59,908	$ 3.24
$ 4.125 to $ 4.125	34,589	5.22	$ 4.13	34,589	$ 4.13
$ 4.375 to $ 6.000	1,320,510	8.71	$ 4.75	122,512	$ 5.85
$ 6.125 to $ 6.125	396,773	5.88	$ 6.13	371,773	$ 6.13
$ 6.250 to $ 6.250	5,000	2.70	$ 6.25	5,000	$ 6.25
$ 8.500 to $ 8.750	28,334	6.42	$ 8.72	22,084	$ 8.71
$10.250 to $12.500	252,539	6.79	$ 11.34	233,664	$ 11.34
$13.250 to $13.875	120,375	6.88	$ 13.35	81,700	$ 13.34
$14.000 to $14.750	723,750	8.46	$ 14.35	188,440	$ 14.35
$16.500 to $18.625	234,915	8.14	$ 16.89	89,115	$ 17.02
$20.000 to $22.500	169,000	7.96	$ 22.22	85,166	$ 22.27
$ 2.810 to $22.500	3,345,693	7.90	$ 9.53	1,293,951	$ 10.36

NOTE P - SEGMENT AND RELATED INFORMATION

Using the guidelines set forth in SFAS No. 131, "Disclosures about Segments of an Enterprise and Related Information", the Company has identified three reportable segments in which it operates based on the products and services it provides. The Company evaluates segment performance and allocates resources based on the segments' EBITDA. "EBITDA" is defined as income from operations before depreciation and amortization. EBITDA is not a measure of performance under Generally Accepted Accounting Principles ("GAAP"). While EBITDA should not be considered in isolation or as a substitute for net income, cash flows from operating activities and other income or cash flow statement data prepared in accordance with GAAP, or as a measure of profitability or liquidity, management understands that EBITDA is customarily used as a criteria in evaluating heath care companies. Moreover, substantially all of the Company's financing agreements contain covenants in which EBITDA is used as a measure of financial performance. EBITDA is presented for each reported segment before reclassifications between EBITDA and other income (expense) made for external reporting purposes.

The reportable segments are: (i) practice management and patient-care centers; (ii) manufacturing; and (iii) distribution. These are described further below:

Practice Management and Patient-Care Centers – This segment consists of the Company's owned and operated O&P patient-care centers as well as OPNET. The patient-care centers provide services to design and fit orthotic and prosthetic devices to patients. These centers also instruct patients in the use, care and maintenance of the devices. OPNET is a national managed care agent for O&P services and a patient referral clearing house.

Manufacturing – This segment consists of the manufacture and fabrication of O&P components and finished patient-care products for both the O&P industry and the Company's own patient-care practices.

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

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

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

	Practice Management And Patient Care Centers	Manufacturing	Distribution	Other	Total
2000					
Net Sales					
Customers	$ 447,470	$ 9,562	$ 28,999	$ ---	$ 486,031
Intersegments	---	15,103	51,427	(66,530)	---
EBITDA	75,446	(3,474)	6,683	(21,511)	57,144
Total assets	493,418	11,255	20,823	236,322	761,818
Capital Expenditures	6,017	1,234	114	2,480	9,845
1999					
Net Sales					
Customers	$ 307,477	$ 10,263	$ 29,086	$ ---	$ 346,826
Intersegments	---	6,050	37,416	(43,466)	---
EBITDA	65,248	485	8,002	(9,628)	64,107
Total assets	142,462	15,689	16,296	575,634	750,081
Capital Expenditures	7,312	1,573	423	3,290	12,598
1998					
Net Sales					
Customers	$ 152,276	$ 8,548	$ 27,046	$ ---	$ 187,870
Intersegments	---	2,576	18,684	(21,260)	---
EBITDA	32,351	433	4,174	(6,451)	30,507
Total assets	57,945	8,947	9,796	129,260	205,948
Capital Expenditures	1,698	576	232	353	2,859

The following table reconciles each reportable segment's EBITDA to consolidated income before income taxes:

	Practice Management And Patient Care Centers	Manufacturing	Distribution	Other	Total
2000					
EBITDA	$ 75,446	$ (3,474)	$ 6,683	$ (21,511)	$ 57,144
Restructuring Costs and Integration Expense	(1,047)	(13)	(6)	(1,298)	(2,364)
Depreciation and Amortization	(19,868)	(2,065)	(300)	(1,095)	(23,328)
Interest expense, net	(50,423)	(28)	0	3,379	(47,072)
Other income (expense)	(164)	309	(6)	(12)	127
Income before taxes	$ 3,944	$ (5,271)	$ 6,371	$ (20,537)	$ (15,493)
1999					
EBITDA	$ 65,248	$ 485	$ 8,002	$ (9,628)	$ 64,107
Restructuring Costs and Integration Expense	(5,763)	(430)	(60)	(87)	(6,340)
Depreciation and Amortization	(11,925)	(1,640)	(187)	(306)	(14,058)
Interest expense, net	(2,003)	(17)	(2)	(20,155)	(22,177)
Other income (expense)	(153)	(88)	6	(117)	(352)
Income before taxes	$ 45,404	$ (1,690)	$ 7,759	$ (30,293)	$ 21,180
1998					
EBITDA	$ 32,351	$ 433	$ 4,174	$ (6,451)	$ 30,507
Depreciation and Amortization	(4,321)	(1,009)	(270)	(182)	(5,782)
Interest expense, net	(1,538)	(48)	6	(322)	(1,902)
Other income (expense)	508	(76)	475	(274)	633
Income before taxes	$ 27,000	$ (700)	$ 4,385	$ (7,229)	$ 23,456

