

FONAR CORP  
Form 10-Q  
November 10, 2014

**FORM 10-Q**

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended **SEPTEMBER 30, 2014**

Commission file number 0-10248

**FONAR CORPORATION**

(Exact name of registrant as specified in its charter)

|  |                     |
|--|---------------------|
| DELAWARE                                 | 11-2464137          |
| (State or other jurisdiction of          | (I.R.S. Employer    |
| incorporation or organization)           | Identification No.) |
| 110 Marcus Drive Melville, New York      | 11747               |
| (Address of principal executive offices) | (Zip Code)          |

Registrant's telephone number, including area code: (631) 694-2929

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 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 (232.405 of this chapter) during the preceding 12 months (or for shorter period that the registrant was required to submit and post such files. YES  NO

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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 definition of accelerated filer, large accelerated filer or smaller reporting company in Rule 12b-2 of the Exchange Act.(Check one): Large accelerated filer\_\_\_ Accelerated filer\_ X\_  
Non-accelerated filer\_\_\_ 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 X

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the close of the latest practicable date.

| <u>Class</u>                               | <u>Outstanding at October 31, 2014</u> |
|--|--|
| Common Stock, par value \$.0001            | 6,050,840                              |
| Class B Common Stock, par value \$.0001    | 146                                    |
| Class C Common Stock, par value \$.0001    | 382,513                                |
| Class A Preferred Stock, par value \$.0001 | 313,438                                |

FONAR CORPORATION AND SUBSIDIARIES

INDEX

|  | PAGE |
|--|------|
| <b>PART I - FINANCIAL INFORMATION</b>  |      |
| Item 1. Financial Statements   | 3    |
| Condensed Consolidated Balance Sheets - September 30, 2014 (Unaudited) and June 30, 2014   | 3    |
| Condensed Consolidated Statements of Income for the Three Months Ended September 30, 2014 and September 30, 2013 (Unaudited)     | 6    |
| Condensed Consolidated Statements of Cash Flows for the Three Months Ended September 30, 2014 and September 30, 2013 (Unaudited) | 7    |
| Notes to Condensed Consolidated Financial Statements (Unaudited)   | 8    |
| Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations                                    | 17   |
| Item 3. Quantitative and Qualitative Disclosures About Market Risk   | 23   |
| Item 4. Controls and Procedures  | 23   |
| <b>PART II - OTHER INFORMATION</b>   | 24   |
| Item 1. Legal Proceedings  | 24   |
| Item 1A. Risk Factors  | 24   |
| Item 2. Unregistered Sales of Equity Securities and Use of Proceeds  | 24   |
| Item 3. Defaults Upon Senior Securities  | 24   |

|                                 |    |
|---------------------------------|----|
| Item 4. Mine Safety Disclosures | 24 |
| Item 5. Other Information       | 24 |
| Item 6. Exhibits                | 24 |
| Signatures                      | 24 |

## FONAR CORPORATION AND SUBSIDIARIES

## CONDENSED CONSOLIDATED BALANCE SHEETS

(Amounts and shares in thousands, except per share amounts)

(UNAUDITED)

## ASSETS

|   | September<br>30,<br>2014 | June 30,<br>2014 * |
|---|--------------------------|--------------------|
| Current Assets:   |                          |                    |
| Cash and cash equivalents   | \$ 10,662                | \$9,952            |
| Accounts receivable – net   | 5,186                    | 4,450              |
| Accounts receivable - related party   | 90                       | —                  |
| Medical receivable – net  | 8,779                    | 8,808              |
| Management and other fees receivable - net                                  | 12,952                   | 11,970             |
| Management and other fees receivable – related medical practices – net      | 3,253                    | 3,427              |
| Costs and estimated earnings in excess of billings on uncompleted contracts | 1,620                    | 760                |
| Inventories   | 2,422                    | 2,444              |
| Prepaid expenses and other current assets                                   | 669                      | 1,011              |
| Total Current Assets  | 45,633                   | 42,822             |
| Deferred income tax asset   | 5,740                    | 5,740              |
| Property and equipment – net  | 14,489                   | 15,030             |
| Goodwill  | 1,767                    | 1,767              |
| Other intangible assets – net   | 10,233                   | 10,509             |
| Other assets  | 905                      | 922                |
| Total Current Assets  | \$ 78,767                | \$76,790           |

\*Condensed from audited financial statements.

See accompanying notes to condensed consolidated financial statements.



