

RadNet, Inc.  
Form 10-Q  
May 11, 2015

**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

**Washington D.C. 20549**

**FORM 10-Q**

(Mark One)

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

For the quarterly period ended March 31, 2015

OR

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

**Commission File Number 001-33307**

**RadNet, Inc.**

(Exact name of registrant as specified in charter)

**Delaware**  
(State or other jurisdiction of

**13-3326724**  
(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  No

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  No

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

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

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

The number of shares of the registrant's common stock outstanding on May 7, 2015 was 44,269,449 shares.

**RADNET, INC.**

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**PART I - FINANCIAL INFORMATION****RADNET, INC. AND SUBSIDIARIES****CONDENSED CONSOLIDATED BALANCE SHEETS****(IN THOUSANDS EXCEPT SHARE AND PER SHARE DATA)**

|   | <b>March 31,<br/>2015<br/>(unaudited)</b> | <b>December<br/>31,<br/>2014</b> |
|---|---|----------------------------------|
| <b>ASSETS</b>   |   |                                  |
| <b>CURRENT ASSETS</b>                                   |   |                                  |
| Cash and cash equivalents                               | \$ 154                                    | \$ 307                           |
| Accounts receivable, net                                | 153,258                                   | 148,235                          |
| Current portion of deferred tax assets                  | 17,246                                    | 17,246                           |
| Due from affiliates                                     | 1,778                                     | 1,561                            |
| Prepaid expenses and other current assets               | 21,884                                    | 24,671                           |
| Total current assets                                    | 194,320                                   | 192,020                          |
| <b>PROPERTY AND EQUIPMENT, NET</b>                      | <b>222,171</b>                            | <b>223,127</b>                   |
| <b>OTHER ASSETS</b>                                     |   |                                  |
| Goodwill  | 200,304                                   | 200,304                          |
| Other intangible assets                                 | 46,856                                    | 47,624                           |
| Deferred financing costs, net of current portion        | 5,560                                     | 6,122                            |
| Investment in joint ventures                            | 30,184                                    | 32,123                           |
| Deferred tax assets, net of current portion             | 38,912                                    | 35,334                           |
| Deposits and other                                      | 4,098                                     | 4,026                            |
| Total assets  | \$ 742,405                                | \$ 740,680                       |
| <b>LIABILITIES AND EQUITY</b>                           |   |                                  |
| <b>CURRENT LIABILITIES</b>                              |   |                                  |
| Accounts payable, accrued expenses and other            | \$ 102,275                                | \$ 97,816                        |
| Due to affiliates                                       | 1,304                                     | 6,289                            |
| Deferred revenue  | 1,762                                     | 1,964                            |
| Current portion of notes payable                        | 19,437                                    | 19,468                           |
| Current portion of deferred rent                        | 2,192                                     | 2,100                            |
| Current portion of obligations under capital leases     | 5,691                                     | 5,637                            |
| Total current liabilities                               | 132,661                                   | 133,274                          |
| <b>LONG-TERM LIABILITIES</b>                            |   |                                  |
| Deferred rent, net of current portion                   | 21,798                                    | 20,965                           |
| Line of credit  | 24,700                                    | 15,300                           |
| Notes payable, net of current portion                   | 545,988                                   | 551,059                          |
| Obligations under capital lease, net of current portion | 4,697                                     | 6,143                            |
| Other non-current liabilities                           | 6,022                                     | 6,241                            |

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|   |            |            |
|---|------------|------------|
| Total liabilities   | 735,866    | 732,982    |
| <b>EQUITY</b>   |            |            |
| RadNet, Inc. stockholders' equity:  |            |            |
| Common stock - \$.0001 par value, 200,000,000 shares authorized; 43,810,279, and 42,825,676 shares issued and outstanding at March 31, 2015 and December 31, 2014, respectively | 4          | 4          |
| Paid-in-capital   | 181,572    | 177,750    |
| Accumulated other comprehensive loss  | (149 )     | (112 )     |
| Accumulated deficit   | (176,834 ) | (172,280)  |
| Total RadNet, Inc.'s stockholders' equity   | 4,593      | 5,362      |
| Noncontrolling interests  | 1,946      | 2,336      |
| Total equity  | 6,539      | 7,698      |
| Total liabilities and equity  | \$ 742,405 | \$ 740,680 |

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

**RADNET, INC. AND SUBSIDIARIES****CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS****(IN THOUSANDS EXCEPT SHARE AND PER SHARE DATA)****(unaudited)**

|  | <b>Three Months Ended</b> |                     |
|--|---------------------------|---------------------|
|  | <b>March 31,</b>          |                     |
|  | <b>2015</b>               | <b>2014</b>         |
| <b>NET REVENUE</b>   |                           |                     |
| Service fee revenue, net of contractual allowances and discounts                             | \$ 165,030                | \$ 158,763          |
| Provision for bad debts  | (7,475 )                  | (6,893 )            |
| Net service fee revenue  | 157,555                   | 151,870             |
| Revenue under capitation arrangements  | 23,712                    | 17,006              |
| Total net revenue  | 181,267                   | 168,876             |
| <b>OPERATING EXPENSES</b>  |                           |                     |
| Cost of operations, excluding depreciation and amortization                                  | 168,921                   | 145,030             |
| Depreciation and amortization  | 14,294                    | 15,571              |
| (Gain) loss on sale and disposal of equipment  | (38 )                     | 246                 |
| Severance costs  | 36                        | 481                 |
| Total operating expenses   | 183,213                   | 161,328             |
| <b>(LOSS) INCOME FROM OPERATIONS</b>   | <b>(1,946 )</b>           | <b>7,548</b>        |
| <b>OTHER INCOME AND EXPENSES</b>   |                           |                     |
| Interest expense   | 9,996                     | 11,772              |
| Meaningful use incentive   | (3,270 )                  | (1,762 )            |
| Equity in earnings of joint ventures   | (1,102 )                  | (1,067 )            |
| Loss on early extinguishment of Senior Notes   | -                         | 15,456              |
| Other expenses (income)  | (3 )                      | 2                   |
| Total other expenses   | 5,621                     | 24,401              |
| <b>LOSS BEFORE INCOME TAXES</b>  | <b>(7,567 )</b>           | <b>(16,853 )</b>    |
| Benefit from income taxes  | 3,091                     | 4,478               |
| <b>NET LOSS</b>  | <b>(4,476 )</b>           | <b>(12,375 )</b>    |
| Net income attributable to noncontrolling interests  | 78                        | 49                  |
| <b>NET LOSS ATTRIBUTABLE TO RADNET, INC.<br/>COMMON STOCKHOLDERS</b>                         | <b>\$ (4,554 )</b>        | <b>\$ (12,424 )</b> |
| <b>BASIC AND DILUTED LOSS PER SHARE<br/>ATTRIBUTABLE TO RADNET, INC. COMMON STOCKHOLDERS</b> | <b>\$ (0.11 )</b>         | <b>\$ (0.31 )</b>   |

**WEIGHTED AVERAGE SHARES OUTSTANDING**

|                   |            |            |
|-------------------|------------|------------|
| Basic and Diluted | 42,747,329 | 40,010,080 |
|-------------------|------------|------------|

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



**RADNET, INC. AND SUBSIDIARIES****CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS****(IN THOUSANDS)****(unaudited)**

|  | <b>Three Months Ended<br/>March 31,</b> |              |
|--|---|--------------|
|  | <b>2015</b>                             | <b>2014</b>  |
| <b>NET LOSS</b>  | \$ (4,476 )                             | \$ (12,375 ) |
| Foreign currency translation adjustments                                       | (37 )                                   | (18 )        |
| <b>COMPREHENSIVE LOSS</b>  | (4,513 )                                | (12,393 )    |
| Less comprehensive income attributable to non-controlling interests            | 78                                      | 49           |
| <b>COMPREHENSIVE LOSS ATTRIBUTABLE TO RADNET, INC.<br/>COMMON STOCKHOLDERS</b> | \$ (4,591 )                             | \$ (12,442 ) |

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

**RADNET, INC. AND SUBSIDIARIES****CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY****(IN THOUSANDS EXCEPT SHARE DATA)****(unaudited)**

|  | Common Stock |        | Paid-in    | Accumulated  | Accumulated   | Total    | Noncontrolling | Total    |
|--|--------------|--------|------------|--------------|---------------|----------|----------------|----------|
|  | Shares       | Amount | Capital    | Deficit      | Other         | Radnet,  | Interests      | Equity   |
|  |              |        |            |              | Comprehensive | Inc.'s   |                |          |
|  |              |        |            |              | Loss          | Equity   |                |          |
| <b>BALANCE -</b>   |              |        |            |              |               |          |                |          |
| <b>JANUARY 1, 2015</b>                                       | 42,825,676   | \$ 4   | \$ 177,750 | \$(172,280 ) | \$ (112 )     | \$ 5,362 | \$ 2,336       | \$ 7,698 |
| Issuance of common stock upon exercise of options            | 260,180      | —      | 324        | —            | —             | 324      | —              | 324      |
| Stock-based compensation                                     | —            | —      | 3,498      | —            | —             | 3,498    | —              | 3,498    |
| Issuance of restricted stock and other awards                | 724,423      | —      | —          | —            | —             | —        | —              | —        |
| Distributions paid to noncontrolling interests               | —            | —      | —          | —            | —             | —        | (468 )         | (468 )   |
| Change in cumulative foreign currency translation adjustment | —            | —      | —          | —            | (37 )         | (37 )    | —              | (37 )    |
| Net (loss) income  | —            | —      | —          | (4,554 )     | —             | (4,554)  | 78             | (4,476)  |
| <b>BALANCE -</b>   |              |        |            |              |               |          |                |          |
| <b>MARCH 31, 2015</b>  | 43,810,279   | \$ 4   | \$ 181,572 | \$(176,834 ) | \$ (149 )     | \$ 4,593 | \$ 1,946       | \$ 6,539 |

