RadNet, Inc.
Form 10-Q
August 09, 2016

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington D.C. 20549

FORM 10-Q

(Mark One)

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended June 30, 2016

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

For the transition period from __________ to __________

Commission File Number 001-33307

RadNet, Inc.

(Exact name of registrant as specified in charter)

Delaware	**13-3326724**
(State or other jurisdiction of	**(I.R.S. Employer**
Incorporation or organization)	**Identification No.)**

1510 Cotner Avenue

Los Angeles, California	**90025**
(Address of principal executive offices)	**(Zip Code)**

(310) 478-7808

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities and Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No o

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

Large accelerated filer o	Accelerated filer x	Non-accelerated filer o (do not check if a smaller reporting company)	Smaller reporting company o

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

The number of shares of the registrant's common stock outstanding on August 5, 2016 was 46,432,404 shares.

RADNET, INC.

Table of Contents

PART I - FINANCIAL INFORMATION

ITEM 1. Condensed Consolidated Financial Statements (unaudited)

RADNET, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

(IN THOUSANDS EXCEPT SHARE AND PER SHARE DATA)

	June 30, 2016 (unaudited)	December 31, 2015
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	$ 433	$ 446
Accounts receivable, net	165,086	162,843
Current portion of deferred tax assets	22,279	22,279
Due from affiliates	4,273	4,815
Prepaid expenses and other current assets	30,510	38,986
Total current assets	222,581	229,369
PROPERTY AND EQUIPMENT, NET	250,426	256,722
OTHER ASSETS		
Goodwill	240,520	239,408
Other intangible assets	44,032	45,253
Deferred financing costs	2,012	2,841
Investment in joint ventures	39,483	33,584
Deferred tax assets, net of current portion	24,352	24,685
Deposits and other	4,935	4,565
Total assets	$ 828,341	$ 836,427
LIABILITIES AND EQUITY		
CURRENT LIABILITIES		
Accounts payable, accrued expenses and other	$ 108,076	$ 113,813
Due to affiliates	8,545	6,564
Deferred revenue	1,598	1,598
Current portion of notes payable	21,609	22,383
Current portion of deferred rent	2,551	2,563
Current portion of obligations under capital leases	7,713	10,038
Total current liabilities	150,092	156,959
LONG-TERM LIABILITIES		

Deferred rent, net of current portion	27,929	26,865
Line of credit	13,800	–
Notes payable, net of current portion	589,177	599,914
Obligations under capital lease, net of current portion	4,710	6,385
Other non-current liabilities	5,667	9,843
Total liabilities	791,375	799,966
EQUITY		
RadNet, Inc. stockholders' equity:		
Common stock - $.0001 par value, 200,000,000 shares authorized; 46,432,404 and 46,281,189 shares issued and outstanding at June 30, 2016 and December 31, 2015, respectively	4	4
Additional paid-in-capital	196,026	197,297
Accumulated other comprehensive loss	(169)	(153)
Accumulated deficit	(162,669)	(164,571)
Total RadNet, Inc.'s stockholders' equity	33,192	32,577
Noncontrolling interests	3,774	3,884
Total equity	36,966	36,461
Total liabilities and equity	$ 828,341	$ 836,427

The accompanying notes are an integral part of these financial statements.

RADNET, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(IN THOUSANDS EXCEPT SHARE DATA)

(unaudited)

	Three Months Ended June 30,		**Six Months Ended June 30,**	
	2016	2015	2016	2015
NET REVENUE				
Service fee revenue, net of contractual allowances and discounts	$203,759	$188,403	$404,601	$353,433
Provision for bad debts	(12,326)	(8,387)	(22,630)	(15,862)
Net service fee revenue	191,433	180,016	381,971	337,571
Revenue under capitation arrangements	27,132	24,273	52,982	47,985
Total net revenue	218,565	204,289	434,953	385,556
OPERATING EXPENSES				
Cost of operations, excluding depreciation and amortization	194,062	175,796	390,888	344,717
Depreciation and amortization	15,811	14,941	32,223	29,235
Loss on sale and disposal of equipment	441	74	441	36
Severance costs	173	94	340	130
Total operating expenses	210,487	190,905	423,892	374,118
INCOME FROM OPERATIONS	8,078	13,384	11,061	11,438
OTHER INCOME AND EXPENSES				
Interest expense	10,745	10,423	21,426	20,419
Meaningful use incentive	–	–	(2,808)	(3,270)
Equity in earnings of joint ventures	(3,274)	(3,207)	(5,553)	(4,309)
Gain from return of common stock	(5,032)	–	(5,032)	–
Other expenses	4	413	6	410
Total other expenses	2,443	7,629	8,039	13,250
INCOME (LOSS) BEFORE INCOME TAXES	5,635	5,755	3,022	(1,812)
(Provision for) benefit from income taxes	(2,253)	(2,192)	(1,073)	899
NET INCOME (LOSS)	3,382	3,563	1,949	(913)
Net (loss) income attributable to noncontrolling interests	(243)	168	47	246
NET INCOME (LOSS) ATTRIBUTABLE TO RADNET, INC. COMMON STOCKHOLDERS	$3,625	$3,395	$1,902	$(1,159)
BASIC NET INCOME (LOSS) PER SHARE ATTRIBUTABLE TO RADNET, INC. COMMON STOCKHOLDERS	$0.08	$0.08	$0.04	$(0.03)

DILUTED NET INCOME (LOSS) PER SHARE ATTRIBUTABLE TO RADNET, INC. COMMON STOCKHOLDERS	$0.08	$0.08	$0.04	$(0.03)
WEIGHTED AVERAGE SHARES OUTSTANDING				
Basic	46,558,944	43,370,024	46,576,631	43,059,686
Diluted	46,882,383	44,685,599	46,960,226	43,059,686

The accompanying notes are an integral part of these financial statements.

