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CAUTIONARY STATEMENT REGARDING FORWARD LOOKING STATEMENTS

The following Quarterly Report on Form 10-Q contains various "forward looking statements" within the meaning of federal securities laws. These forward looking statements represent management's expectations or beliefs concerning future events, including statements regarding anticipated product introductions; changes in markets, customers and customer order rates; changes in third party reimbursement rates; expenditures for research and development; growth in revenue; taxation levels; and the effects of pricing decisions. When used in this 10-Q, the words "anticipate," "believe," "expect," "estimate" and similar expressions are generally intended to identify forward-looking statements. These and other forward looking statements made by the Company must be evaluated in the context of a number of factors that may affect the Company's financial condition and results of operations, including, but not limited to, the following:

- The Company acquired two businesses during the year ended June 30, 1999 and a third in July 1999. Although integration of those businesses has been substantially completed without significant problems, complete integration may not be concluded as smoothly as anticipated and the Company may discover issues with respect to acquired businesses of which it was unaware.
- Like many medical device companies, the Company has a large balance of uncollected receivables. If it cannot collect an amount of receivables that is consistent with historical collection rates, it might be required to charge off a portion of uncollected receivables, significantly impacting earnings.
- The Company has incurred a significant amount of indebtedness to finance acquired businesses. The interest expense on such indebtedness reduces earnings and could cause the Company to be short of cash if its operations do not meet expectations.
- In the United States, the Company's products and services are frequently reimbursed by private and public insurers that impose limits on reimbursement and strict rules on applications for reimbursement. Changes in the rates, eligibility or requirements for reimbursement, or failure to comply with reimbursement requirements, could cause a reduction in earnings or fines or both.
- The Company maintains significant amounts of inventory on consignment at clinics for distribution to patients. It may not be able to completely control losses of this inventory and if inventory losses are not consistent with historical experience, the Company might be required to write off a portion of the carrying value of inventory.
- The clinical effectiveness of the Company's electrotherapy products has periodically been challenged. Publicity about the effectiveness of electrotherapy for pain relief or other clinical applications could negatively impact sales and earnings.
- The Company formed a subsidiary in the United Kingdom in fiscal 1999 and acquired a Swiss company in the first quarter of fiscal 2000. These European operations may be more difficult to supervise, and may be subject to different economic influences than United States operations, and may subject the Company to significant exposure from currency fluctuations.

PART I - FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

Included herein is the following unaudited condensed financial information:

Consolidated Balance Sheets as of December 31, 2000 and June 30, 2000

Consolidated Statements of Operations for the three months and six months ended December 31, 2000 and 1999

Consolidated Statements of Cash Flows for the six months ended December 31, 2000 and 1999

Notes to Consolidated Financial Statements

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	December 31, 2000

ASSETS	

CURRENT ASSETS:	
Cash and cash equivalents	\$ 1,510,881
Receivables, less reserve for uncollectible accounts of \$6,901,609 and \$6,575,715	18,990,756
Inventories -	
Raw materials	1,784,501
Work in process	45,962
Finished goods	6,264,970
Deferred tax assets	3,351,294
Prepaid expenses	1,885,131

Total current assets	33,833,495

PROPERTY, PLANT AND EQUIPMENT:	13,508,132
Less accumulated depreciation	(8,072,224)

Net property, plant and equipment	5,435,908

Intangible assets, net	11,804,164
Deferred tax assets	218,669
Other assets	442,882

	\$ 51,735,118
	=====
LIABILITIES AND STOCKHOLDERS' EQUITY	

CURRENT LIABILITIES:	
Current maturities of long-term debt	\$ 2,162,277
Note payable	400,000
Accounts payable	2,921,345
Medicare lawsuit payable	1,588,510
Accrued liabilities -	
Payroll	397,061
Commissions	283,041
Income taxes	1,023,962
Other	2,688,377

Total current liabilities	11,464,573
LONG-TERM LIABILITIES:	
Long term-debt	11,785,850
Deferred tax liabilities	766,256

Total liabilities	24,016,679

STOCKHOLDERS' EQUITY	
Common stock, \$.10 par value: 25,000,000 shares authorized; issued and outstanding 10,764,487 and 10,558,710 shares, respectively	1,076,449
Preferred stock, no par value; 5,000,000 shares authorized; none	

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issued and outstanding	-----
Additional paid-in capital	21,367,816
Less note receivable from officer/stockholder	(210,417)
Accumulated other non-owner changes in equity	(164,754)
Retained earnings	5,649,345