## FONAR CORPORATION AND SUBSIDIARIES

## CONDENSED CONSOLIDATED BALANCE SHEETS

(Amounts and shares in thousands, except per share amounts)

(UNAUDITED)

## LIABILITIES AND STOCKHOLDERS' EQUITY

|   | September<br>30,<br>2014 | June 30,<br>2014 * |
|---|--------------------------|--------------------|
| Current Liabilities:  |                          |                    |
| Current portion of long-term debt and capital leases                        | \$ 2,892                 | \$2,891            |
| Accounts payable  | 2,805                    | 2,482              |
| Other current liabilities   | 9,242                    | 9,024              |
| Unearned revenue on service contracts                                       | 5,296                    | 4,731              |
| Unearned revenue on service contracts – related party                       | 83                       | —                  |
| Customer deposits   | 1,570                    | 1,927              |
| Billings in excess of costs and estimated earnings on uncompleted contracts | 142                      | 142                |
| Total Current Liabilities   | 22,030                   | 21,197             |
| Long-Term Liabilities:  |                          |                    |
| Deferred income tax liability   | 584                      | 584                |
| Due to related medical practices  | 228                      | 234                |
| Long-term debt and capital leases, less current portion                     | 7,559                    | 8,482              |
| Other liabilities   | 263                      | 386                |
| Total Long-Term Liabilities   | 8,634                    | 9,686              |
| Total Liabilities   | 30,664                   | 30,883             |

\*Condensed from audited financial statements.

See accompanying notes to condensed consolidated financial statements.





## FONAR CORPORATION AND SUBSIDIARIES

## CONDENSED CONSOLIDATED BALANCE SHEETS

(Amounts and shares in thousands, except per share amounts)

(UNAUDITED)

## LIABILITIES AND STOCKHOLDERS' EQUITY (Continued)

|  | September<br>30, 2014 | June 30,<br>2014 * |
|--|-----------------------|--------------------|
| <b>STOCKHOLDERS' EQUITY:</b>   |                       |                    |
| Class A non-voting preferred stock \$.0001 par value; 453 shares authorized at September 30, 2014 and June 30, 2014, 313 issued and outstanding at September 30, 2014 and June 30, 2014  | \$—                   | \$—                |
| Preferred stock \$.001 par value; 567 shares authorized at September 30, 2014 and June 30, 2014, issued and outstanding – none   | —                     | —                  |
| Common Stock \$.0001 par value; 8,500 shares authorized at September 30, 2014 and June 30, 2014, 6,062 and 6,057 issued at September 30, 2014 and June 30, 2014, respectively; 6,051 and 6,046 outstanding at September 30, 2014 and June 30, 2014, respectively | 1                     | 1                  |
| Class B Common Stock (10 votes per share) \$.0001 par value; 227 shares authorized at September 30, 2014 and June 30, 2014; .146 issued and outstanding at September 30, 2014 and June 30, 2014  | —                     | —                  |
| Class C Common Stock (25 votes per share) \$.0001 par value; 567 shares authorized at September 30, 2014 and June 30, 2014, 383 issued and outstanding at September 30, 2014 and June 30, 2014   | —                     | —                  |
| Paid-in capital in excess of par value   | 175,413               | 175,284            |
| Accumulated deficit  | (146,724)             | (149,259)          |
| Notes receivable from employee stockholders  | (37 )                 | (39 )              |
| Treasury stock, at cost - 12 shares of common stock at September 30, 2014 and June 30, 2014  | (675 )                | (675 )             |
| Total Fonar Corporation Stockholder Equity   | 27,978                | 25,312             |
| Noncontrolling interests   | 20,125                | 20,595             |
| Total Stockholders' Equity   | 48,103                | 45,907             |
| Total Liabilities and Stockholders' Equity   | \$78,767              | \$76,790           |

\*Condensed from audited financial statements.

See accompanying notes to condensed consolidated financial statements.



## FONAR CORPORATION AND SUBSIDIARIES

## CONDENSED CONSOLIDATED STATEMENTS OF INCOME

(Amounts and shares in thousands, except per share amounts)

(UNAUDITED)