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

**RADNET, INC. AND SUBSIDIARIES****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS****(IN THOUSANDS)****(unaudited)**

|   | <b>Three Months<br/>Ended March 31,</b> |             |
|---|---|-------------|
|   | <b>2015</b>                             | <b>2014</b> |
| <b>CASH FLOWS FROM OPERATING ACTIVITIES</b>   |   |             |
| Net loss  | \$(4,476 )                              | \$(12,375 ) |
| Adjustments to reconcile net loss to net cash provided by (used in) operating activities:                             |   |             |
| Depreciation and amortization   | 14,294                                  | 15,571      |
| Provision for bad debts   | 7,475                                   | 6,893       |
| Equity in earnings of joint ventures  | (1,102 )                                | (1,067 )    |
| Distributions from joint ventures   | 3,041                                   | 1,866       |
| Deferred rent amortization  | 925                                     | 343         |
| Amortization and write off of deferred financing costs and loan discount  | 1,288                                   | 1,833       |
| (Gain) loss on sale and disposal of equipment   | (38 )                                   | 246         |
| Loss on early extinguishment of Senior Notes  | -                                       | 15,456      |
| Stock-based compensation  | 3,554                                   | 1,025       |
| Changes in operating assets and liabilities, net of assets acquired and liabilities assumed in purchase transactions: |   |             |
| Accounts receivable   | (12,498)                                | (13,923 )   |
| Other current assets  | 2,787                                   | (4,503 )    |
| Other assets  | (289 )                                  | (575 )      |
| Deferred taxes  | (3,578 )                                | (4,536 )    |
| Deferred revenue  | (202 )                                  | (39 )       |
| Accounts payable, accrued expenses and other  | 6,288                                   | (11,075 )   |
| Net cash provided by (used in) operating activities   | 17,469                                  | (4,860 )    |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES</b>   |   |             |
| Purchase of imaging facilities  | -                                       | (360 )      |
| Purchase of property and equipment  | (19,826)                                | (17,047 )   |
| Proceeds from sale of equipment   | 205                                     | 4           |
| Equity contributions in existing and purchase of interest in joint ventures   | -                                       | (789 )      |
| Net cash used in investing activities   | (19,621)                                | (18,192 )   |
| <b>CASH FLOWS FROM FINANCING ACTIVITIES</b>   |   |             |
| Principal payments on notes and leases payable  | (2,030 )                                | (1,929 )    |
| Proceeds from borrowings  | -                                       | 210,000     |
| Payments on Term Loan Debt/Senior Notes   | (5,190 )                                | (204,468)   |
| Deferred financing costs  | -                                       | (6,650 )    |
| Net proceeds on revolving credit facility   | 9,400                                   | 18,100      |

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|  |         |          |
|--|---------|----------|
| Distributions paid to noncontrolling interests                           | (468 )  | (133 )   |
| Proceeds from issuance of common stock upon exercise of options/warrants | 324     | 29       |
| Net cash provided by financing activities                                | 2,036   | 14,949   |
| <b>EFFECT OF EXCHANGE RATE CHANGES ON CASH</b>                           | (37 )   | (18 )    |
| <b>NET DECREASE IN CASH AND CASH EQUIVALENTS</b>                         | (153 )  | (8,121 ) |
| <b>CASH AND CASH EQUIVALENTS, beginning of period</b>                    | 307     | 8,412    |
| <b>CASH AND CASH EQUIVALENTS, end of period</b>                          | \$154   | \$291    |
| <b>SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION</b>                  |         |          |
| Cash paid during the period for interest                                 | \$8,624 | \$14,508 |

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 \$12.3 million and \$5.0 million during the three months ended March 31, 2015 and 2014, respectively, which were not paid for as of March 31, 2015 and 2014, respectively. The offsetting amounts due were recorded in our consolidated balance sheet under accounts payable, accrued expenses and other.

## **RADNET, INC. AND SUBSIDIARIES**

### **NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**(unaudited)**

#### **NOTE 1 – NATURE OF BUSINESS AND BASIS OF PRESENTATION**

We provide diagnostic imaging services including magnetic resonance imaging (MRI), computed tomography (CT), positron emission tomography (PET), nuclear medicine, mammography, ultrasound, diagnostic radiology (X-ray), fluoroscopy and other related procedures. At March 31, 2015 we operated directly or indirectly through joint ventures, 259 imaging centers located in California, Maryland, Florida, Delaware, New Jersey, Rhode Island and New York. Our operations comprise a single segment for financial reporting purposes.

The condensed consolidated financial statements include the accounts of Radnet Management, Inc. (or “Radnet Management”) and Beverly Radiology Medical Group III, a professional partnership (“BRMG”). The condensed 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”) Section 810-10-15-14 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 own a majority voting interest and all VIEs for 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 is deemed to be the beneficial owner, directly and indirectly, of approximately 12.3% of our outstanding common stock as of March 31, 2015. Dr. Berger also owns, indirectly, 99% of the equity interests in BRMG. BRMG provides all of

the professional medical services at the majority 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 other 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. BRMG is a partnership of ProNet Imaging Medical Group, Inc., Breastlink Medical Group, Inc. and Beverly Radiology Medical Group, Inc., each of which is 99% or 100% owned by Dr. Berger.

John V Crues, III, M.D. is our Medical Director, a member of our Board of Directors and a 1% owner of BRMG. Dr. Crues owns a controlling interest in four medical groups ("Cruces Entities") which provide professional medical services at some of our facilities in Manhattan and Brooklyn, New York while Dr. Berger owns a controlling interest in two medical groups ("NY Berger Entities") which provide professional medical services at one of our Manhattan, New York facilities. The Cruces Entities and the NY Berger Entities are collectively hereinafter referred to as the "B&C Entities."

RadNet provides non-medical, technical and administrative services to BRMG and the B&C Entities for which it receives a management fee, pursuant to the related management agreements. Through these management agreements and our relationship with both Dr. Berger and Dr. Crues, we have exclusive authority over all non-medical decision-making related to the ongoing business operations of BRMG and the B&C Entities and we determine the annual budget of BRMG and the B&C Entities. BRMG and the B&C Entities both have insignificant operating assets and liabilities, and de minimis equity. Through these management agreements, we are paid the fair market value of our services, the result of which is that generally all net cash flows of both BRMG and the B&C Entities are transferred to us.

We have determined that BRMG and the B&C Entities are VIEs, and that we are the primary beneficiary, and consequently, we consolidate the revenue, expenses, assets and liabilities of each such entity. BRMG and the B&C Entities on a combined basis recognized \$25.5 million and \$20.6 million of revenue, net of management service fees to RadNet for the three months ended March 31, 2015 and 2014, respectively, and \$25.5 million and \$20.6 million of operating expenses for the three months ended March 31, 2015 and 2014, respectively. RadNet, Inc. recognized in its condensed consolidated statement of operations \$99.0 million and \$89.0 million of total billed net service fee revenue relating to these VIE's for the three months ended March 31, 2015 and 2014, respectively, of which \$73.5 million and \$68.5 million was for management services provided to BRMG and the B&C Entities relating primarily to the technical portion of total billed net service fee revenue for the three months ended March 31, 2015 and 2014, respectively.

The cash flows of BRMG and the B&C Entities 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 March 31, 2015 and December 31, 2014, we have included approximately \$84.3 million and \$79.7 million, respectively, of accounts receivable and approximately \$8.7 million and \$9.0 million, respectively, of accounts payable and accrued liabilities, related to BRMG and the B&C Entities combined.

The creditors of both BRMG and the B&C Entities 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 B&C Entities. However, because of the relationship RadNet may be required to provide financial support to cover any operating expenses in excess of operating revenues.

Aside from certain centers in California and all of our centers in New York City where we contract with BRMG and the B&C Entities, respectively, for the provision of professional medical services, at all of our other centers, 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 intended to compensate us for the fair market value of our services which in some instances may be 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-B&C Entities) 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 March 31, 2015 and 2014 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, 2014 filed on March 16, 2015, as amended.

### *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, 2014, 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, 2014, 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. As it relates to centers affiliated with both BRMG and the B&C Entities, this service fee revenue includes payments for both the professional medical interpretation revenue recognized by BRMG and the B&C Entities 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 B&C Entities. As it relates to non-BRMG and B&C Entity centers, this service fee revenue is earned through providing the administration of the non-medical functions relating to the professional medical practice at our non-BRMG and B&C Entity centers, including among other functions, provision of 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 patient 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 under managed care health plans are based upon the payment terms specified in the related contractual agreements. Contractual payment terms in managed care agreements are generally based upon predetermined rates per discounted fee-for-service rates. We also record a provision for doubtful accounts (based primarily on historical collection experience) related to patients and copayment 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 in which we are obligated to provide services to plan enrollees under contracts with various health plans.

Our revenue, net of contractual allowances, discounts and provision for bad debts for the three months ended March 31, 2015 and 2014 is summarized in the following table (in thousands):

|  | <b>Three Months<br/>Ended<br/>March 31,<br/>2015      2014</b> |           |
|--|--|-----------|
| Commercial insurance   | \$99,885   | \$98,881  |
| Medicare   | 37,036   | 36,202    |
| Medicaid   | 5,470  | 5,774     |
| Workers' compensation/personal injury                            | 7,400  | 9,635     |
| Other  | 15,239   | 8,271     |
| Service fee revenue, net of contractual allowances and discounts | 165,030  | 158,763   |
| Provision for bad debts  | (7,475 )   | (6,893 )  |
| Net service fee revenue  | 157,555  | 151,870   |
| Revenue under capitation arrangements                            | 23,712   | 17,006    |
| Total net revenue  | \$181,267  | \$168,876 |

#### *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 each type of payer over an 18-month look-back period, 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.

### *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 will 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. Once an attestation is accepted by Medicare, payments will be made in four to eight weeks to the same taxpayer identification number and through the same channels as their claims payments are made. 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 \$3.3 million and \$1.8 million during the three months ended March 31, 2015, and 2014, respectively, relating to this incentive. These amounts were earned under a Medicare program to promote the use of electronic health record technology.

### *Liquidity and Capital Resources*

We had cash and cash equivalents of \$154,000 and accounts receivable of \$153.3 million at March 31, 2015, compared to cash and cash equivalents of \$307,000 and accounts receivable of \$148.2 million at December 31, 2014. We had a working capital balance of \$61.7 million and \$58.7 million at March 31, 2015 and December 31, 2014, respectively. We had net loss attributable to RadNet, Inc. common stockholders for the three months ended March 31, 2015 and 2014 of \$4.6 million and \$12.4 million respectively. We also had stockholders' equity of \$4.6 million and \$5.4 million at March 31, 2015 and December 31, 2014, 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 March 31, 2015 is \$563.3 million of senior secured term loan debt (net of unamortized discounts of \$11.2 million), broken down by loan agreement as follows (in thousands):

|                        | <b>Face<br/>Value</b> | <b>Discount</b> | <b>Total<br/>Carrying<br/>Value</b> |
|------------------------|-----------------------|-----------------|-------------------------------------|
| First Lien Term Loans  | \$ 394,559            | \$(8,681 )      | \$ 385,878                          |
| Second Lien Term Loans | \$ 180,000            | \$(2,558 )      | \$ 177,442                          |
| Total                  | \$ 574,559            | \$(11,239 )     | \$ 563,320                          |

Our revolving credit facility has a \$24.7 million aggregate principal amount outstanding as of March 31, 2015.

As of March 31, 2015, we were in compliance with all financial covenants under our Refinance Agreement, as amended by the 2014 Amendment, and the Second Lien Credit and Guaranty Agreement, each as defined below. Also described below are details of our \$200 million senior notes, redemption of which was completed in 2014.