Total stockholders' equity	27,718,439

	\$ 51,735,118
	=====

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REHABILICARE INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS

	Three Months Ended December 31		
	2000	1999	
	-----	-----	-----
Net sales and rental revenue	\$15,028,717	\$14,778,144	\$ 3
Cost of sales and rentals	4,646,357	4,107,485	
	-----	-----	---
Gross profit	10,382,360	10,670,659	2
Operating expenses:			
Selling, general and administrative	8,047,110	7,677,079	1
Research and development	481,563	353,071	
	-----	-----	---
	8,528,673	8,030,150	1
	-----	-----	---
Income from operations	1,853,687	2,640,509	
Other income (expense):			
Interest expense	(333,821)	(404,281)	
Other income (expense)	16,219	(84,331)	
Minority interest	---	11,931	
Gain on sale of building	---	---	
	-----	-----	---
Income before income taxes	1,536,085	2,163,828	
Provision for income taxes	714,000	932,000	
	-----	-----	---
Net income	\$ 822,085	\$ 1,231,828	\$
	=====	=====	=====
Net income per common and common equivalent share			
Basic	\$ 0.08	\$ 0.12	\$

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Diluted	=====	=====	=====
	\$ 0.08	\$ 0.12	\$
	=====	=====	=====
Weighted average number of shares outstanding			
Basic	10,764,487	10,546,701	1
	=====	=====	=====
Diluted	10,778,078	10,705,843	1
	=====	=====	=====

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REHABILICARE INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS

		Six D

		2000

OPERATING ACTIVITIES:		
Net income		\$ 1,944,263
Adjustments to reconcile net income to net cash provided by (used in) operating activities		
Gain on sale of building		---
Depreciation and amortization		1,283,935
Change in long-term portion of deferred taxes		187,583
Minority interest		---
Change in current assets and liabilities, excluding effects of business combinations		
Receivables		277,495
Inventories		341,222
Prepaid expenses		(789,613)
Accounts payable		(187,169)
Accrued liabilities		(771,045)

Net cash provided by operating activities		2,286,671

INVESTING ACTIVITIES:		
Purchases of property and equipment		(235,929)
Cash paid in asset acquisition, net of cash received		---
Proceeds from sale of building		---
Change in other assets, net		(625,992)

Net cash used in investing activities		(861,921)

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FINANCING ACTIVITIES:

Proceeds from new financing	---
Principal payments on long-term obligations	(1,885,157)
Proceeds from (payments on) line of credit, net	(800,000)
Payment of finance obligation	---
Proceeds from issuance of restricted stock grants and exercise of stock options	455,000
Proceeds from issuance of employer stock purchase	59,657

Net cash provided by (used in) financing activities	(2,170,500)

Effect of exchange on cash and cash equivalents	29,279

Net increase (decrease) in cash and cash equivalents	(716,471)

CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	2,227,352

CASH AND CASH EQUIVALENTS AT END OF PERIOD	\$ 1,510,881
	=====
SUPPLEMENTAL CASH FLOW INFORMATION	
Interest paid	\$ 712,708
	=====
Income taxes paid	\$ 1,653,728
	=====

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REHABILICARE INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2000

1. ACCOUNTING POLICIES

The amounts set forth in the preceding financial statements are unaudited as of and for the periods ended December 31, 2000 and 1999 but, in the opinion of management, reflect all adjustments (consisting only of normal recurring adjustments) necessary for a fair statement of the results for the periods presented. Such results are not necessarily indicative of results for the full year. The significant accounting policies and certain financial information which are normally included in financial statements prepared in accordance with generally accepted accounting principles, but which are not required for interim reporting purposes, have been omitted. The accompanying financial statements of the Company should be read in conjunction with the audited consolidated financial statements for the year ended June 30, 2000, included in the Company's Annual Report on Form 10-K.

Certain previously reported amounts have been reclassified to conform to classifications adopted in fiscal year 2001. These reclassifications had no effect on net income, cash flows or shareholders' equity.

2. BUSINESS COMBINATIONS

On July 16, 1999, the Company acquired substantially all the assets of Complex SA, a Swiss-based medical products company for cash of approximately \$11.0

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million. The acquisition was financed principally with debt and provided for additional contingent consideration of up to \$2 million based on the performance of Compex through December 31, 2000. In connection with the acquisition, the purchase consideration and transaction costs were allocated as follows:

Net assets acquired	\$	1,612,085
Goodwill		9,060,772
Developed technology		1,400,000
Existing workforce		1,400,000
Debt structuring costs		346,970

	\$	13,819,827
		=====

Included in goodwill is a contingent payment of \$1,777,185 made during fiscal 2000 to the former Compex shareholders. The final contingent payment of \$222,815 was accrued at December 31, 2000 and will be paid in March 2001. That amount is also included in goodwill and will be amortized beginning in January 2001.