4

RADNET, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

(IN THOUSANDS)

(unaudited)

	Three Months Ended June 30,		**Six Months Ended June 30,**	
	2016	2015	2016	2015
NET INCOME (LOSS)	$3,382	$3,563	$1,949	$(913)
Foreign currency translation adjustments	(20)	(4)	(16)	(41)
COMPREHENSIVE INCOME (LOSS)	3,362	3,559	1,933	(954)
Less comprehensive (loss) income attributable to non-controlling interests	(243)	168	47	246
COMPREHENSIVE INCOME (LOSS) ATTRIBUTABLE TO RADNET, INC. COMMON STOCKHOLDERS	$3,605	$3,391	$1,886	$(1,200)

The accompanying notes are an integral part of these financial statements.

RADNET, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF EQUITY

(IN THOUSANDS EXCEPT SHARE DATA)

(unaudited)

	Common Stock		Additional Paid-in	Accumulated	Accumulated Other	Radnet, Inc. Stockholders'	Noncontrolling	Total
	Shares	Amount	Capital	Deficit	Comprehensive Loss	Equity	Interests	Equity
BALANCE - JANUARY 1, 2016	46,281,189	$ 4	$ 197,297	$ (164,571)	$ (153)	$ 32,577	$ 3,884	$ 36,461
Issuance of common stock upon exercise of options/warrants	314,448	–	150	–	–	150	–	150
Stock-based compensation	–	–	3,611	–	–	3,611	–	3,611
Issuance of restricted stock and other awards	795,303	–	–	–	–	–	–	–
Return of common stock	(958,536)	–	(5,032)	–	–	(5,032)	–	(5,032)
Distributions paid to noncontrolling interests	–	–	–	–	–	–	(157)	(157)
Change in cumulative foreign currency translation adjustment	–	–	–	–	(16)	(16)	–	(16)
Net income	–	–	–	1,902	–	1,902	47	1,949
BALANCE - JUNE 30, 2016	46,432,404	$ 4	$ 196,026	$ (162,669)	$ (169)	$ 33,192	$ 3,774	$ 36,966

The accompanying notes are an integral part of these financial statements.

RADNET, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(IN THOUSANDS)

(unaudited)

	Six Months Ended June 30,	
	2016	2015
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income (loss)	$1,949	$(913)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and amortization	32,223	29,235
Provision for bad debts	22,630	15,862
Gain from return of common stock	(5,032)	–
Equity in earnings of joint ventures	(5,553)	(4,309)
Distributions from joint ventures	2,098	6,195
Amortization and write off of deferred financing costs and loan discount	2,738	2,631
Loss on sale and disposal of equipment	441	36
Stock-based compensation	3,761	5,571
Changes in operating assets and liabilities, net of assets acquired and liabilities assumed in purchase transactions:		
Accounts receivable	(24,873)	(19,368)
Other current assets	8,454	(3,058)
Other assets	220	(3,687)
Deferred taxes	333	(1,854)
Deferred rent	1,052	4,602
Deferred revenue	–	(564)
Accounts payable, accrued expenses and other	10,983	(2,423)
Net cash provided by operating activities	51,424	27,956
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchase of imaging facilities	(6,603)	(34,407)
Purchase of property and equipment	(40,267)	(31,649)
Proceeds from sale of equipment	63	–
Cash distribution from new JV partner	994	–
Equity contributions in existing and purchase of interest in joint ventures	(734)	(265)
Net cash used in investing activities	(46,547)	(66,116)
CASH FLOWS FROM FINANCING ACTIVITIES		
Principal payments on notes and leases payable	(6,310)	(3,969)
Proceeds from borrowings	–	74,401
Payments on Term Loan Debt	(12,357)	(11,369)
Deferred financing costs	–	(531)
Net proceeds (repayments) on revolving credit facility	13,800	(15,300)

Distributions paid to noncontrolling interests	(157)	(613)
Proceeds from issuance of common stock upon exercise of options/warrants	150	594
Net cash (used in) provided by financing activities	(4,874)	43,213
EFFECT OF EXCHANGE RATE CHANGES ON CASH	(16)	(41)
NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS	(13)	5,012
CASH AND CASH EQUIVALENTS, beginning of period	446	307
CASH AND CASH EQUIVALENTS, end of period	$433	$5,319
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION		
Cash paid during the period for income taxes	$–	–

The accompanying notes are an integral part of these financial statements.

RADNET, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (CONTINUED)

(unaudited)

Supplemental Schedule of Non-Cash Investing and Financing Activities

We acquired equipment and certain leasehold improvements for approximately $15.4 million and $10.8 million during the six months ended June 30, 2016 and 2015, respectively, which were not paid for as of June 30, 2016 and 2015, respectively. The offsetting amounts due were recorded in our consolidated balance sheet under accounts payable, accrued expenses and other.

During the six months ended June 30, 2016 we added capital lease debt of approximately $1.3 million.

We recognized a non-cash gain from the return of common stock of $5.0 million in June 2016. See Note 2, Gain from Return of Common Stock.

We transferred $2.7 million in fixed assets in June 2016 to our new joint venture, Glendale Advanced Imaging LLC. See Note 6.