2014 Amendment to the Refinance Agreement and Second Lien Credit and Guaranty Agreement:

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

*2014 Amendment of the Refinance Agreement.* Radnet Management amended that certain Credit and Guaranty Agreement dated October 10, 2012, by that certain first amendment dated April 3, 2013 (the “2013 Amendment”) (collectively, the “Refinance Agreement”), and subsequently by entering into a second amendment to the Refinance Agreement on March 25, 2014 (the “2014 Amendment”) to provide for, among other things, the borrowing by Radnet Management of \$30.0 million of additional first lien term loans (the “2014 First Lien Term Loans”).

*Second Lien Credit and Guaranty Agreement.* Radnet Management entered into a Second Lien Credit and Guaranty Agreement dated March 25, 2014 (the “Second Lien Credit Agreement”) to provide for, among other things, the borrowing by Radnet Management 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 senior notes, as more fully described below under the heading “Senior Notes”, 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 Refinance 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 Refinance 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 Refinance Agreement. The revolver bears interest based on types of borrowings as follows: (i) unpaid principal at 6.5% 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 2014 Amendment provides for the following:

*Interest.* The interest rates payable on the 2014 First Lien Term Loans are the same as the rates payable under the Refinance Agreement, as amended by the 2013 Amendment, which are (a) the Adjusted Eurodollar Rate (as defined in the Refinance Agreement) plus 3.25% or (b) the Base Rate (as defined in the Refinance Agreement) plus 2.25%. With respect to all of the term loans under the Refinance Agreement, as amended by the 2014 Amendment, the Adjusted Eurodollar Rate has a minimum floor of 1.0%. The Adjusted Eurodollar Rate at March 31, 2015 was 0.40%.

*Payments.* The scheduled amortization of the term loans under the Refinance Agreement, as amended by the 2014 Amendment, has been 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 by \$16.8 million from pre-amendment terms, representing a rise from 1% per annum to 5% per annum of the initial amount borrowed.

*Guarantees and Collateral.* The obligations under the Refinance Agreement, as amended by the 2014 Amendment, 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 Refinance Agreement, as amended by the 2014 Amendment, 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 covenants, the Refinance Agreement, as amended by the 2014 Amendment, 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 Refinance Agreement, as amended by the 2014 Amendment 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 Refinance Agreement, as amended by the 2014 Amendment, include failure to pay the outstanding 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 Refinance Agreement, as amended by the 2014 Amendment, 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 Refinance Agreement, as amended by the 2014 Amendment, to declare all amounts borrowed, together with accrued interest and fees, to be immediately due and payable and to exercise other default remedies.

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 Eurodollar Rate at March 31, 2015 was 0.40%. The rate paid on the Second Lien Credit Agreement at March 31, 2015 is 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) or events of default per section 8.01 as described below.

*Restrictive Covenants.* In addition to certain 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 transaction, 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 events of default, events of default under the Second Lien Credit Agreement include failure to pay the outstanding 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.

#### Senior Notes

On April 6, 2010, we issued and sold \$200 million of 10 3/8% senior unsecured notes due 2018 at a price of 98.680% (the "senior notes"). All payments of the senior notes, including principal and interest, were guaranteed jointly and



severally on a senior unsecured basis by RadNet, Inc., and all of Radnet Management's current and future domestic wholly owned restricted subsidiaries. The senior notes were issued under an indenture dated April 6, 2010 (the "Indenture"), by and among Radnet Management, Inc., as issuer, RadNet, Inc., as parent guarantor, the subsidiary guarantors thereof and U.S. Bank National Association, as trustee. We paid interest on the senior notes on April 1 and October 1 of each year, commencing October 1, 2010, and they were scheduled to expire on April 1, 2018.

We completed the retirement of our \$200 million in senior notes on April 24, 2014 and following such retirement the Company completed the satisfaction and discharge of the Indenture. The transactions leading to the retirement of the Senior Notes are described below:

*Tender Offer.* On March 7, 2014, we commenced a tender offer to purchase for cash any and all outstanding senior notes. In connection with the tender offer, we also commenced a consent solicitation to amend the Indenture to eliminate or modify certain restrictive covenants. On March 25, 2014, we made a payment in cash for all senior notes tendered prior to 5:00 P.M., New York City time, on March 20, 2014 (the "Consent Payment Deadline"). As of the Consent Payment Deadline, we received tenders and consents in respect of \$193,464,000 aggregate principal amount of the senior notes, representing 96.73% of the outstanding senior notes, all of which were accepted for purchase. The total consideration for each \$1,000 principal amount of senior notes validly tendered and not withdrawn at or prior to the Consent Payment Deadline and accepted for purchase was \$1,056.88, which amount included a consent payment (the "Consent Payment") of \$30.00 per \$1,000 principal amount of senior notes. In addition, all senior notes accepted for payment received accrued and unpaid interest in respect of such notes from the last interest payment date prior to the applicable settlement date to, but not including, the applicable settlement date. The tender offer expired on April 3, 2014 and between the Consent Payment Deadline and the expiration of the tender offer, no additional senior notes were tendered. With a net carrying amount including discount and unamortized issue costs of \$189.2 million, a loss on early extinguishment of debt of \$15.5 million was recorded in the first quarter of 2014.

*Exercise of Optional Redemption on March 25, 2014.* On March 25, 2014, we called for redemption all of our remaining outstanding senior notes not purchased prior to the expiration of the tender offer described above, with a redemption date of April 24, 2014 (the “Redemption Date”). Upon redemption on April 24, 2014, the holders of the senior notes being redeemed received a redemption price equal to 105.188% of the outstanding principal amount of the senior notes being redeemed (or \$1,051.88 per \$1,000 in principal amount of the senior notes) in accordance with the terms of the Indenture, or approximately \$6.9 million in total, including approximately \$43,000 of accrued and unpaid interest up to, but excluding the Redemption Date. As of that date, we completed the satisfaction and discharge of the Indenture in accordance with its terms and no senior notes remained outstanding. With a net carrying amount including discount and unamortized issue costs of \$6.4 million, a loss on early extinguishment of debt of \$471,000 was recorded in the second quarter of 2014.

## **NOTE 2 – NEW ACCOUNTING STANDARDS**

In April 2015, FASB issued ASU No. 2015-03 (“ASU 2015-03”), *Interest – Imputation of Interest*, (Subtopic 835-30). ASU 2015-03 changes the accounting method for debt issuance costs from a deferred charge (i.e. an asset) to a contra liability in part because such costs provide no future economic benefit. Debt issue costs related to a recognized debt liability are to be presented in the balance sheet as a direct deduction from the carrying amount of the debt liability, consistent with the presentation of debt discounts. 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. We are currently evaluating the impact of the GAAP update on our consolidated financial position, results of operations and cash flows.

In February 2015, FASB issued ASU No. 2015-02 (“ASU 2015-02”), *Consolidation – Amendments to the Consolidation Analysis*, (Topic 810). ASU 2015-02 changes the analysis that a reporting entity must perform to determine whether it should consolidate certain types of legal entities. It is effective for annual reporting periods, and interim periods within those years, beginning after December 15, 2015. Early adoption is permitted, including adoption in an interim period. We are currently evaluating the impact of the GAAP update on our consolidated financial position, results of operations and cash flows.

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 is effective for fiscal years (and interim reporting periods within fiscal years) beginning after December 15, 2016. We are currently evaluating the impact of the GAAP update on our consolidated financial position, results of operations and cash flows.

**NOTE 3 – EARNINGS PER SHARE**

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

|  | <b>Three Months Ended<br/>March 31,</b> |               |
|--|---|---------------|
|  | <b>2015</b>                             | <b>2014</b>   |
| Net loss attributable to RadNet, Inc. common stockholders  | \$(4,554                                | ) \$(12,424 ) |
| <b>BASIC AND DILUTED NET LOSS PER SHARE ATTRIBUTABLE TO RADNET,<br/>INC. COMMON STOCKHOLDERS</b> |   |               |
| Weighted average number of common shares outstanding during the period                           | 42,747,329                              | 40,010,080    |
| Basic and diluted net loss per share attributable to RadNet, Inc. common stockholders            | \$(0.11                                 | ) \$(0.31 )   |

For the three months ended March 31, 2015 and 2014 we excluded all outstanding options and restricted stock awards in the calculation of diluted earnings per share because their effect would be antidilutive.

**NOTE 4 – INVESTMENT IN JOINT VENTURES**

We have ten unconsolidated joint ventures with ownership interests ranging from 35% to 50%. These joint ventures represent partnerships with hospitals, health systems or radiology practices and were formed for the purpose of owning and operating diagnostic imaging centers. Professional services at the joint venture diagnostic imaging centers are performed by contracted radiology practices or a radiology practice that participates in the joint venture. Our investment in these joint ventures is accounted for under the equity method.

The following table is a roll forward of our investment in joint ventures during the three months ended March 31, 2015 (in thousands):

|  |          |
|--|----------|
| Balance as of December 31, 2014            | \$32,123 |
| Equity in earnings in these joint ventures | 1,102    |
| Distribution of earnings                   | (3,041 ) |
| Balance as of March 31, 2015               | \$30,184 |

We earned management service fees from the centers underlying these joint ventures of approximately \$2.4 million in each of the three months ended March 31, 2015 and 2014, respectively. At the end of the period we eliminate from total fees recorded the uncollected portion of these fees that are associated with our ownership interests and offset this with an increase to our equity earnings.

The following table is a summary of key financial data for these joint ventures as of March 31, 2015 and for the three months ended March, 2015 and 2014 (in thousands):

|  |                               |
|--|-------------------------------|
|  | <b>March<br/>31,<br/>2015</b> |
| Balance Sheet Data:  |                               |
| Current assets   | \$18,566                      |
| Noncurrent assets  | 49,222                        |
| Current liabilities  | (8,237 )                      |
| Noncurrent liabilities   | (5,915 )                      |
| Total net assets   | \$53,636                      |
| Book value of RadNet joint venture interests                     | \$25,206                      |
| Cost in excess of book value of acquired joint venture interests | 4,978                         |
| Total value of Radnet joint venture interests                    | \$30,184                      |
| Total book value of other joint venture partner interests        | \$28,430                      |

| Income statement data for the three months ended March 31, | <b>2015</b> | <b>2014</b> |
|--|-------------|-------------|
| Net revenue  | \$26,442    | \$22,806    |
| Net income   | \$3,030     | \$2,149     |

**NOTE 5 – STOCK-BASED COMPENSATION****Stock Incentive Plans***Options and Warrants*

We have one long-term incentive plan which we refer to as the 2006 Plan. As of March 31, 2015, we have reserved for issuance under the 2006 Plan 11,000,000 shares of common stock. Certain options granted under the 2006 Plan to employees are intended to qualify as incentive stock options under existing tax regulations. In addition, we may issue non-qualified stock options under the 2006 Plan from time to time to non-employees, in connection with acquisitions and for other purposes and we may also issue restricted stock under the 2006 Plan. Stock options and warrants generally vest over two to five years and expire five to ten years from date of grant.

As of March 31, 2015, 1,699,176, or approximately 97.5%, of the 1,742,509 outstanding stock options granted under our 2006 Plan are fully vested. During the three months ended March 31, 2015, we did not grant options or warrants under our 2006 Plan.