3. NOTE PAYABLE AND LONG TERM DEBT

In conjunction with its acquisition of Compex SA, the Company entered into a new \$20,000,000 credit facility which provides for both term and revolving borrowings at varying rates based either on the bank's prime rate or LIBOR. The initial term loan of \$15,000,000 was used to fund the acquisition and repay the balance of a note and a revolving loan provided under a credit facility with another bank.

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Borrowings under the credit facility are secured by substantially all assets of the Company other than those pledged as collateral on existing lease or mortgage obligations. The interest rate on the term loan was 8.99% at December 31, 2000. There were borrowings of \$400,000 under the revolving line of credit as of December 31, 2000, and had a weighted average interest rate of 9.5%.

The Company was in compliance with all financial covenants in its credit agreement as of December 31, 2000 and for the period then ended.

4. SEGMENT INFORMATION

Rehabilitcare and its consolidated subsidiaries operate their business in one reportable segment, the manufacture and distribution of electromedical pain management and rehabilitation products. The Company's chief operating decision makers use consolidated results to make operating and strategic decisions. Net revenue from the United States and foreign sources (primarily Europe) are as follows:

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	For the Six Months Ended December 31	
	2000	1999
United States revenue	\$ 21,692,082	\$ 21,023,638
Foreign revenue	8,404,282	7,630,718
	<u>\$ 30,096,364</u>	<u>\$ 28,654,356</u>

Net revenue by product line was as follows:

	For the Six Months Ended December 31	
	2000	1999
Rehabilitation products	\$ 6,139,659	\$ 5,893,597
Pain management	6,990,371	7,117,778
Consumer Products	5,997,539	5,334,690
Accessories and supplies	10,968,795	10,308,291
	<u>\$ 30,096,364</u>	<u>\$ 28,654,356</u>

During the first six months of fiscal 2001, one customer accounted for approximately 15% of total consolidated revenue. This customer represented approximately 4% of total accounts receivable at December 31, 2000.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

OVERVIEW

The Company designs, manufactures and distributes electrotherapy products used for pain management, rehabilitation and training. Its products are used in clinical, home health care, sports medicine and occupational medicine

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applications. It also distributes other medical products used in related applications. The Company operates in one business segment, distributing its products through sales to medical product dealers and distributors, sport shops and, in the United States, through direct rental or sale to patients.

The direct rental or sale approach involves placing electrotherapy units with physicians, physical therapists and other health care providers who then refer those units to patients after determining an appropriate treatment regimen. Units are left on consignment with the health care providers for such referral. The Company then bills the patient or the patient's insurance carrier directly after being notified that a unit has been prescribed and provided to the patient. The Company takes responsibility for subsequent patient follow-up, including extension of the rental period, sale of the unit, if appropriate, and sale of additional supplies required for continued use of the electrotherapy units. This distribution approach requires the Company to maintain significant investments in inventories and receivables.

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RESULTS OF OPERATIONS

The following table sets forth information from the statements of operations as a percentage of revenue for the periods indicated:

	Three Months Ended December 31		Six Months En December 31
	2000	1999	2000
Net sales and rental revenue	100.0%	100.0%	100.0%
Cost of sales and rentals	(30.9)	(27.8)	(31.2)

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Gross profit	69.1	72.2	68.8
Operating expenses -			
Selling, general and administrative	(53.6)	(51.9)	(52.4)
Research and development	(3.2)	(2.4)	(2.8)
Total operating expenses	(56.8)	(54.3)	(55.2)
Income from operations	12.3	17.9	13.6
Other income (expense), net	(2.0)	(3.3)	(2.2)
Gain on sale of building	---	---	---
Income tax provision	(4.8)	(6.0)	(4.9)
Net income	5.5	8.6	6.5