RADNET, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

NOTE 1 – NATURE OF BUSINESS AND BASIS OF PRESENTATION

We are a national provider of freestanding, fixed-site outpatient diagnostic imaging services. At June 30, 2016, we operated directly or indirectly through joint ventures with hospitals, 310 centers located in California, Delaware, Florida, Maryland, New Jersey, New York and Rhode Island. Our centers provide physicians with imaging capabilities to facilitate the diagnosis and treatment of diseases and disorders. Our services include magnetic resonance imaging (MRI), computed tomography (CT), positron emission tomography (PET), nuclear medicine, mammography, ultrasound, diagnostic radiology (X-ray), fluoroscopy and other related procedures. The vast majority of our centers offer multi-modality imaging services. Our multi-modality strategy diversifies revenue streams, reduces exposure to reimbursement changes and provides patients and referring physicians one location for multiple procedures. Our operations comprise a single segment for financial reporting purposes.

The consolidated financial statements include the accounts of Radnet Management, Inc. (or "Radnet Management") and Beverly Radiology Medical Group III, a professional partnership ("BRMG"). BRMG is a partnership of ProNet Imaging Medical Group, Inc., Breastlink Medical Group, Inc. and Beverly Radiology Medical Group, Inc. The consolidated financial statements also include Radnet Management I, Inc., Radnet Management II, Inc., Radiologix, Inc., Radnet Managed Imaging Services, Inc., Delaware Imaging Partners, Inc., New Jersey Imaging Partners, Inc. and Diagnostic Imaging Services, Inc. ("DIS"), all wholly owned subsidiaries of Radnet Management. All of these affiliated entities are referred to collectively as "RadNet", "we", "us", "our" or the "Company" in this report.

Accounting Standards Codification ("ASC") 810-10-15-14, *Consolidation*, stipulates that generally any entity with a) insufficient equity to finance its activities without additional subordinated financial support provided by any parties, or b) equity holders that, as a group, lack the characteristics specified in the ASC which evidence a controlling financial interest, is considered a Variable Interest Entity ("VIE"). We consolidate all VIEs in which we are the primary beneficiary. We determine whether we are the primary beneficiary of a VIE through a qualitative analysis that identifies which variable interest holder has the controlling financial interest in the VIE. The variable interest holder who has both of the following has the controlling financial interest and is the primary beneficiary: (1) the power to direct the activities of the VIE that most significantly impact the VIE's economic performance and (2) the obligation to absorb losses of, or the right to receive benefits from, the VIE that could potentially be significant to the VIE. In performing our analysis, we consider all relevant facts and circumstances, including: the design and activities of the VIE, the terms of the contracts the VIE has entered into, the nature of the VIE's variable interests issued and how they were negotiated with or marketed to potential investors, and which parties participated significantly in the design or redesign of the entity.

Howard G. Berger, M.D., is our President and Chief Executive Officer, a member of our Board of Directors, and also owns, indirectly, 99% of the equity interests in BRMG. BRMG is responsible for all of the professional medical services at nearly all of our facilities located in California under a management agreement with us, and employs physicians or contracts with various other independent physicians and physician groups to provide the professional medical services at most of our California facilities. We generally obtain professional medical services from BRMG in California, rather than provide such services directly or through subsidiaries, in order to comply with California's prohibition against the corporate practice of medicine. However, as a result of our close relationship with Dr. Berger and BRMG, we believe that we are able to better ensure that medical service is provided at our California facilities in a manner consistent with our needs and expectations and those of our referring physicians, patients and payors than if we obtained these services from unaffiliated physician groups.

We contract with nine medical groups which provide professional medical services at all of our facilities in Manhattan and Brooklyn, New York. These contracts are similar to our contract with BRMG. Six of these groups are owned by John V. Crues, III, M.D., RadNet's Medical Director, a member of our Board of Directors, and a 1% owner of BRMG. Dr Berger owns a controlling interest in two of these medical groups which provide professional medical services at one of our Manhattan facilities.

RadNet provides non-medical, technical and administrative services to BRMG and the nine medical groups mentioned above ("NY Groups") for which it receives a management fee, pursuant to the related management agreements. Through the management agreements we have exclusive authority over all non-medical decision making related to the ongoing business operations of BRMG and the NY Groups and we determine the annual budget of BRMG and the NY Groups. BRMG and the NY Groups both have insignificant operating assets and liabilities, and de minimis equity. Through management agreements with us, substantially all cash flows of BRMG and the NY Groups after expenses including professional salaries, are transferred to us.

We have determined that BRMG and the NY Groups are variable interest entities, and that we are the primary beneficiary, and consequently, we consolidate the revenue and expenses, assets and liabilities of each. BRMG and the NY Groups on a combined basis recognized $33.0 million and $28.2 million of revenue, net of management service fees to RadNet, for the three months ended June 30, 2016 and 2015, respectively, and $33.0 million and $28.2 million of operating expenses for the three months ended June 30, 2016 and 2015, respectively. RadNet, Inc. recognized in its condensed consolidated statement of operations $137.1 million and $114.9 million of total billed net service fee revenue relating to these VIE's for the three months ended June 30, 2016 and 2015, respectively, of which $104.1 million and $86.7 million was for management services provided to these VIE's relating primarily to the technical portion of total billed net service fee revenue for the three months ended June 30, 2016 and 2015, respectively.

For the six months ended June 30, 2016 and 2015, respectively, the VIE's recognized $66.9 million and $53.7 million of revenue, net of management services fees to RadNet, respectively, and $66.9 million and $53.7 million of operating expenses. RadNet, Inc. recognized in its condensed consolidated statement of operations $274.9 million and $213.9 million of total billed net service fee revenue relating to these VIE's for the six months ended June 30, 2016 and 2015, respectively, of which $208.0 million and $160.2 million was for management services provided to these VIE's relating primarily to the technical portion of total billed net service fee revenue for the six months ended June 30, 2016 and 2015 respectively.

The cash flows of BRMG and the NY Groups are included in the accompanying consolidated statements of cash flows. All intercompany balances and transactions have been eliminated in consolidation. In our consolidated balance sheets at June 30, 2016 and December 31, 2015, we have included approximately $101.5 million and $89.8 million, respectively, of accounts receivable and approximately $7.7 million and $8.5 million of accounts payable and accrued liabilities related to BRMG and the NY Groups.