The following summarizes all of our option and warrant transactions during the three months ended March 31, 2015:

| <b>Outstanding Options and Warrants<br/>Under the 2006 Plan</b> | <b>Shares</b> | <b>Weighted<br/>Average<br/>Exercise<br/>price<br/>Per<br/>Common<br/>Share</b> | <b>Weighted<br/>Average<br/>Remaining<br/>Contractual<br/>Life<br/>(in years)</b> | <b>Aggregate<br/>Intrinsic<br/>Value</b> |
|---|---------------|---|---|--|
| Balance, December 31, 2014                                      | 2,092,509     | \$ 3.58   |   |  |
| Granted   | —             | —   |   |  |
| Exercised   | (325,000 )    | 2.69  |   |  |
| Canceled, forfeited or expired                                  | (25,000 )     | 2.22  |   |  |
| Balance, March 31, 2015   | 1,742,509     | 3.76  | 1.03  | \$8,230,904                              |
| Exercisable at March 31, 2015                                   | 1,699,176     | 3.80  | 0.97  | 7,955,304                                |

Aggregate intrinsic value in the table above represents the total pretax intrinsic value (the difference between our closing stock price on March 31, 2015 and the exercise price, multiplied by the number of in-the-money options or warrants, as applicable) that would have been received by the holder had all holders exercised their options or warrants, as applicable, on March 31, 2015. Total intrinsic value of options and warrants exercised during the three months ended March 31, 2015 and 2014 was approximately \$1.9 million and \$16,000, respectively. As of March 31, 2015, total unrecognized stock-based compensation expense related to non-vested employee awards was \$30,000, which is expected to be recognized over a weighted average period of approximately 1.6 years.

***Restricted Stock Awards (“RSA’s”)***

The 2006 Plan permits the award of restricted stock. As of March 31, 2015, we have issued a total of 3,441,208 RSA’s of which 881,194 were unvested at March 31, 2015.

The following summarizes all unvested RSA’s activities during the three months ended March 31, 2015:

|  | <b>Shares</b> | <b>Weighted-<br/>Average<br/>Remaining<br/>Contractual<br/>Term<br/>(Years)</b> | <b>Weighted-<br/>Average<br/>Fair<br/>Value</b> |
|--|---------------|---|---|
| RSA's outstanding at December 31, 2014 | 942,023       |   | \$ 1.96   |
| Changes during the period              |               |   |   |
| Granted                                | 724,423       |   | \$ 8.66   |
| Vested                                 | (785,253)     |   | \$ 4.53   |
| RSA's outstanding at March 31, 2015    | 881,194       | 1.21  | \$ 5.17   |

We determine the fair value of all RSA’s based of the closing price of our common stock on award date.

In sum, of the 11,000,000 shares of common stock reserved for issuance under the 2006 Plan, at March 31, 2015, we had 7,944,958 options, shares of restricted stock and other bonus awards issued and 3,055,042 shares of common stock available for future awards.

**NOTE 6 – FAIR VALUE MEASUREMENTS**

**FAIR VALUE MEASUREMENTS** – Assets and liabilities subject to fair value measurements are required to be disclosed within a fair value hierarchy. The fair value hierarchy ranks the quality and reliability of inputs used to determine fair value. Accordingly, assets and liabilities carried at, or permitted to be carried at, fair value are classified within the fair value hierarchy in one of the following categories based on the lowest level input that is significant to a fair value measurement:

Level 1—Fair value is determined by using unadjusted quoted prices that are available in active markets for identical assets and liabilities.

Level 2—Fair value is determined by using inputs other than Level 1 quoted prices that are directly or indirectly observable. Inputs can include quoted prices for similar assets and liabilities in active markets or quoted prices for identical assets and liabilities in inactive markets. Related inputs can also include those used in valuation or other pricing models such as interest rates and yield curves that can be corroborated by observable market data.

Level 3—Fair value is determined by using inputs that are unobservable and not corroborated by market data. Use of these inputs involves significant and subjective judgment.

The table below summarizes the estimated fair value of our long-term debt as follows (in thousands):

|                        | <b>As of March 31, 2015</b> |                |                |                         |                         |
|------------------------|-----------------------------|----------------|----------------|-------------------------|-------------------------|
|                        | <b>Level 1</b>              | <b>Level 2</b> | <b>Level 3</b> | <b>Total Fair Value</b> | <b>Total Face Value</b> |
| First Lien Term Loans  | \$–                         | \$395,052      | \$ –           | \$395,052               | \$394,559               |
| Second Lien Term Loans |                             | \$178,200      | \$ –           | 178,200                 | \$180,000               |

  

|                        | <b>As of December 31, 2014</b> |                |                |              |                         |
|------------------------|--------------------------------|----------------|----------------|--------------|-------------------------|
|                        | <b>Level 1</b>                 | <b>Level 2</b> | <b>Level 3</b> | <b>Total</b> | <b>Total Face Value</b> |
| First Lien Term Loans  | \$–                            | \$394,753      | \$ –           | \$394,753    | \$399,750               |
| Second Lien Term Loans |                                | – 178,200      |                | – 178,200    | 180,000                 |



The carrying value of our revolving credit facility at March 31, 2015 and December 31, 2014 of \$24.7 million and \$15.3 million, respectively, approximated its fair value.

We consider the carrying amounts of cash and cash equivalents, receivables, other current assets and current liabilities to approximate their fair value because of the relatively short period of time between the origination of these instruments and their expected realization or payment. Additionally, we consider the carrying amount of our capital lease obligations to approximate their fair value because the weighted average interest rate used to formulate the carrying amounts approximates current market rates.

#### **NOTE 7 – SUBSEQUENT EVENTS**

On April 1, 2015, RadNet purchased substantially all of the assets of New York Radiology Partners (NYRP) for \$31.4 million in total consideration, consisting of \$29.8 million in cash and issued a promissory note for the remainder in the amount of \$1.6 million.

On April 30, 2015, RadNet entered into a joinder to its existing senior secured first lien credit agreement to provide for the borrowing of \$75.0 million of incremental first lien term loans. The incremental first lien term loans will be treated as part of the same class as the existing tranche B term loans currently outstanding under the existing first lien credit agreement and will bear the same interest rate as the rate currently payable on the existing tranche B term loans under the existing first lien credit agreement, which is (a) the adjusted LIBOR rate plus 3.25% or (b) the base rate plus 2.25%. Proceeds from the incremental term loans were used to repay all the borrowings outstanding under the first lien revolving loan facility and pay approximately \$1 million of fees and expenses associated with the transaction.

## **ITEM 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations**

The following discussion of our financial condition and results of operations should be read in conjunction with our consolidated financial statements and the related notes and other financial information appearing elsewhere in this quarterly report.

### **Forward-Looking Statements**

This quarterly report on Form 10-Q contains “forward-looking statements” within the meaning of Section 27A of the Securities Act of 1933, as amended (the “Securities Act”) and Section 21E of the Securities Exchange Act of 1934, as amended. Forward-looking statements reflect current views about future events and are based on our currently available financial, economic and competitive data and on current business plans. Actual events or results may differ materially depending on risks and uncertainties that may affect our operations, markets, services, prices and other factors.

In some cases, you can identify forward-looking statements by terminology such as “may,” “will,” “should,” “expect,” “intend,” “plan,” “anticipate,” “believe,” “estimate,” “predict,” “potential,” “continue,” “assumption” or the negative of these terms or other comparable terminology. Statements in this quarterly report concerning our ability to successfully acquire and integrate new operations, to grow our contract management business, our financial guidance, our future cost saving efforts, our increased business from new equipment or operations and our ability to finance our operations and repay our outstanding indebtedness, including our increased amortization payments, are forward-looking statements.

The factors included in “Risk Factors,” in our annual report on Form 10-K for the fiscal year ended December 31, 2014, as amended or supplemented by the information, in Part II – Item 1A below, among others, could cause our actual results to differ materially from those expressed in, or implied by, the forward-looking statements. You should consider the inherent limitations on, and risks associated with, forward-looking statements and not unduly rely on the accuracy of predictions contained in such forward-looking statements. These forward-looking statements speak only as of the date when they are made. Except as required under the federal securities laws or by the rules and regulations of the Securities and Exchange Commission, we do not undertake any responsibility to release publicly any revisions to these forward-looking statements to take into account events or circumstances that occur after the date of those statements. Additionally, we do not undertake any responsibility to update you on the occurrence of any unanticipated events which may cause actual results to differ from those expressed or implied by the forward-looking statements contained in this quarterly report.

### **Overview**

We are the leading national provider of freestanding, fixed-site outpatient diagnostic imaging services in the United States based on number of locations and annual imaging revenue. At March 31, 2015, we operated directly or indirectly through joint ventures, 259 centers located in California, Maryland, Florida, Delaware, New Jersey, Rhode Island and New York. Our centers provide physicians with imaging capabilities to facilitate the diagnosis and treatment of diseases and disorders and may reduce unnecessary invasive procedures, often reducing the cost and amount of care for patients. 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.

We seek to develop leading positions in regional markets in order to leverage operational efficiencies. Our scale and density within selected geographies provides close, long-term relationships with key payors, radiology groups and referring physicians. Each of our facility managers is responsible for managing relationships with local physicians and payors, meeting our standards of patient service and maintaining profitability. We provide corporate training programs, standardized policies and procedures and sharing of best practices among the physicians in our regional networks.

We derive substantially all of our revenue, directly or indirectly, from fees charged for the diagnostic imaging services performed at our facilities. For the three months ended March 31, 2015 and 2014, we performed 1,211,797 and 1,115,847 diagnostic imaging procedures, respectively, and generated total net revenue of \$181.3 million and \$168.9 million, respectively.

The condensed consolidated financial statements include the accounts of Radnet Management, Inc. (or “Radnet Management”) and Beverly Radiology Medical Group III, a professional partnership (“BRMG”). The condensed 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”) Section 810-10-15-14 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 own a majority voting interest and all VIEs for 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 is deemed to be the beneficial owner, directly and indirectly, of approximately 12.3% of our outstanding common stock as of March 31, 2015. Dr. Berger also owns, indirectly, 99% of the equity interests in BRMG. BRMG provides all of the professional medical services at the majority 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 other 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. BRMG is a partnership of ProNet Imaging Medical Group, Inc., Breastlink Medical Group, Inc. and Beverly Radiology Medical Group, Inc., each of which is 99% or 100% owned by Dr. Berger.

John V Crues, III, M.D. is our Medical Director, a member of our Board of Directors and a 1% owner of BRMG. Dr. Crues owns a controlling interest in four medical groups (“Crues Entities”) which provide professional medical services at some of our facilities in Manhattan and Brooklyn, New York while Dr. Berger owns a controlling interest in two medical groups (“NY Berger Entities”) which provide professional medical services at one of our Manhattan, New York facilities. The Crues Entities and the NY Berger Entities are collectively hereinafter referred to as the “B&C Entities.”