Revenue was \$15,029,000 for the second quarter of fiscal 2001, a 2% increase from \$14,778,000 for the second quarter of fiscal 2000. Revenue for the six months ended December 31, 2000 increased 5% to \$30,096,000 from \$28,654,000 in the first six months of fiscal 1999. The increase was primarily attributable to United States operations where revenue increased 6% in the second quarter and 11% for the first six months of fiscal 2001 over the same period in fiscal 2000. The Company continues its recovery from the impact of a whistleblower lawsuit disclosed in the third quarter of fiscal 2000, which adversely impacted earnings growth during the last half of fiscal 2000. Compex accounted for \$3,822,000 of revenue in the second quarter and \$7,856,000 for the first six months of fiscal 2001, compared to \$4,043,000 in the second quarter and \$7,019,000 for the first six months of fiscal 2000. Revenue from Compex was lower than expected in the second quarter of fiscal 2001 due mainly to poor weather in Europe during November and December that impacted consumer retail sales.

Gross profit was \$10,383,000 or 69.1% of revenue in the second quarter and \$20,701,000 or 68.8% of revenue for the first six months of fiscal 2001 compared with \$10,671,000 or 72.2% of revenue in the second quarter and \$19,948,000 or 69.6% of revenue for the first six months of fiscal 2000. Cost of sales in the first quarter of fiscal 2000 included a one-time charge of \$645,000 related to the step-up in basis of inventory recorded in connection with the Compex acquisition. Without that charge, gross profit would have been 71.5% of revenue for the six months. The current year reduction in gross profit resulted

primarily from increased focus on sales of Compex sport products through retail store outlets, rather than direct to consumers, in order to expand market penetration.

Selling, general and administrative expenses increased 5% to \$8,048,000 in the second quarter of fiscal 2001 from \$7,677,000 in fiscal 2000. As a percent of revenue, those expenses increased from 52% to 54%. For the six months ended December 31, 2000, those expenses increased 5% to \$15,765,000 from \$15,004,000 in fiscal 2000, but stayed the same as a percentage of revenue at 52%. That increase is primarily attributable to an increase in the provision for

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uncollectible accounts receivable to reflect actual collection experience.

Research and development expense increased 36% to \$482,000 in the second quarter of fiscal 2001, compared with \$353,000 in fiscal 2000. For the six months ended December 31, 2000, these costs increased 38% to \$840,000 compared to \$607,000 in fiscal 2000. Those increases reflect expanded new product development activities.

Interest expense decreased slightly from \$750,000 in the first six months of fiscal 2000 to \$713,000 in the current period. The decrease resulted from slightly lower interest rates and lower outstanding borrowings under the Company's revolving line of credit.

Operating results for the first six months of fiscal 2000 include a gain on the sale of the former Staodyn building in Longmont, Colorado in the amount of \$1,076,000. The Company exercised its option to purchase that building in the first quarter of fiscal 1999 and closed the purchase and the subsequent sale on July 7, 1999.

The provision for income taxes was increased from 40% of income before taxes in the first quarter of fiscal 2001 to 43% for the six months ended December 31, 2000, compared with 41% and 42%, respectively, in the prior year. The Company now operates in various countries in Europe as well as the United States. Some countries have higher tax rates than the United States as well as different rules on the deductibility of certain expenses and the availability of certain credits for taxes paid to other jurisdictions. In addition, the Company has relocated certain operations and negotiated new agreements with certain European taxing authorities. The Company believes that 43% is a reasonable estimate of the effective rate for fiscal 2001 based on most recent estimates of expected sources of revenue and expenses for the entire year.

As a result of all the above changes, net income decreased from \$1,232,000 in the second quarter of fiscal 2000 to \$822,000 in the second quarter of fiscal 2001. For the six months ended December 31, 2000 net income decreased to \$1,944,000 from \$2,666,000 during the same period in fiscal 2000. Diluted earnings per share decreased from \$.12 to \$.08 for the second quarter and \$.25 to \$.18 for the six month period. Before the one time gain related to the building sale and the one time charge related to the Compex inventory step-up, net income was \$2,462,000 of \$.23 per share for the first six months of fiscal 2000.

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During the six months ended December 31, 2000, the Company's operations provided cash of \$2,287,000, mainly from net income and a reduction in inventory and accounts receivable of \$341,000 and \$277,000, respectively. These amounts were offset by an increase in prepaid expenses of \$790,000 and decreases of \$187,000 in accounts payable and \$771,000 in accrued liabilities.

The Company used \$862,000 in investing activities in the first six months of fiscal 2001 for net purchases of property and equipment and a net increase in clinical and rental equipment.