The creditors of BRMG and the NY Groups do not have recourse to our general credit and there are no other arrangements that could expose us to losses on behalf of BRMG and the NY Groups. However, RadNet may be required to provide financial support to cover any operating expenses in excess of operating revenues.

Aside from centers in California where we contract with BRMG for the provision of professional medical services and centers in New York City, where we contract with the NY Groups for the provision of professional medical services, at the remaining centers in California and at all of the centers which are located outside of California and New York City, we have entered into long-term contracts with independent radiology groups in the area to provide physician services at those facilities. These third party radiology practices provide professional services, including supervision and interpretation of diagnostic imaging procedures, in our diagnostic imaging centers. The radiology practices maintain full control over the provision of professional services. In these facilities we enter into long-term agreements with radiology practice groups (typically 40 years). Under these arrangements, in addition to obtaining technical fees for the use of our diagnostic imaging equipment and the provision of technical services, we provide management services and receive a fee based on the practice group's professional revenue, including revenue derived outside of our diagnostic imaging centers. We own the diagnostic imaging equipment and, therefore, receive 100% of the technical reimbursements associated with imaging procedures. The radiology practice groups retain the professional reimbursements associated with imaging procedures after deducting management service fees paid to us. We have no financial controlling interest in the independent (non-BRMG or non-NY Groups) radiology practices; accordingly, we do not consolidate the financial statements of those practices in our consolidated financial statements.

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X and, therefore, do not include all information and footnotes necessary for conformity with U.S. generally accepted accounting principles for complete financial statements; however, in the opinion of our management, all adjustments consisting of normal recurring adjustments necessary for a fair presentation of the financial position, results of operations and cash flows for the interim periods ended June 30, 2016 and 2015 have been made. The results of operations for any interim period are not necessarily indicative of the results for a full year. These interim condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and related notes thereto contained in our annual report on Form 10-K for the year ended December 31, 2015 filed on March 15, 2016, as amended.

NOTE 2 –SIGNIFICANT ACCOUNTING POLICIES

During the period covered in this report, there have been no material changes to the significant accounting policies we use and have explained, in our annual report on Form 10-K for the fiscal year ended December 31, 2015, as amended. The information below is intended only to supplement the disclosure in our annual report on Form 10-K for the fiscal year ended December 31, 2015, as amended.

Revenues

Service fee revenue, net of contractual allowances and discounts, consists of net patient fees received from various payors and patients themselves based mainly upon established contractual billing rates, less allowances for contractual adjustments and discounts. As it relates to BRMG and the NY Groups centers, this service fee revenue includes payments for both the professional medical interpretation revenue recognized by BRMG and the NY Groups as well as the payment for all other aspects related to our providing the imaging services, for which we earn management fees from BRMG and the NY Groups. As it relates to non-BRMG and NY Groups centers, namely the affiliated physician groups, this service fee revenue is earned through providing the use of our diagnostic imaging equipment and the provision of technical services as well as providing administration services such as clerical and administrative personnel, bookkeeping and accounting services, billing and collection, provision of medical and office supplies, secretarial, reception and transcription services, maintenance of medical records, and advertising, marketing and promotional activities.

Service fee revenues are recorded during the period the services are provided based upon the estimated amounts due from the patients and third-party payors. Third-party payors include federal and state agencies (under the Medicare and Medicaid programs), managed care health plans, commercial insurance companies and employers. Estimates of contractual allowances are based on historical collection rates of payor reimbursement contract agreements. We also record a provision for doubtful accounts based primarily on historical collection rates related to patient copayments and deductible amounts for patients who have health care coverage under one of our third-party payors.

Under capitation arrangements with various health plans, we earn a per-enrollee amount each month for making available diagnostic imaging services to all plan enrollees under the capitation arrangement. Revenue under capitation arrangements is recognized in the period which we are obligated to provide services to plan enrollees under contracts with various health plans.

Our service fee revenue, net of contractual allowances and discounts, the provision for bad debts, and revenue under capitation arrangements are summarized in the following table (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Commercial insurance	$129,920	$117,107	$256,302	$216,872
Medicare	45,558	42,088	91,385	79,172
Medicaid	6,890	5,974	13,915	11,469
Workers' compensation/personal injury	8,966	8,130	18,485	15,559
Other	12,425	15,104	24,514	30,361
Service fee revenue, net of contractual allowances and discounts	203,759	188,403	404,601	353,433
Provision for bad debts	(12,326)	(8,387)	(22,630)	(15,862)
Net service fee revenue	191,433	180,016	381,971	337,571
Revenue under capitation arrangements	27,132	24,273	52,982	47,985
Total net revenue	$218,565	$204,289	$434,953	$385,556

Provision for Bad Debts

We provide for an allowance against accounts receivable that could become uncollectible to reduce the carrying value of such receivables to their estimated net realizable value. We estimate this allowance based on the aging of our accounts receivable by the historical payment patterns of each type of payor, write-off trends, and other relevant factors. A significant portion of our provision for bad debt relates to co-payments and deductibles owed to us from patients with insurance. Although we attempt to collect deductibles and co-payments due from patients with insurance at the time of service, this attempt to collect at the time of service is not an assessment of the patient’s ability to pay nor are revenues recognized based on an assessment of the patient's ability to pay. There are various factors that can impact collection trends, such as changes in the economy, which in turn have an impact on the increased burden of co-payments and deductibles to be made by patients with insurance. These factors continuously change and can have an impact on collection trends and our estimation process.