RadNet provides non-medical, technical and administrative services to BRMG and the B&C Entities for which it receives a management fee, pursuant to the related management agreements. Through these management agreements and our relationship with both Dr. Berger and Dr. Crues, we have exclusive authority over all non-medical decision-making related to the ongoing business operations of BRMG and the B&C Entities and we determine the annual budget of BRMG and the B&C Entities. BRMG and the B&C Entities both have insignificant operating assets and liabilities, and de minimis equity. Through these management agreements, we are paid the fair market value of our services, the result of which is that generally all net cash flows of both BRMG and the B&C Entities are transferred to us.

We have determined that BRMG and the B&C Entities are VIEs, and that we are the primary beneficiary, and consequently, we consolidate the revenue, expenses, assets and liabilities of each such entity. BRMG and the B&C Entities on a combined basis recognized \$25.5 million and \$20.6 million of revenue, net of management service fees to RadNet for the three months ended March 31, 2015 and 2014, respectively, and \$25.5 million and \$20.6 million of operating expenses for the three months ended March 31, 2015 and 2014, respectively. RadNet, Inc. recognized in its condensed consolidated statement of operations \$99.0 million and \$89.0 million of total billed net service fee revenue relating to these VIE's for the three months ended March 31, 2015 and 2014, respectively, of which \$73.5 million and \$68.5 million was for management services provided to BRMG and the B&C Entities relating primarily to the technical portion of total billed net service fee revenue for the three months ended March 31, 2015 and 2014, respectively.

The cash flows of BRMG and the B&C Entities 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 March 31, 2015 and December 31, 2014, we have included approximately \$84.3 million and \$79.7 million, respectively, of accounts receivable and approximately \$8.7 million and \$9.0 million, respectively, of accounts payable and accrued liabilities, related to BRMG and the B&C Entities combined.

The creditors of both BRMG and the B&C Entities 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 B&C Entities. However, because of the relationship RadNet may be required to provide financial support to cover any operating expenses in excess of operating revenues.

Aside from certain centers in California and all of our centers in New York City where we contract with BRMG and the B&C Entities, respectively, for the provision of professional medical services, at all of our other centers, 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. The contracted radiology practices generally have outstanding physician and practice credentials and reputations; strong competitive market positions; a broad sub-specialty mix of physicians; a history of growth and potential for continued growth. 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 intended to compensate us for the fair market value of our services which in some instances may be 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-B&C Entities) radiology practices; accordingly, we do not consolidate the financial statements of those practices in our consolidated financial statements.

We typically experience some seasonality to our business. During the first quarter of each year we generally experience the lowest volumes of procedures and the lowest level of revenue for any quarter during the year. This is primarily the result of two factors. First, our volumes and revenue are typically impacted by winter weather conditions in our northeastern operations. It is common for snowstorms and other inclement weather to result in patient appointment cancellations and, in some cases, imaging center closures. Second, in recent years, we have observed greater participation in high deductible health plans by patients. As these high deductibles reset in January for most of these patients, we have observed that patients utilize medical services less during the first quarter, when securing medical care will result in significant out-of-pocket expenditures.

### **Critical Accounting Policies**

The Securities and Exchange Commission defines critical accounting estimates as those that are both most important to the portrayal of a company's financial condition and results of operations and require management's most difficult, subjective or complex judgment, often as a result of the need to make estimates about the effect of matters that are inherently uncertain and may change in subsequent periods. In Note 2 to our consolidated financial statements in our annual report on Form 10-K for the year ended December 31, 2014, as amended, we discuss our significant accounting policies, including those that do not require management to make difficult, subjective or complex judgments or estimates. The most significant areas involving management's judgments and estimates are described below.

### ***Use of Estimates***

Our discussion and analysis of financial condition and results of operations are based on our consolidated financial statements that were prepared in accordance with U.S. generally accepted accounting principles, or GAAP. Management makes estimates and assumptions when preparing financial statements. These estimates and assumptions affect various matters, including:

- our reported amounts of assets and liabilities in our consolidated balance sheets at the dates of the financial statements;
- our disclosure of contingent assets and liabilities at the dates of the financial statements; and
- our reported amounts of net revenue and expenses in our consolidated statements of operations during the reporting periods.

These estimates involve judgments with respect to numerous factors that are difficult to predict and are beyond management's control. As a result, actual amounts could differ materially from these estimates.

During the period covered in this report, there were no material changes to the critical accounting estimates we use, and have described in our annual report on Form 10-K for the fiscal year ended December 31, 2014, 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. As it relates to centers affiliated with both BRMG and the B&C Entities, this service fee revenue includes payments for both the professional medical interpretation revenue recognized by BRMG and the B&C Entities 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 B&C Entities. As it relates to non-BRMG and B&C Entity centers, this service fee revenue is earned through providing the administration of the non-medical functions relating to the professional medical practice at our non-BRMG and B&C Entity centers, including among other functions, provision of 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 patient 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 under managed care health plans are based upon the payment terms specified in the related contractual agreements. Contractual payment terms in managed care agreements are generally based upon predetermined rates per discounted fee-for-service rates. We also record a provision for doubtful accounts (based primarily on historical collection experience) related to patients and copayment and deductible amounts for patients who have health care coverage under one of our third-party payers.

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 in which we are obligated to provide services to plan enrollees under contracts with various health plans.

Our revenue, net of contractual allowances, discounts and provision for bad debts for the three months ended March 31, 2015 and 2014 is summarized in the following table (in thousands):

|                                       | <b>Three Months<br/>Ended<br/>March 31,<br/>2015      2014</b> |          |
|---------------------------------------|--|----------|
| Commercial insurance                  | \$99,885   | \$98,881 |
| Medicare                              | 37,036   | 36,202   |
| Medicaid                              | 5,470  | 5,774    |
| Workers' compensation/personal injury | 7,400  | 9,635    |



|  |            |            |
|--|------------|------------|
| Other  | 15,239     | 8,271      |
| Service fee revenue, net of contractual allowances and discounts | 165,030    | 158,763    |
| Provision for bad debts  | (7,475 )   | (6,893 )   |
| Net service fee revenue  | 157,555    | 151,870    |
| Revenue under capitation arrangements                            | 23,712     | 17,006     |
| Total net revenue  | \$ 181,267 | \$ 168,876 |

### ***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 each type of payer over an 18-month look-back period, 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.

### ***Accounts Receivable***

Substantially all of our accounts receivable are due under fee-for-service contracts from third party payors, such as insurance companies and government-sponsored healthcare programs, or directly from patients. Services are generally provided pursuant to one-year contracts with healthcare providers. Receivables generally are collected within industry norms for third-party payors. We continuously monitor collections from our payors and maintain an allowance for bad debts based upon specific payor collection issues that we have identified and our historical experience.

### ***Depreciation and Amortization of Long-Lived Assets***

We depreciate our long-lived assets over their estimated economic useful lives with the exception of leasehold improvements where we use the shorter of the assets useful lives or the lease term of the facility for which these assets are associated.

### ***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. At March 31, 2015, we determined that approximately \$56.2 million of our net deferred tax assets are more likely than not to be realized.

### ***Valuation of Goodwill and Indefinite Lived Intangibles***

Goodwill at March 31, 2015 totaled \$200.3 million. Indefinite Lived Intangible Assets at March 31, 2015 totaled \$7.5 million and are associated with the value of certain trade name intangibles. Goodwill and trade name intangibles are recorded as a result of business combinations. Management evaluates goodwill and trade name intangibles, at a minimum, on an annual basis and whenever events and changes in circumstances suggest that the carrying amount may not be recoverable. Impairment of goodwill is tested at the reporting unit level by comparing the reporting unit's carrying amount, including goodwill, to the fair value of the reporting unit. The fair value of a reporting unit is estimated using a combination of the income or discounted cash flows approach and the market approach, which uses comparable market data. If the carrying amount of the reporting unit exceeds its fair value, goodwill is considered impaired and a second step is performed to measure the amount of impairment loss, if any. Impairment of trade name intangibles is tested at the subsidiary level by comparing the subsidiary's trade name carrying amount to its respective fair value. We tested both goodwill and trade name intangibles for impairment on October 1, 2014, noting no impairment, and have not identified any indicators of impairment through March 31, 2015.

### ***Long-Lived Assets***

We evaluate our long-lived assets (property and equipment) and intangibles, other than goodwill, for impairment whenever indicators of impairment exist. The accounting standards require that if the sum of the undiscounted expected future cash flows from a long-lived asset or definite-lived intangible is less than the carrying value of that asset, an asset impairment charge must be recognized. The amount of the impairment charge is calculated as the excess of the asset's carrying value over its fair value, which generally represents the discounted future cash flows from that asset or in the case of assets we expect to sell, at fair value less costs to sell. No indicators of impairment were identified with respect to our long-lived assets as of March 31, 2015.

### **New Accounting Standards**

In April 2015, FASB issued ASU No. 2015-03 ("ASU 2015-03"), *Interest – Imputation of Interest*, (Subtopic 835-30). ASU 2015-03 changes the accounting method for debt issuance costs from a deferred charge (i.e. an asset) to a contra liability in part because such costs provide no future economic benefit. Debt issue costs related to a recognized debt liability are to be presented in the balance sheet as a direct deduction from the carrying amount of the debt liability, consistent with the presentation of debt discounts. 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. We are currently evaluating the impact of the GAAP update on our consolidated financial position, results of operations and cash flows.

In February 2015, FASB issued ASU No. 2015-02 ("ASU 2015-02"), *Consolidation – Amendments to the Consolidation Analysis*, (Topic 810). ASU 2015-02 changes the analysis that a reporting entity must perform to determine whether it should consolidate certain types of legal entities. It is effective for annual reporting periods, and interim periods within those years, beginning after December 15, 2015. Early adoption is permitted, including adoption in an interim period. We are currently evaluating the impact of the GAAP update on our consolidated financial position, results of operations and cash flows.

In May 2014, the Financial Accounting Standard Board issued a GAAP update "Revenue from Contracts with Customers". This GAAP update 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. This GAAP update 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 GAAP update is effective for fiscal years (and interim reporting periods within fiscal years) beginning after December 15, 2016. We are currently evaluating the impact of the GAAP update on our consolidated financial position, results of operations and cash flows.

## Industry Updates

On April 16, 2015, the President signed into law the Medicare Access and CHIP Reauthorization Act (H.R. 2), which provides for sweeping changes to how Medicare pays physicians, as well as averts the 21% reduction to Medicare payments under the Medicare Physician Fee Schedule that was scheduled to take effect on April 1, 2016. H.R. 2, among other things, repealed the Sustainable Growth Rate (“SGR”) formula enacted in 1997 and freezes payment rates at their current levels until rates increase by 0.5% for services furnished during the last 6 months of calendar year 2015. For services paid under the physician fee schedule and furnished during calendar years 2016 through 2019, Medicare’s payment rates will increase by 0.5% per year. Fees will remain at the 2019 level through 2025, but high performing providers participating in alternative payment models will have the opportunity for additional payments. Such payments will be based upon quality, resource use, clinical practice improvement activities and meaningful use of electronic health record technology.