The Company's financing activities used \$2,171,000 of cash during the first six months of fiscal 2001, mainly for the repayment of debt on the \$20,000,000 credit facility used to finance the Compex acquisition. The Company initially borrowed \$15,000,000 under the credit facility to finance the Compex purchase and to repay an outstanding note. At December 31, 2000, \$11,697,000 is outstanding under the facility.

Managing receivables represents one of the biggest business challenges to the Company. The process of determining what products will be reimbursed by third party payors and the amounts to be paid for those products is very complex and the reimbursement environment is constantly changing. That risk is spread across many payors throughout the United States. The determination of an appropriate reserve for uncollectible accounts at the end of each reporting period includes various factors including historical trends and relationships and experience with insurance companies or other third party payors. As discussed in the Form 10-Q for the third quarter ended March 31, 2000, the Medicare whistleblower suit disclosed in early February 2000 adversely affected morale and productivity in the Company's patient support operations. Careful evaluation of that situation and the nature of remaining receivables at June 30, 2000 led management to conclude that an additional \$1,000,000 should be provided for uncollectible accounts. The Company believes that the reserve at December 31, 2000 is adequate to cover future losses on its receivables based on collection history and trends. The provision for uncollectible accounts recorded in the income statement may continue to fluctuate significantly from quarter to quarter as such trends change. The reserve was 26.7% of receivables at December 31, 2000 compared to 25.4% at June 30, 2000. The Company believes that the ratio will be favorably impacted in the future as a result of including receivables from Compex SA and Rehabilicare (UK) Ltd. which are more traditional trade receivables and not dependent on third party payors.

At December 31, 2000 the Company was committed to pay \$1,588,000 settlement of the Medicare whistleblower suit and this amount was remitted in full to the United States Government on January 29, 2001. The Company has no material commitment for capital expenditures. The Company believes that available cash and borrowings under its credit line will be adequate to fund cash requirements operations for the current fiscal year.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The Company is exposed to market risk from changes in the interest rates on certain of its outstanding debt. The outstanding loan balance under the \$20 million credit facility bears interest at a variable rate based on the bank's prime rate or LIBOR. Based on the average outstanding bank debt for the period ended December 31, 2000, a 100 basis point change in interest rates would not change interest expense by a material amount.

PART II - OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

On September 11, 2000, the Company announced that it had reached an agreement with the United States Government to settle allegations of improper Medicare billing that were asserted in a lawsuit filed by a former employee. The Company agreed to pay \$1,588,510 to settle the lawsuit and that amount was remitted to the United States Government on January 29, 2001. The Company has denied allegations that it engaged in fraudulent Medicare billing practices.

Under the terms of the settlement, the Company also entered into a Corporate Integrity Agreement ("CIA"). The CIA has a duration of five years and provides for an independent audit of claims submitted to federal health care programs to ensure, among other things, proper filing of future Medicare claims. The Company previously hired a corporate compliance officer and implemented a corporate compliance program to ensure that the Company is in compliance with all applicable laws and regulations.

The Company has also, from time to time, been a party to other claims, legal actions and complaints arising in the ordinary course of business. Management does not believe that the resolution of such matters has had or will have a material impact on the Company's results of operations or financial position.

ITEM 2. CHANGES IN SECURITIES AND USE OF PROCEEDS - None

ITEM 3. DEFAULTS UPON SENIOR SECURITIES - None

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ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

The annual meeting of shareholders of Rehabiliticare was held on December 12, 2000. Shareholders holding 8,310,777 shares, or approximately 77.2% of outstanding shares, were represented at the meeting by proxy or in person. The only matter submitted at the meeting for vote by the shareholders was as follows:

a. Election of Directors

The following nominees were elected to serve as members of the Board of Directors until the annual meeting of shareholders in 2001 or until such time as a successor may be elected:

	IN FAVOR -----	WITH -----
Frederick H. Ayers	8,241,847	6
W. Bayne Gibson	8,173,310	13
Richard E. Jahnke	8,244,547	6
David B. Kaysen	8,249,203	6
John H.P. Maley	8,249,904	6
Robert C. Wingrove	8,247,680	6

ITEM 5. OTHER INFORMATION - None

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) Exhibits

None

(b) Reports on Form 8-K

None filed during the quarter ended December 31, 2000

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

REHABILICARE INC.

February 14, 2001

Date

/s/ David B. Kaysen

David B. Kaysen
President and Chief Executive
Officer

February 14, 2001

Date

/s/ W. Glen Winchell

W. Glen Winchell
Vice President of Finance
(Principal Financial and
Accounting Officer)