Deferred Tax Assets

Income tax expense is computed using an asset and liability method and using expected annual effective tax rates. Under this method, deferred income tax assets and liabilities result from temporary differences in the financial reporting bases and the income tax reporting bases of assets and liabilities. The measurement of deferred tax assets is reduced, if necessary, by the amount of any tax benefit that, based on available evidence, is not expected to be realized. When it appears more likely than not that deferred taxes will not be realized, a valuation allowance is recorded to reduce the deferred tax asset to its estimated realizable value. For net deferred tax assets we consider estimates of future taxable income, including tax planning strategies, in determining whether our net deferred tax assets are more likely than not to be realized.

Deferred Financing Costs

Costs of financing are deferred and amortized on a straight-line basis over the life of the associated loan, which approximates the effective interest rate method.

Presentation of Deferred Financing Costs

In the first quarter of 2016, we adopted Accounting Standards Update ("ASU") 2015-03, *Simplifying the Presentation of Debt Issuance Costs*, which requires that deferred financing costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of such debt liability, consistent with debt discounts. In a subsequent Staff Announcement, codified as ASU 2015-15, the SEC announced that it would not object to the deferral and presentation of deferred financing costs relating to line-of-credit arrangements as an asset. We have applied the guidance retrospectively to all periods presented. Such retrospective adoption had an insignificant impact to our December 31, 2015 consolidated balance sheet, and had no impact to our consolidated statements of operations, comprehensive loss, stockholders' equity, and cash flows. The table below summarizes the impacts on the Company's December 31, 2015 Consolidated Balance Sheet:

	Impact of new accounting pronouncement		
In thousands	As previously reported	Impact of adoption	As currently reported
Prepaid expenses and other current assets	$40,139	(1,153)	38,986
Deferred financing costs, net of current portion	3,696	(855)	2,841
Others	794,600	–	794,600
Total assets	$838,435	$(2,008)	$836,427
Current portion of notes payable	23,076	(693)	22,383
Notes payable, net of current portion	601,229	(1,315)	599,914
Others	177,669	–	177,669
Total liabilities	801,974	(2,008)	799,966
Total equity	36,461	–	36,461
Total liabilities and equity	$838,435	$(2,008)	$836,427

Meaningful Use Incentive

Under the American Recovery and Reinvestment Act of 2009, a program was enacted that provides financial incentives for providers that successfully implement and utilize electronic health record technology to improve patient care. Our software development team in Canada established an objective to build a Radiology Information System (RIS) software platform that has been awarded Meaningful Use certification. As this certified RIS system is implemented throughout our imaging centers, the radiologists that utilize this software can be eligible for the available financial incentives. In order to receive such incentive payments providers must attest that they have demonstrated meaningful use of the certified RIS in each stage of the program. We account for this meaningful use incentive under the Gain Contingency Model outlined in ASC 450-30. Under this model, we record within non-operating income, meaningful use incentive only after Medicare accepts an attestation from the qualified eligible professional demonstrating meaningful use. We recorded approximately $2.8 million and $3.3 million during the six months ended

June 30, 2016, and 2015, respectively, relating to this incentive.

Gain from Return of Common Stock

In the second quarter of 2016, we determined that certain pre-acquisition financial information of Diagnostic Imaging Group ("DIG") provided to us by the sellers contained errors. As a result of this, we negotiated and reached a settlement with the sellers of DIG in June 2016 for the return of 958,536 shares of common stock which had a fair value of $5.0 million on the date of return. Such return has been recognized as a gain from return of common stock in our statement of operations.

Liquidity and Capital Resources

We had cash and cash equivalents of $433,000 and accounts receivable of $165.1 million at June 30, 2016, compared to cash and cash equivalents of $446,000 and accounts receivable of $162.8 million at December 31, 2015. We had a working capital balance of $72.5 million and $72.4 million at June 30, 2016 and December 31, 2015, respectively. We had net income attributable to RadNet, Inc. common stockholders for the three months ended June 30, 2016 and 2015 of $3.6 million and $3.4 million respectively. We had net income attributable to RadNet, Inc. common stockholders for the six months ended June 30, 2016 of $1.9 million and net loss for the six months ended June 30, 2015 of $1.2 million. We also had stockholders' equity of $33.2 million and $32.6 million at June 30, 2016 and December 31, 2015, respectively.

We operate in a capital intensive, high fixed-cost industry that requires significant amounts of capital to fund operations. In addition to operations, we require a significant amount of capital for the initial start-up and development of new diagnostic imaging facilities, the acquisition of additional facilities and new diagnostic imaging equipment. Because our cash flows from operations have been insufficient to fund all of these capital requirements, we have depended on the availability of financing under credit arrangements with third parties.

Based on our current level of operations, we believe that cash flow from operations and available cash, together with available borrowings from our senior secured credit facilities, will be adequate to meet our liquidity needs. Our future liquidity requirements will be for working capital, capital expenditures, debt service and general corporate purposes. Our ability to meet our working capital and debt service requirements, however, is subject to future economic conditions and to financial, business and other factors, many of which are beyond our control. If we are not able to meet such requirements, we may be required to seek additional financing. There can be no assurance that we will be able to obtain financing from other sources on terms acceptable to us, if at all.

On a continuing basis, we also consider various transactions to increase shareholder value and enhance our business results, including acquisitions, divestitures and joint ventures. These types of transactions may result in future cash proceeds or payments but the general timing, size or success of any acquisition, divestiture or joint venture effort and the related potential capital commitments cannot be predicted. We expect to fund any future acquisitions primarily with cash flow from operations and borrowings, including borrowing from amounts available under our senior secured credit facilities or through new equity or debt issuances.

We and our subsidiaries or affiliates may from time to time, in our or their sole discretion, purchase, repay, redeem or retire any of our outstanding debt or equity securities in privately negotiated or open market transactions, by tender offer or otherwise.