## Results of Operations

The following table sets forth, for the periods indicated, the percentage that certain items in the statements of operations bears to revenue, net of contractual allowances and discounts and inclusive of revenue under capitation contracts.

### RADNET, INC. AND SUBSIDIARIES

(unaudited)

|  | <b>Three Months<br/>Ended<br/>March 31,<br/>2015    2014</b> |       |
|--|--|-------|
| <b>NET REVENUE</b>   |  |       |
| Service fee revenue, net of contractual allowances and discounts | 87.4%  | 90.3% |
| Provision for bad debts  | -4.0%  | -3.9% |
| Net service fee revenue  | 83.5%  | 86.4% |
| Revenue under capitation arrangements                            | 12.6%  | 9.7%  |
| Total net revenue  | 96.0%  | 96.1% |
| <b>OPERATING EXPENSES</b>  |  |       |
| Cost of operations, excluding depreciation and amortization      | 89.5%  | 82.5% |
| Depreciation and amortization                                    | 7.6%   | 8.9%  |
| (Gain) loss on sale and disposal of equipment                    | 0.0%   | 0.1%  |
| Severance costs  | 0.0%   | 0.3%  |

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|  |       |       |
|--|-------|-------|
| Total operating expenses   | 97.1% | 91.8% |
| <b>INCOME FROM OPERATIONS</b>  | -1.0% | 4.3%  |
| <b>OTHER INCOME AND EXPENSES</b>                                     |       |       |
| Interest expense   | 5.3%  | 6.7%  |
| Meaningful use incentive   | -1.7% | -1.0% |
| Equity in earnings of joint ventures                                 | -0.6% | -0.6% |
| Loss on early extinguishment of Senior Notes                         | 0.0%  | 8.8%  |
| Other (income) expenses  | 0.0%  | 0.0%  |
| Total other expenses   | 3.0%  | 13.9% |
| <b>LOSS BEFORE INCOME TAXES</b>                                      | -4.0% | -9.6% |
| Benefit From income taxes  | 1.6%  | 2.5%  |
| <b>NET LOSS</b>  | -2.4% | -7.0% |
| Net income attributable to noncontrolling interests                  | 0.0%  | 0.0%  |
| <b>NET LOSS ATTRIBUTABLE TO RADNET, INC.<br/>COMMON STOCKHOLDERS</b> | -2.4% | -7.1% |

***Three Months Ended March 31, 2015 Compared to the Three Months Ended March 31, 2014***

***Service Fee Revenue***

Service fee revenue for the three months ended March 31, 2015 was \$165.0 million compared to \$158.8 million for the three months ended March 31, 2014, an increase of \$6.2 million, or 3.9%.

Service fee revenue, including only those centers which were in operation throughout the first quarters of both 2015 and 2014 decreased \$1.3 million or 0.8%. This 0.8% decrease resulted from inclement weather on the eastern seaboard that affected our operations during the first quarter of 2015. This comparison excludes revenue contributions from centers that were acquired or divested subsequent to January 1, 2014. For the three months ended March 31, 2015, service fee revenue from centers that were acquired or divested subsequent to January 1, 2014 and excluded from the above comparison was \$7.8 million. For the three months ended March 31, 2014, service fee revenue from centers that were acquired or divested subsequent to January 1, 2014 and excluded from the above comparison was \$267,000.

***Provision for Bad Debts***

Provision for bad debts increased \$582,000, or 8.4%, to approximately \$7.5 million, or 4.0% of revenue, for the three months ended March 31, 2015 compared to \$6.9 million, or 3.9% of service fee revenue, for the three months ended March 31, 2014.

***Revenue Under Capitation Arrangements***

Revenue under capitation arrangements for the three months ended March 31, 2015 was \$23.7 million compared to \$17.0 million for the three months ended March 31, 2014, an increase of \$6.7 million or 39.4%.

Revenue under capitation arrangements, including only those centers which were in operation throughout the first quarters of both 2015 and 2014 increased \$5.7 million, or 34.0%. This 34.0% increase was mainly due to both new and expanded contractual relationships with private insurers. This comparison excludes revenue contributions from centers that were acquired or divested subsequent to January 1, 2014. For the three months ended March 31, 2015, revenue under capitation arrangements from centers that were acquired or divested subsequent to January 1, 2014 and excluded from the above comparison was \$1.1 million. For the three months ended March 31, 2014, capitation

revenue from centers that were acquired or divested subsequent to January 1, 2014 and excluded from the above comparison was \$127,000.

### *Operating Expenses*

Cost of operations for the three months ended March 31, 2015 increased approximately \$21.9 million, or 13.6%, from \$161.3 million for the three months ended March 31, 2014 to \$183.2 million for the three months ended March 31, 2015. The following table sets forth our cost of operations and total operating expenses for the three months ended March 31, 2015 and 2014 (in thousands):

|  | <b>2015</b> | <b>2014</b> |
|--|-------------|-------------|
| Salaries and professional reading fees, excluding stock-based compensation | \$90,200    | \$80,713    |
| Stock-based compensation   | 3,554       | 1,025       |
| Building and equipment rental  | 17,117      | 15,615      |
| Medical supplies   | 11,503      | 8,787       |
| Other operating expenses *   | 46,547      | 38,890      |
| Cost of operations   | 168,921     | 145,030     |
| Depreciation and amortization  | 14,294      | 15,571      |
| (Gain) loss on sale and disposal of equipment                              | (38 )       | 246         |
| Severance costs  | 36          | 481         |
| Total operating expenses   | \$183,213   | \$161,328   |

\* Includes billing fees, office supplies, repairs and maintenance, insurance, business tax and license, outside services, utilities, marketing, travel and other expenses.

### **Salaries and professional reading fees, excluding stock-based compensation and severance**

Salaries and professional reading fees increased \$9.5 million, or 11.8%, to \$90.2 million for the three months ended March 31, 2015 compared to \$80.7 million for the three months ended March 31, 2014.

Salaries and professional reading fees, including only those centers which were in operation throughout the first quarters of both 2015 and 2014, increased \$6.8 million, or 8.5%. The 8.5% increase is consistent with the rise in total net revenue over the same period in the prior year when adjusted for certain bonuses recorded in the current quarter not reflected in the prior year's quarter. This comparison excludes expenses from centers that were acquired or divested subsequent to January 1, 2014. For the three months ended March 31, 2015, salaries and professional reading fees from centers that were acquired or divested subsequent to January 1, 2014 and excluded from the above comparison was \$3.0 million. For the three months ended March 31, 2014, salaries and professional reading fees from centers that were acquired or divested subsequent to January 1, 2014 and excluded from the above comparison was approximately \$265,000.

### **Stock-based compensation**

Stock-based compensation increased \$2.5 million, or 246.7%, to approximately \$3.5 million for the three months ended March 31, 2015 compared to \$1.0 million for the three months ended March 31, 2014. This increase was driven by the higher fair value of RSA's awarded and vested in the first quarter of 2015 as compared to RSA's awarded and vested in the prior year's first quarter.

### **Building and equipment rental**

Building and equipment rental expenses increased \$1.5 million or 9.6%, to \$17.1 million for the three months ended March 31, 2015 compared to \$15.6 million for the three months ended March 31, 2014.

Building and equipment rental expenses, including only those centers which were in operation throughout the first quarters of both 2015 and 2014, increased \$710,000, or 4.6%. This 4.6% increase is mainly related to additional radiology equipment operating leases in support of operations. This comparison excludes expenses from centers that were acquired or divested subsequent to January 1, 2014. For the three months ended March 31, 2015, building and equipment rental expenses from centers that were acquired or divested subsequent to January 1, 2014 and excluded from the above comparison was \$881,000. For the three months ended March 31, 2014, building and equipment rental expenses from centers that were acquired or divested subsequent to January 1, 2014 and excluded from the above comparison was approximately \$89,000.



### **Medical supplies**

Medical supplies expense increased \$2.7 million, or 30.9%, to \$11.5 million for the three months ended March 31, 2015 compared to \$8.8 million for the three months ended March 31, 2014.

Medical supplies expenses, including only those centers which were in operation throughout the first quarters of both 2015 and 2014, increased \$1.9 million, or 21.5%. This 21.5% rise is primarily due to increased purchases stemming from volumes along with supplier price increases. This comparison excludes expenses from centers that were acquired or divested subsequent to January 1, 2014. For the three months ended March 31, 2015, medical supplies expenses from centers that were acquired or divested subsequent to January 1, 2014 and excluded from the above comparison was \$833,000. For the three months ended March 31, 2014, medical supplies expense from centers that were acquired or divested subsequent to January 1, 2014 and excluded from the above comparison was \$3,000.

### **Other operating expenses**

Other operating expenses increased \$7.6 million, or 19.7%, to \$46.5 million for the three months ended March 31, 2015 compared to \$38.9 million for the three months ended March 31, 2014.

Other operating expenses, including only those centers which were in operation throughout the first quarters of both 2015 and 2014, increased \$4.5 million, or 11.7%. This 11.7 % increase is due in part to higher utility costs driven by both usage and rates. Also included are phone service rebates recognized for the three months ending March 31, 2014 not granted in the current year's quarter . This comparison excludes expenses from centers that were acquired or divested subsequent to January 1, 2014. For the three months ended March 31, 2015, other operating expense from centers that were acquired or divested subsequent January 1, 2014 and excluded from the above comparison was \$3.3 million. For the three months ended March 31, 2014, other operating expense from centers that were acquired or divested subsequent to January 1, 2014 was \$150,000.

## **Depreciation and amortization**

Depreciation and amortization decreased \$1.3 million, or 8.2%, to \$14.3 million for the three months ended March 31, 2015 compared to \$15.6 million for the three months ended March 31, 2014.

Depreciation and amortization, including only those centers which were in operation throughout the first quarters of both 2015 and 2014, decreased \$1.7 million, or 11%. This comparison excludes expenses from centers that were acquired or divested subsequent to January 1, 2014. For the three months ended March 31, 2015, depreciation expense from centers that were acquired or divested subsequent to January 1, 2014 and excluded from the above comparison was \$512,000. For the three months ended March 31, 2014, depreciation and amortization from centers that were acquired or divested subsequent to January 1, 2014 and excluded from the above comparison was \$99,000.

## **Gain on sale and disposal of equipment**

We recorded a gain on sale of equipment of approximately \$38,000 for the three months ended March 31, 2015.