The following table presents the details of "Other" EBITDA for the years ended December 31:

	1998	1999	2000
Corporate general and administrative expenses	$ 6,399	$ 9,549	$ 21,511
Other	52	79	---
	$ 6,451	$ 9,628	$ 21,511

The following table presents the details of "Other" total assets at December 31:

	1998	1999	2000
Corporate intercompany receivable from Practice Management and Patient-Care Centers segment	$ 93,713	$ 533,978	$ 159,416
Corporate intercompany receivable from Manufacturing segment	20,217	16,277	21,926
Corporate intercompany receivable from Distribution segment	3,788	1,469	(588)
Other	11,542	23,910	55,568
	$ 129,260	$ 575,634	$ 236,322

"Other" total assets presented in the preceding table primarily consist of corporate cash and deferred taxes not specifically identifiable to the reportable segments.

The Company's foreign and export sales and assets located outside of the United States are not significant. Additionally, no single customer accounted for more than 10% of revenues in 1998, 1999 or 2000.

REPORT OF INDEPENDENT ACCOUNTANTS

To the Board of Directors and Shareholders of Hanger Orthopedic Group, Inc:

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of operations, changes in shareholders' equity and cash flows present fairly, in all material respects, the financial position of Hanger Orthopedic Group, Inc. and its subsidiaries at December 31, 1999 and 2000, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2000 in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Company's management; our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States of America, which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

PricewaterhouseCoopers LLP

Philadelphia, Pennsylvania
March 28, 2001

MARKET FOR REGISTRANT'S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

Our common stock has been listed and traded on the New York Stock Exchange since December 15, 1998, under the symbol "HGR." The following table sets forth the high and low intra-day sale prices for the common stock for the periods indicated as reported on the New York Stock Exchange:

Year Ended December 31, 1999	High	Low
First Quarter	$ 27.50	$ 12.00
Second Quarter	19.44	12.38
Third Quarter	15.00	10.50
Fourth Quarter	15.50	8.75

Year Ended December 31, 2000	High	Low
First Quarter	$ 10.3125	$ 3.7500
Second Quarter	5.5000	3.7500
Third Quarter	4.8750	3.2500
Fourth Quarter	4.1875	0.9375

At March 29, 2001, there were approximately 807 holders of record of the Company's Common Stock.

DIVIDEND POLICY

We have never paid cash dividends on our common stock and intend to continue this policy for the foreseeable future. We plan to retain earnings for use in our business. The terms of our agreements with our financing sources and certain other agreements prohibit the payment of dividends on our common stock and preferred stock and such agreements will continue to prohibit the payment of dividends in the future. Any future determination to pay cash dividends will be at the discretion of our Board of Directors and will be dependent on our results of operations, financial condition, contractual and legal restrictions and any other factors deemed to be relevant.

CORPORATE INFORMATION

Independent Accountants
PricewaterhouseCoopers LLP
Two Commerce Square
2001 Market Street
Philadelphia, PA 19103

Legal Counsel
Foley & Lardner
3000 K Street, NW
Washington, DC 20007

Annual Report on Form 10-K for year ended December 31, 2000
The company reports annually to the Securities and Exchange commission on Form 10-K. Stockholders may obtain a copy at no charge upon written request to:

Dennis T. Currier, Chief Financial Officer
Hanger Orthopedic Group, Inc.
Two Bethesda Metro Center, Suite 1200
Bethesda, MD 20814

Annual Meeting of Shareholders
May 31, 2001 at 10:00 a.m.
Hyatt Regency Bethesda Hotel
One Bethesda Metro Center
Bethesda, MD 20814
All shareholders are welcome to attend

Common Stock
The company's common stock is traded on the New York Stock Exchange. The ticker symbol is HGR.

Transfer Agent
Chase Mellon Shareholders Service, LLC
P.O. Box 3315
South Hackensack, NJ 07606-1915
ATTN: Shareholder Services
www.chasemellon.com

Shareholder Inquiries
Communications concerning transfer requirements, lost certificates and change of address should be directed to the Transfer Agent.

Corporate Headquarters
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BOARD OF DIRECTORS

Ivan R. Sabel, CPO
Chairman of the Board, President and
Chief Executive Officer
Hanger Orthopedic Group, Inc.

Mitchell Blutt, M.D.
Executive Partner
J.P. Morgan Partners LLC

Edmond E. Charrette, M.D.
Partner
Latin Healthcare Fund

Thomas P. Cooper, M.D.
Chief Executive Officer
Senior Psychology Services
Adjunct Professor
Columbia Business School

Robert J. Glaser, M.D.
Bio-Medical Consultant
Professor of Medicine Emeritus
Stanford University

C. Raymond Larkin, Jr.
Principal
3xNell, and
Managing Director
Group Outcome

Risa J. Lavizzo-Mourey, M.D., M.B.A.
Professor of Medicine
University of Pennsylvania
School of Medicine

Brigadier General William L. McCulloch*
(USMC Retired)
President
Association Communication and
Marketing Services

H.E. "Ted" Thranhardt, CPO
Former President and
Chief Executive Officer
J.E. Hanger of Georgia, Inc.

* Brg. General McCulloch resigned on April 2, 2001 and Eric Green, a partner of J.P. Morgan Partners LLC, was appointed to fill the vacancy.

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Phone 301.986.0701 Fax 301.986.0702 **www.hanger.com**