Included in our condensed consolidated balance sheet at June 30, 2016 is $609.0 million of senior secured term loan debt (net of unamortized discounts of $9.7 million), broken down by loan agreement as follows (in thousands):

	As of June 30, 2016		
	Face Value	Discount	**Total Carrying Value**
First Lien Term Loans	$368,601	$(6,715)	$361,886
2015 Incremental First	$70,066	$(753)	$69,313
Second Lien Term Loans	$180,000	$(2,195)	$177,805
Total	$618,667	$(9,663)	$609,004

Our $101.25 million revolving credit facility had a $13.8 million aggregate principal amount outstanding as of June 30, 2016.

As of June 30, 2016, we were in compliance with all covenants under the Original Credit Agreement (as amended by the 2013 Amendment, the 2014 Amendment, and the 2015 Joinder) and the Second Lien Credit Agreement.

The following describes our 2015 financing activities:

2015 Incremental First Lien Term Loans:

On April 30, 2015, we entered into the 2015 Joinder to the Credit Agreement to provide for the borrowing of $75.0 million of incremental First Lien Term Loans (“2015 Incremental First Lien Term Loans”). The 2015 Incremental First Lien Term Loans are treated as part of the same class as the existing tranche B term loans currently outstanding under the Credit Agreement. We used the proceeds from the 2015 Incremental First Lien Term Loans to repay all of the borrowings outstanding under the first lien revolving loan facility and to pay approximately $1.1 million of fees and expenses associated with the transaction.

Interest. The interest rates payable on the 2015 Incremental First Lien Term Loans are the same rates currently payable on the existing tranche B term loans under the Credit Agreement, which are (a) the Adjusted Eurodollar Rate (as defined in the Credit Agreement) plus 3.25% per annum or (b) the Base Rate (as defined in the Credit Agreement) plus 2.25% per annum. As applied to the first lien tranche B term loans, the Adjusted Eurodollar Rate has a minimum floor of 1.0%. The Adjusted Eurodollar Rate at June 30, 2016 was 0.92%.

Payments. The scheduled quarterly amortization of the 2015 Incremental First Lien Term Loans is approximately $987,000, beginning in June 2015. The scheduled quarterly amortization for all of the term loans under the Credit Agreement, including the 2015 Incremental First Lien Term Loans, was increased to approximately $6.2 million, beginning in June 2015.

Maturity Date. The maturity date for the 2015 Incremental First Lien Term Loans shall be on the earlier to occur of (i) October 10, 2018, and (ii) the date on which the 2015 Incremental First Lien Term Loans shall otherwise become due and payable in full under the Credit Agreement, whether by acceleration or otherwise.

Guarantees and Collateral. The obligations under the Credit Agreement, including the 2015 Incremental First Lien Term Loans, are guaranteed by RadNet, Inc., all of our current and future domestic subsidiaries and certain of our affiliates (other than certain excluded foreign subsidiaries). The obligations under the Credit Agreement, including the 2015 Incremental First Lien Term Loans, and the guarantees are secured by a perfected first priority security interest (subject to certain permitted exceptions) in substantially all of Radnet Management’s and the guarantors’ tangible and intangible assets, including, but not limited to, pledges of equity interests of Radnet Management and all of our current and future domestic subsidiaries.

Restrictive Covenants. In addition to certain customary covenants, the Credit Agreement places limits on our ability to declare dividends or redeem or repurchase capital stock, prepay, redeem or purchase debt, incur liens and engage in sale-leaseback transactions, make loans and investments, incur additional indebtedness, amend or otherwise alter debt and other material agreements, engage in mergers, acquisitions and asset sales, enter into transactions with affiliates and alter the business we and our subsidiaries currently conduct.

Financial Covenants. The Credit Agreement contains financial covenants including a maximum total leverage ratio and a limit on annual capital expenditures.

Events of Default. In addition to certain customary events of default, events of default under the Credit Agreement include failure to pay principal of any loans as and on the date when due, failure to pay any interest on any loan or any fee or other amount payable under the Credit Agreement, as modified by the 2015 Joinder, within five days after the due date, failure of any loan party to comply with any covenant or agreement in the loan documents (subject to applicable grace periods and/or notice requirement), a representation or warranty contained in the loan documents is false in a material respect, events of bankruptcy and a change of control. The occurrence of an event of default could permit the lenders under the Credit Agreement to declare all amounts borrowed, together with accrued interest and fees, to be immediately due and payable and to exercise other default remedies.

The following describes our 2014 financing activities:

<u>2014 Amendment to the Original Credit Agreement and Second Lien Credit and Guaranty Agreement</u>:

On March 25, 2014, we simultaneously entered into two agreements which resulted in the creation of a direct financial obligation as follows:

2014 Amendment of the Original Credit Agreement. We entered into the 2014 Amendment to provide for, among other things, the borrowing of $30.0 million of additional First Lien Term Loans (the “2014 First Lien Term Loans”).

Second Lien Credit and Guaranty Agreement. We entered into the Second Lien Credit Agreement to provide for, among other things, the borrowing of $180.0 million of second lien term loans (the “Second Lien Term Loans”). The proceeds from the Second Lien Term Loans and the 2014 First Lien Term Loans were used to redeem the 10 3/8% senior unsecured notes, due 2018, to pay the expenses related to the transaction and for general corporate purposes.