## ***Interest expense***

Interest expense for the three months ended March 31, 2015 decreased approximately \$1.8 million, or 15.1%, to \$10.0 million for the three months ended March 31, 2015 compared to \$11.8 million for the three months ended March 31, 2014. Interest expense for the three months ended March 31, 2015 included \$1.3 million of combined non-cash amortization of deferred loan costs, discount on issuance of debt, and unfavorable contracts. Interest expense for the three months ended March 31, 2014 included \$1.9 million of non-cash amortization and write-off of deferred loan costs due to refinance, discount on issuance of debt and unfavorable contracts. Excluding these non-cash amounts for each period, interest expense decreased approximately \$1.2 million for the three months ended March 31, 2015 compared to the three months ended March 31, 2014. This decrease was primarily due to a reduction in interest expense stemming from the redemption of the \$200 million senior notes. See "Liquidity and Capital Resources" below for more details on our debt refinancing.

## ***Meaningful use incentive***

For the three months ended March 31, 2015 and March 31, 2014, we recognized other income from meaningful use incentive in the amount of \$3.3 million and \$1.8 million, respectively. These amounts were earned under a Medicare program to promote the use of electronic health record technology. See Note 1 to the condensed consolidated financial

statements contained herein for more detail regarding this meaningful use incentive.

***Equity in earnings from unconsolidated joint ventures***

For both periods in the three months ended March 31, 2015 and 2014, we recognized equity in earnings from unconsolidated joint ventures of \$1.1 million, respectively.

***Loss on early extinguishment of Senior Notes***

For the three months ended March 31, 2014, we recognized a \$15.5 million loss on early extinguishment of debt through our tender offer for our senior notes. Completion of the tender was conditioned on the closing of the amendment to the First Lien and Second Lien Credit and Guaranty Agreement. As of March 31, 2014, holders of 96.73% of the outstanding senior notes, amounting to \$193.5 million face value, accepted the 105.688% tender offer consideration, totaling \$204.5 million. The net carrying amount adjusted for unamortized discount, note issue costs and related expenses was \$189.0 million. See "Liquidity and Capital Resources" below and Note 1 to the condensed consolidated financial statements contained herein for more details on our debt refinancing.

***Adjusted EBITDA***

We use both GAAP and non-GAAP metrics to measure our financial results. One non-GAAP measure we believe assists us is Adjusted EBITDA. We believe that, in addition to GAAP metrics, these non-GAAP metrics assist us in measuring our cash generated from operations and ability to service our debt obligations. We believe this information is useful to investors and other interested parties because we are highly leveraged and our non-GAAP metrics remove non-cash and certain other charges that occur in the affected period and provide a basis for measuring the Company's financial condition against other quarters.

We define Adjusted EBITDA as earnings before interest, taxes, depreciation and amortization, each from continuing operations and exclude losses or gains on the disposal of equipment, other income or loss, loss on debt extinguishments, bargain purchase gains and non-cash equity compensation. Adjusted EBITDA includes equity earnings in unconsolidated operations and subtracts allocations of earnings to non-controlling interests in subsidiaries, and is adjusted for non-cash or extraordinary and one-time events taking place during the period.

Adjusted EBITDA is a non-GAAP financial measure used as an analytical indicator by us and the healthcare industry to assess business performance, and is a measure of leverage capacity and ability to service debt. Adjusted EBITDA should not be considered a measure of financial performance under GAAP, and the items excluded from Adjusted EBITDA should not be considered in isolation or as alternatives to net income, cash flows generated by operating, investing or financing activities or other financial statement data presented in the consolidated financial statements as an indicator of financial performance or liquidity. As Adjusted EBITDA is not a measurement determined in accordance with GAAP and is therefore susceptible to varying methods of calculation, this metric, as presented, may not be comparable to other similarly titled measures of other companies.

Adjusted EBITDA is most comparable to the GAAP financial measure, net income (loss) attributable to RadNet, Inc. common stockholders. The following is a reconciliation of GAAP net income (loss) attributable to RadNet, Inc. common stockholders to Adjusted EBITDA for the three months ended March 31, 2015 and 2014, respectively:

|   | <b>Three Months<br/>Ended<br/>March 31,<br/>2015      2014</b> |                 |
|---|--|-----------------|
| Net income attributable to RadNet, Inc. common stockholders | \$(4,554 )   | \$(12,424)      |
| Plus provision for (benefit from) income taxes              | (3,091 )   | (4,478 )        |
| Plus other expenses (income)                                | (3 )   | 2               |
| Plus loss on early extinguishment of Senior Notes           | –  | 15,456          |
| Plus interest expense                                       | 9,996  | 11,772          |
| Plus severance costs  | 36   | 481             |
| Plus loss (gain) on sale and disposal of equipment          | (38 )  | 246             |
| Plus depreciation and amortization                          | 14,294   | 15,571          |
| Plus non-cash employee stock-based compensation             | 3,554  | 1,025           |
| <b>Adjusted EBITDA</b>                                      | <b>\$20,194</b>  | <b>\$27,651</b> |

## Liquidity and Capital Resources

We had cash and cash equivalents of \$154,000 and accounts receivable of \$153.3 million at March 31, 2015, compared to cash and cash equivalents of \$307,000 and accounts receivable of \$148.2 million at December 31, 2014. We had a working capital balance of \$61.7 million and \$58.7 million at March 31, 2015 and December 31, 2014, respectively. We had net loss attributable to RadNet, Inc. common stockholders for the three months ended March 31,

2015 and 2014 of \$4.6 million and \$12.4 million respectively. We also had stockholders' equity of \$4.6 million and \$5.4 million at March 31, 2015 and December 31, 2014, 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.

Under the 2014 Amendment to the Refinance Agreement explained in further detail below, the scheduled annual amortization payments on the First Lien Term Loan increased from 1% per annum to 5% per annum. As a result, scheduled amortization increased by \$16.8 million from pre-amendment terms. 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.

At March 31, 2015 we had borrowed \$24.7 million under our \$101 million revolving credit facility, which expires in October 2017. 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 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. However, we have no formal plan of doing so at this time.

Included in our condensed consolidated balance sheet at March 31, 2015 is \$563.3 million of senior secured term loan debt (net of unamortized discounts of \$11.2 million), broken down by loan agreement as follows (in thousands):

|                        | <b>Face<br/>Value</b> | <b>Discount</b> | <b>Total<br/>Carrying<br/>Value</b> |
|------------------------|-----------------------|-----------------|-------------------------------------|
| First Lien Term Loans  | \$394,559             | \$(8,681 )      | \$385,878                           |
| Second Lien Term Loans | \$180,000             | \$(2,558 )      | \$177,442                           |
| Total                  | \$574,559             | \$(11,239 )     | \$563,320                           |

#### Sources and Uses of Cash

Cash provided by operating activities was \$17.5 million for the three months ended March 31, 2015 compared to cash used in operating activities of \$4.9 million for the three months ended March 31, 2014.

Cash used in investing activities was \$19.6 million and \$18.2 million for the three months ended March 31, 2015 and 2014, respectively. For the three months ended March 31, 2015, we purchased property and equipment for approximately \$19.8 million.

Cash provided by financing activities was \$2.0 and \$14.9 million for the three months ended March 31, 2015 and 2014, respectively. The cash provided by financing activities for the three months ended March 31, 2015, was primarily due to amounts received from borrowings under our revolving line of credit, offset by principal payments on our \$394.6 million face value term loan and equipment notes and capital leases. (See Note 1 to the condensed consolidated financial statements herein).

As of March 31, 2015, we were in compliance with all financial covenants under our Refinance Agreement, as amended by the 2014 Amendment, and the Second Lien Credit and Guaranty Agreement, each as defined below. Also described below are details of our \$200 million senior notes, redemption of which was completed in 2014.

2014 Amendment to the Refinance Agreement and Second Lien Credit and Guaranty Agreement:

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

*2014 Amendment of the Refinance Agreement.* Radnet Management amended that certain Credit and Guaranty Agreement dated October 10, 2012, as amended by that certain first amendment date April 3, 2013 (the “2013 Amendment”) (collectively, the “Refinance Agreement”), by entering into a second amendment to the Refinance Agreement on March 25, 2014 (the “2014 Amendment”) to provide for, among other things, the borrowing by Radnet Management of \$30.0 million of additional first lien term loans (the “2014 First Lien Term Loans”).

*Second Lien Credit and Guaranty Agreement.* Radnet Management entered into a Second Lien Credit and Guaranty Agreement (the “Second Lien Credit Agreement”) to provide for, among other things, the borrowing by Radnet Management 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 senior notes, as more fully described below under the heading “Senior Notes”, 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 and Guaranty Agreement dated October 10, 2012 was unaltered by the agreements above and remains in place.

The 2014 Amendment provides for the following:

*Interest.* The interest rates payable on the 2014 First Lien Term Loans are the same as the rates payable under the Refinance Agreement, as amended by the 2013 Amendment, which are (a) the Adjusted Eurodollar Rate plus 3.25% or (b) the Base Rate plus 2.25%. The Adjusted Eurodollar Rate has a minimum floor of 1.0% on all of the term loans under the Refinance Agreement. The Adjusted Eurodollar Rate at March 31, 2015 was 0.40%.

*Payments.* The scheduled amortization of the term loans under the Refinance Agreement has been increased from quarterly payments of \$975,000 to quarterly payments of \$5.2 million starting in June 2014, with the remaining balance to be paid at maturity.

The other material terms of the Refinance Agreement remain unchanged as described in our annual report on Form 10-K for the fiscal year ended December 31, 2014, as amended.

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 Eurodollar Rate at March 31, 2015 was 0.40%. The rate paid on the Second Lien Credit Agreement at March 31, 2015 is 8%.

*Payments.* There is no scheduled amortization of the principal of the Second Lien Term Loans. All principal will be due and payable on the termination date described below.

*Termination.* The termination 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 acceleration or otherwise.

*Restrictive Covenants.* In addition to certain customary covenants, the Second Lien Credit Agreement places restrictions on indebtedness, liens, and investments, and places limits on distributions to stockholders (including the repurchase of shares) and other junior payments.



*Financial Covenants.* The Second Lien 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 Second Lien Credit Agreement include failure to pay the outstanding 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, subject to applicable grace periods and/or notice requirements, or a material breach of any representation or warranty contained in the loan documents. 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.

### Senior Notes

On April 6, 2010, we issued and sold \$200 million of 10 3/8% senior unsecured notes due 2018 at a price of 98.680% (the "senior notes"). All payments of the senior notes, including principal and interest, were guaranteed jointly and severally on a senior unsecured basis by RadNet, Inc., and all of Radnet Management's current and future domestic wholly owned restricted subsidiaries. The senior notes were issued under an indenture dated April 6, 2010 (the "Indenture"), by and among Radnet Management, Inc., as issuer, RadNet, Inc., as parent guarantor, the subsidiary guarantors thereof and U.S. Bank National Association, as trustee. We paid interest on the senior notes on April 1 and October 1 of each year, commencing October 1, 2010, and they were scheduled to expire on April 1, 2018.