Revolving Credit Facility. The $101.25 million revolving credit line established in the Credit Agreement was unaltered by the agreements above and remains in place. The termination date for the $101.25 million revolving credit facility is the earliest to occur of (i) October 10, 2017, (ii) the date the revolving credit facility is permanently reduced to zero pursuant to section 2.13(b) of the Credit Agreement, which addresses voluntary commitment reductions and (iii) the date of the termination of the revolving credit facility due to specific events of default pursuant to section 8.01 of the Credit Agreement. The revolving credit facility bears interest based on types of borrowings as follows: (i) unpaid principal at the Adjusted Eurodollar Rate (as defined in the Credit Agreement) plus 4.25% per annum or the Base Rate (as defined in the Credit Agreement) plus 3.25% per annum, (ii) letter of credit and fronting fees at 4.5% per annum, and (iii) commitment fee of 0.5% per annum on the unused revolver balance. The Adjusted Eurodollar Rate at June 30, 2016 was 0.92%.

The 2014 Amendment provided for the following:

Interest. The interest rates payable on the 2014 First Lien Term Loans are the same as the rates currently payable under the Original Credit Agreement, as amended by the 2013 Amendment, which are (a) the Adjusted Eurodollar Rate (as defined in the Credit Agreement) plus 3.25% or (b) the Base Rate (as defined in the Credit Agreement) plus 2.25%. With respect to all of the term loans under the Credit Agreement, the Adjusted Eurodollar Rate has a minimum floor of 1.0%. The Adjusted Eurodollar Rate at June 30, 2016 was 0.92%.

Payments. The scheduled amortization of the term loans under the Original Credit Agreement, as amended by the 2013 Amendment and the 2014 Amendment, was increased, starting in June 2014 from quarterly payments of $975,000 to quarterly payments of approximately $5.2 million, with the remaining balance to be paid at maturity. Scheduled amortization increased annually by $16.8 million from pre-2014 Amendment terms, representing a rise from 1% per annum to 5% per annum of the initial amount borrowed. This $16.8 million additional cash obligation will be partially offset by annual interest savings of approximately $5.0 million under the terms of the Second Lien Term Loan as compared to that under the retired Senior Notes. We expect to fund this approximately $11.8 million net increase in amortization payments from cash provided by operating activities.

The Second Lien Credit Agreement provides for the following:

Interest. The interest rates payable on the Second Lien Term Loans are (a) the Adjusted Eurodollar Rate (as defined in the Second Lien Credit Agreement) plus 7.0% or (b) the Base Rate (as defined in the Second Lien Credit Agreement) plus 6.0%. The Adjusted Eurodollar Rate has a minimum floor of 1.0% on the Second Lien Term Loans. The Adjusted Eurodollar Rate at June 30, 2016 was 0.92%. The rate paid on the Second Lien Term Loan at June 30, 2016 was 8%.

Payments. There is no scheduled amortization of the principal of the Second Lien Term Loans. Unless otherwise prepaid as a result of the occurrence of certain mandatory prepayment events, all principal will be due and payable on the termination date described below.

Termination. The maturity date for the Second Lien Term Loans is the earlier to occur of (i) March 25, 2021, and (ii) the date on which the Second Lien Term Loans shall otherwise become due and payable in full under the Second Lien Credit Agreement, whether by voluntary prepayment per section 2.13(a) of the Second Lien Credit Agreement or events of default per section 8.01 of the Second Lien Credit Agreement as described below.

Restrictive Covenants. In addition to certain customary covenants, the Second Lien Credit Agreement places limits on our ability declare dividends or redeem or repurchase capital stock, prepay, redeem or purchase debt, incur liens and engage in sale-leaseback transactions, make loans and investments, incur additional indebtedness, amend or otherwise alter debt and other material agreements, engage in mergers, acquisitions and asset sales, enter into transactions with affiliates and alter the business we and our subsidiaries currently conduct.

Events of Default. In addition to certain customary events of default, events of default under the Second Lien Credit Agreement include failure to pay principal of any loans as and on the date when due, failure to pay any interest on any loan or any fee or other amount payable under the Second Lien Term Loans within five days after the due date, failure of any loan party to comply with any covenant or agreements in the loan documents (subject to applicable grace periods and/or notice requirements), a representation or warranty contained in the loan documents is false in a material respect, events of bankruptcy and a change of control. The occurrence of an event of default could permit the lenders under the Second Lien Credit Agreement to declare all amounts borrowed, together with accrued interest and fees, to be immediately due and payable and to exercise other default remedies.

The following describes our key financing activities prior to 2014:

2013 Amendment to the Credit Agreement

On April 3, 2013, we entered into the 2013 Amendment. Pursuant to this amendment, we re-priced the balance of our term loan of $348.3 million and borrowed an additional $40.0 million for a new senior secured term loan total of $388.3 million. The proceeds from the amendment were used to: (i) repay in full all existing term loans under the Original Credit Agreement; (ii) repay outstanding revolving loans; (iii) repay premium, fees and expenses incurred; and (iv) general corporate purposes.

2012 Refinancing and Original Credit Agreement

On October 10, 2012 we completed the refinancing of our then existing credit facilities by entering into the Original Credit Agreement with a syndicate of banks and other financial institutions. The total amount of refinancing was $451.25 million, consisting of (i) a $350 million senior secured term loan and (ii) a $101.25 million senior secured revolving credit facility. The obligations under the Original Credit Agreement are guaranteed by RadNet, Inc. and our current and future domestic subsidiaries and certain of our affiliates (other than certain excluded foreign subsidiaries). The obligations under the Original Credit Agreement, including the guarantees, are secured by a perfected first-priority security interest in all of our tangible and intangible assets, including, but not limited to, pledges of equity interests of Radnet Management and all of our current and future domestic subsidiaries.

We used the net proceeds of the Original Credit Agreement to repay in full our then existing six year term loan facility for $277.9 million in principal amount outstanding, which would have matured on April 6, 2016, and our revolving credit facility for $59.8 million in principal amount outstanding, which would have matured on April 6, 2015.