We completed the retirement of our \$200 million in senior notes on April 24, 2014 and following such retirement the Company completed the satisfaction and discharge of the Indenture. The transactions leading to the retirement of the Senior Notes are described below:

*Tender Offer.* On March 7, 2014, we commenced a tender offer to purchase for cash any and all outstanding senior notes. In connection with the tender offer, we also commenced a consent solicitation to amend the Indenture to eliminate or modify certain restrictive covenants. On March 25, 2014, we made a payment in cash for all senior notes tendered prior to 5:00 P.M., New York City time, on March 20, 2014 (the “Consent Payment Deadline”). As of the Consent Payment Deadline, we received tenders and consents in respect of \$193,464,000 aggregate principal amount of the senior notes, representing 96.73% of the outstanding senior notes, all of which were accepted for purchase. The total consideration for each \$1,000 principal amount of senior notes validly tendered and not withdrawn at or prior to the Consent Payment Deadline and accepted for purchase was \$1,056.88, which amount included a consent payment (the “Consent Payment”) of \$30.00 per \$1,000 principal amount of senior notes. In addition, all senior notes accepted for payment received accrued and unpaid interest in respect of such notes from the last interest payment date prior to the applicable settlement date to, but not including, the applicable settlement date. The tender offer expired on April 3, 2014 and between the Consent Payment Deadline and the expiration of the tender offer, no additional senior notes were tendered. With a net carrying amount including discount and unamortized issue costs of \$189.2 million, a loss on early extinguishment of debt of \$15.5 million was recorded in the first quarter of 2014.

*Exercise of Optional Redemption on March 25, 2014.* On March 25, 2014, we called for redemption all of our remaining outstanding senior notes not purchased prior to the expiration of the tender offer described above, with a redemption date of April 24, 2014 (the “Redemption Date”). Upon redemption on April 24, 2014, the holders of the senior notes being redeemed received a redemption price equal to 105.188% of the outstanding principal amount of the senior notes being redeemed (or \$1,051.88 per \$1,000 in principal amount of the senior notes) in accordance with the terms of the Indenture, or approximately \$6.9 million in total, including approximately \$43,000 of accrued and unpaid interest up to, but excluding the Redemption Date. As of that date, we completed the satisfaction and discharge of the Indenture in accordance with its terms and no senior notes remained outstanding. With a net carrying amount including discount and unamortized issue costs of \$6.4 million, a loss on early extinguishment of debt of \$471,000 was recorded in the second quarter of 2014.

## **Subsequent Events**

On April 1, 2015, we purchased New York Radiology Partners (NYRP) for \$31.4 million in total consideration, consisting of \$29.8 million in cash and issued a promissory note for the remainder in the amount of \$1.6 million. In connection with the purchase we borrowed an additional \$29.8 million under our first lien revolving credit facility.

On April 30, 2015, RadNet entered into a joinder to its existing senior secured first lien credit agreement to provide for the borrowing of \$75.0 million of incremental first lien term loans. The incremental first lien term loans will be treated as part of the same class as the existing tranche B term loans currently outstanding under the existing first lien credit agreement and will bear the same interest rate as the rate currently payable on the existing tranche B term loans under the existing first lien credit agreement, which is (a) the adjusted LIBOR rate plus 3.25% or (b) the base rate plus 2.25%. Proceeds from the incremental term loans were used to repay all the borrowings outstanding under the first lien revolving loan facility, fund cash to the balance sheet and pay approximately \$1 million of fees and expenses associated with the transaction.

### ITEM 3. Quantitative and Qualitative Disclosures about Market Risk

**Foreign Currency Exchange Risk.** We sell our services exclusively in the United States and receive payment for our services exclusively in United States dollars. As a result, our financial results are unlikely to be affected by factors such as changes in foreign currency, exchange rates or weak economic conditions in foreign markets.

We maintain research and development facilities in Prince Edward Island, Canada and Budapest, Hungary for which expenses are paid in the local currency. Accordingly, we do have currency risk resulting from fluctuations between such local currency and the United States Dollar. At the present time, we do not have any foreign currency exchange contracts to mitigate this risk. A hypothetical 1% decline in the currency exchange rates between the U.S. dollar against the Canadian dollar and the Hungarian Forint would have resulted in an annual increase of approximately \$31,000 in operating expenses.

**Interest Rate Sensitivity.** We pay interest on various types of debt instruments to our suppliers, investors and lending institutions. The agreements entail either fixed or variable interest rates. Instruments which have fixed rates are mainly leases on radiology equipment. Variable rate interest obligations relate primarily to amounts borrowed under our outstanding credit facilities, which allows elections of either Adjusted Eurodollar or prime rates of interest. Under the 2014 Amendment to the Refinance Agreement and Second Lien Credit Agreement's election facilities', borrowed funds bear a 1.00% floor or 6 month Adjusted Eurodollar Rate plus an applicable margin of 3.25% for the 2014 First Lien Term Loans and 7% for the Second Lien Term Loans. At March 31, 2015, we had \$394.6 million outstanding subject to an Adjusted Eurodollar election on the 2014 First Lien Term Loans and \$180.0 million on the Second Lien Term Loans. As the Adjusted Eurodollar floor exceeds the current spot rate of 6 month Adjusted Eurodollar, the spot rate would have to increase more than 60 basis points before an additional interest expense would be accrued. An increase of 160 basis points would be necessary to realize a hypothetical 1% increase in the borrowing rate and an annual increase of \$5.7 million of interest expense under our first and second lien term loans. At March 31, 2015, an additional \$29.9 million in debt instruments tied to the prime rate. A hypothetical 1% increase in the prime rate for 2014-2015 would have resulted in an annual increase in interest expense of approximately \$299,000.

#### **ITEM 4. CONTROLS AND PROCEDURES**

##### *Evaluation of Disclosure Controls and Procedures*

We maintain controls and procedures designed to ensure that we are able to collect the information we are required to disclose in the reports we file with the SEC, and to process, summarize and disclose this information within the time periods specified in the rules of the SEC. Our management, with the participation of our Chief Executive Officer and our Chief Financial Officer, has conducted an evaluation of the design and operation of our “disclosure controls and procedures” as defined in Rule 13a-15(e) and 15d-15(e) under the Exchange Act. Based on this evaluation, our Chief Executive Officer and our Chief Financial Officer have concluded that our disclosure controls and procedures are effective as of the end of the period covered by this report to ensure that information required to be disclosed in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC’s rules and forms.

##### *Changes in Internal Control over Financial Reporting*

There has been no change in our internal control over financial reporting during the three months ended March 31, 2015 that has materially affected, or is reasonably likely to materially affect, our internal controls over financial reporting.

## **PART II – OTHER INFORMATION**

### **ITEM 1. Legal Proceedings**

We are engaged from time to time in the defense of lawsuits arising out of the ordinary course and conduct of our business. We do not believe that the outcome of any of our current litigation will have a material adverse impact on our business, financial condition and results of operations. However, we could be subsequently named as a defendant in other lawsuits that could adversely affect us.

### **ITEM 1A. Risk Factors**

The following is an update to risk factors described in our annual report on Form 10-K for the year ended December 31, 2014, as amended, and should be read in conjunction with the other risk factors therein. The risks described below and in our Form 10-K, as amended, are not the only risks facing our Company. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business, financial condition and/or operating results.

#### **Changes in the method or rates of third party reimbursement could have a negative impact on our results.**

From time to time, changes designed to contain healthcare costs have been implemented, some of which have resulted in decreased reimbursement rates for diagnostic imaging services that impact our business. For services for which we bill Medicare directly, we are paid under the Medicare Physician Fee Schedule, which is updated on an annual basis.

Medicare program reimbursements for physician services as well as other services to Medicare beneficiaries who are not enrolled in Medicare Advantage plans are based upon the fee-for-service rates set forth in the Medicare Physician Fee Schedule. Each year, on January 1<sup>st</sup>, the Medicare program updates the Medicare Physician Fee Schedule reimbursement rates. Many private payors use the Medicare Physician Fee Schedule to determine their own reimbursement rates.

In 2013, Congress adjusted Medicare payment rates for physician imaging services in an attempt to better reflect actual usage, by revising upward the assumed usage rate for diagnostic imaging equipment costing more than \$1 million to 90% effective January 1, 2014. Other changes in reimbursement for services rendered by Medicare Advantage plans may reduce the revenues we receive for services rendered to Medicare Advantage enrollees.

On April 16, 2015, the President signed into law the Medicare Access and CHIP Reauthorization Act (H.R. 2), which provides for sweeping changes to how Medicare pays physicians, as well as averts the 21% reduction to Medicare payments under the Medicare Physician Fee Schedule that was scheduled to take effect on April 1, 2016. H.R. 2, among other things, repealed the Sustainable Growth Rate (“SGR”) formula enacted in 1997 and freezes payment rates at their current levels until rates increase by 0.5% for services furnished during the last 6 months of calendar year 2015. For services paid under the physician fee schedule and furnished during calendar years 2016 through 2019, Medicare’s payment rates will increase by 0.5% per year. Fees will remain at the 2019 level through 2025, but high performing providers participating in alternative payment models will have the opportunity for additional payments. Such payments will be based upon quality, resource use, clinical practice improvement activities and meaningful use of electronic health record technology. Given that the value-based payment mechanisms have yet to take effect, we cannot determine the impact of such payments models on our business at this time. However, in general, shifting to value-based care may decrease our revenue and require us to invest heavily in new IT infrastructure and analytic tools.

**ITEM 2. Unregistered Sales of Equity Securities and Use of Proceeds**

None.

**ITEM 3. Defaults Upon Senior Securities**

None.

**ITEM 4. Mine Safety Disclosures**

Not applicable.

**ITEM 5. Other Information**

None.

**ITEM 6. Exhibits**

Reference is made to the Exhibit Index immediately following the signature page of this report on Form 10-Q.







**INDEX TO EXHIBITS**

| <b><u>Exhibit Number</u></b> | <b><u>Description</u></b>  |
|------------------------------|--|
| 31.1                         | Certification of Howard G. Berger, M.D. pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.   |
| 31.2                         | Certification of Mark D. Stolper pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.  |
| 32.1*                        | Certification of Howard G. Berger, M.D pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |
| 32.2*                        | Certification of Mark D. Stolper pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.       |
| 101.INS**                    | XBRL Instance Document   |
| 101.SCH**                    | XBRL Schema Document   |
| 101.CAL**                    | XBRL Calculation Linkbase Document   |
| 101.LAB**                    | XBRL Label Linkbase Document   |
| 101.PRE**                    | XBRL Presentation Linkbase Document  |
| 101.DEF**                    | XBRL Definition Linkbase Document  |

\* This certification is being furnished solely to accompany this report pursuant to 18 U.S.C. 1350, and is not being filed for purposes of Section 18 of the Exchange Act and is not to be incorporated by reference into any filing of the registrant, whether made before or after the date hereof, regardless of any general incorporation language in such filing.

\*\* Pursuant to Rule 406T of Regulation S-T, the Interactive Data Files on Exhibit 101 hereto are deemed not filed or part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933, as deemed not filed for purposes of Section 18 of the Securities and Exchange Act of 1934, as amended, and otherwise are not subject to liability under those sections.