NOTE 3 – RECENT ACCOUNTING STANDARDS

In March 2016, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2016-09 ("ASU 2016-09"), *Compensation—Stock Compensation*, (Topic 718): Improvements to Employee Share-Based Payment Accounting. ASU 2016-09 requires excess tax benefits and tax deficiencies, which arise due to differences between the measure of compensation expense and the amount deductible for tax purposes, to be recorded directly through the statement of operations as a component of income tax expense. Under current GAAP, these differences are generally recorded in additional paid-in capital and thus have no impact on income. The change in treatment of excess tax benefits and tax deficiencies will also impact the computation of diluted earnings per share, and the cash flows associated with those items will be classified as operating activities on the statement of cash flows. The ASU will permit certain elective changes associated with stock compensation accounting. For example, companies can elect to account for forfeitures of awards as they occur rather than projecting forfeitures in the accrual of compensation expense. In addition, the ASU increases the proportion of shares an employer is permitted (though not required) to withhold on behalf of an employee to satisfy the employee's income tax burden on a share-based award without causing the award to become subject to liability accounting. The amendments in this update are effective for fiscal years (and interim reporting periods within fiscal years) beginning after December 15, 2016, with early adoption permitted. We are currently evaluating the impact of the GAAP update on our results of operations and cash flows.

In February 2016, the FASB issued ASU No. 2016-02 ("ASU 2016-02"), *Leases,* (Topic 842): Amendments to the FASB Accounting Standards Codification. ASU 2016-02 amends the existing accounting standards for lease accounting, including requiring lessees to recognize most leases on their balance sheets and making targeted changes to lessor accounting. The new standard requires a modified retrospective transition approach for all leases existing at, or entered into after, the date of initial application, with an option to use certain transition relief. The amendments in this update are effective for fiscal years (and interim reporting periods within fiscal years) beginning after December 15, 2018. Early adoption of the amendments is permitted for all entities. We are currently evaluating the impact of the GAAP update on our results of operations and cash flows.

In November 2015, the FASB issued ASU No. 2015-17 ("ASU 2015-17"), *Income Taxes* (Topic 740): Balance Sheet Classification of Deferred Taxes. ASU 2015-17 changes the classification of deferred taxes to be a noncurrent asset or liability regardless of the classification of the related asset or liability for financial reporting. The update is effective for fiscal years beginning after December 15, 2016. Early application is permitted at the beginning of an interim or annual reporting period. We are currently evaluating the impact of the GAAP update on our results of operations and cash flows.

In September 2015, the FASB issued Accounting Standards Update ("ASU") No. 2015-16 ("ASU 2015-16"), *Business Combinations,* (Topic 805): Simplifying the Accounting for Measurement-Period Adjustments. ASU 2015-16 eliminates the requirement to retrospectively apply adjustments made to provisional amounts recognized in a business combination. An entity will now recognize any adjustments in the reporting period in which the amounts are determined, calculated as if the accounting had been completed at the acquisition date. Disclosure is required for the portion of adjustments recorded in current-period earnings that would have been recorded in previous reporting periods had they been recognized as of the acquisition date. The update is effective for fiscal years (and interim reporting periods within fiscal years) beginning after December 15, 2015. Early adoption is permitted for financial statements that have not been previously issued. The update has been adopted and has had no material effect on our results of operations and cash flows.

In August 2014, the FASB issued ASU No. 2014-15 ("ASU 2014-15"), *Presentation of Financial Statements* (Subtopic 205-40): Going Concern. AUS 2014-15 ASU 2014-15 In connection with preparing financial statements for each annual and interim reporting period, an entity's management should evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about the entity's ability to continue as a going concern within one year after the date that the financial statements are issued. If conditions or events raise substantial doubt about an entity's ability to continue as a going concern, but the substantial doubt is alleviated as a result of consideration of management's plans, the entity should disclose information. The update is effective for the annual period ending after December 15, 2016, and for annual periods and interim periods thereafter. Early application is permitted. The impact of the GAAP update is expected to have minimal impact on our financial disclosures.

In May 2014, the FASB issued ASU No. 2014-09 ("ASU 2014-09"), *Revenue from Contracts with Customers*, (Topic 606). ASU 2014-09 requires an entity to recognize revenue when it transfers promised goods or services to customers in an amount that reflects what it expects in exchange for the goods or services. It also requires more detailed disclosures to enable users of the financial statements to understand the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers. The update was effective for fiscal years (and interim reporting periods within fiscal years) beginning after December 15, 2016, which has been extended to December 31, 2017. We are currently evaluating the impact of the GAAP update on our results of operations and cash flows.

NOTE 4 – EARNINGS PER SHARE

Earnings per share is based upon the weighted average number of shares of common stock and common stock equivalents outstanding, as follows (in thousands except share and per share data):

	Three Months Ended June 30,		**Six Months Ended June 30,**	
	2016	2015	2016	2015
Net income (loss) attributable to RadNet, Inc.'s common stockholders	$3,625	$3,395	$1,902	$(1,159)
BASIC NET INCOME (LOSS) PER SHARE ATTRIBUTABLE TO RADNET, INC.'S COMMON STOCKHOLDERS				
Weighted average number of common shares outstanding during the period	46,558,944	43,370,024	46,576,631	43,059,686
Basic net income (loss) per share attributable to RadNet, Inc.'s common stockholders	$0.08	$0.08	$0.04	$(0.03)
DILUTED NET INCOME (LOSS) PER SHARE ATTRIBUTABLE TO RADNET, INC.'S COMMON STOCKHOLDERS				
Weighted average number of common shares outstanding during the period	46,558,944	43,370,024	46,576,631	43,059,686
Add nonvested restricted stock subject only to service vesting	77,162	897,892	155,447	–