|  | FOR THE THREE<br>MONTHS ENDED<br>SEPTEMBER 30, |          |
|--|--|----------|
|  | 2014   | 2013     |
| <b>REVENUES</b>  |  |          |
| Product sales – net  | \$1,271  | \$28     |
| Service and repair fees – net  | 2,491  | 2,512    |
| Service and repair fees - related parties – net                        | 28   | 28       |
| Patient fee revenue, net of contractual allowances and discounts       | 6,787  | 5,827    |
| Provision for bad debts for patient fee                                | (3,146 )                                       | (2,040 ) |
| Management and other fees – net  | 8,738  | 8,511    |
| Management and other fees - related medical practices – net            | 1,816  | 1,965    |
| Total Revenues – Net   | 17,985   | 16,831   |
| <b>COSTS AND EXPENSES</b>  |  |          |
| Costs related to product sales   | 1,085  | 48       |
| Costs related to service and repair fees                               | 507  | 544      |
| Costs related to service and repair fees - related parties             | 6  | 6        |
| Costs related to patient fee revenue                                   | 1,899  | 1,848    |
| Costs related to management and other fees                             | 5,590  | 5,075    |
| Costs related to management and other fees – related medical practices | 979  | 1,219    |
| Research and development   | 397  | 395      |
| Selling, general and administrative                                    | 3,578  | 3,737    |
| Provision for bad debts  | 506  | (94 )    |
| Total Costs and Expenses   | 14,547   | 12,778   |
| Income From Operations   | 3,438  | 4,053    |
| Interest Expense   | (204 )   | (243 )   |
| Investment Income  | 62   | 61       |
| Other Expense  | —  | (151 )   |
| Income Before Provision for Income Taxes and noncontrolling Interests  | 3,296  | 3,720    |
| Provision for Income Taxes   | 40   | 100      |
| Net Income   | 3,256  | 3,620    |
| Net Income - Noncontrolling Interests                                  | (721 )   | (1,183 ) |
| Net Income - Controlling Interests                                     | \$2,535  | \$2,437  |
| Net Income Available to Common Stockholders                            | \$2,370  | \$2,277  |
| Net Income Available to Class A Non-Voting Preferred Stockholders      | \$123  | \$119    |
| Net Income Available to Class C Common Stockholders                    | \$42   | \$41     |
| Basic Net Income Per Common Share Available to Common Stockholders     | \$0.39   | \$0.38   |
| Diluted Net Income Per Common Share Available to Common Stockholders   | \$0.38   | \$0.37   |
| Basic and Diluted Income Per Share - Class C Common                    | \$0.11   | \$0.11   |
| Weighted Average Basic Shares Outstanding – Common Stockholders        | 6,050  | 5,978    |
| Weighted Average Diluted Shares Outstanding - Common Stockholders      | 6,178  | 6,106    |

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|  |     |     |
|--|-----|-----|
| Weighted Average Basic Shares Outstanding – Class C Common   | 383 | 383 |
| Weighted Average Diluted Shares Outstanding – Class C Common | 383 | 383 |

See accompanying notes to condensed consolidated financial statements.

Page 6

## FONAR CORPORATION AND SUBSIDIARIES

## CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Amounts and shares in thousands, except per share amounts)

(UNAUDITED)

|   | FOR THE THREE<br>MONTHS ENDED<br>SEPTEMBER 30, |         |
|---|--|---------|
|   | 2014   | 2013    |
| Cash Flows from Operating Activities:   |  |         |
| Net income  | \$3,256  | \$3,620 |
| Adjustments to reconcile net income to net cash provided by operating activities: |  |         |
| Depreciation and amortization   | 888  | 982     |
| Provision for bad debts   | 506  | (94 )   |
| Compensatory element of stock issuances   | 53   | 19      |
| Stock issued for costs and expenses   | 76   | 110     |
| (Increase) decrease in operating assets, net:                                     |  |         |
| Accounts, medical and management fee receivable(s)                                | (2,111 )                                       | (1,974) |
| Notes receivable  | 81   | 35      |
| Costs and estimated earnings in excess of billings on uncompleted contracts       | (860 )   | —       |
| Inventories   | 22   | (49 )   |
| Prepaid expenses and other current assets   | 284  | 210     |
| Other assets  | (5 )   | 40      |
| Increase (decrease) in operating liabilities, net:                                |  |         |
| Accounts payable  | 323  | (58 )   |
| Other current liabilities   | 865  | 1,008   |
| Customer deposits   | (357 )   | 60      |
| Other liabilities   | (123 )   | (29 )   |
| Due to related medical practices  | (6 )   | (1 )    |
| Income tax payable  | —  | (20 )   |
| Net cash provided by operating activities   | 2,892  | 3,859   |
| Cash Flows from Investing Activities:   |  |         |
| Purchases of property and equipment   | (26 )  | (182 )  |
| Cost of patents   | (46 )  | (47 )   |
| Net cash used in investing activities   | (72 )  | (229 )  |
| Cash Flows from Financing Activities:   |  |         |
| Repayment of borrowings and capital lease obligations                             | (921 )   | (970 )  |
| Distributions to noncontrolling interests   | (1,191 )                                       | (1,295) |
| Repayment of notes receivable from employee stockholders                          | 2  | 2       |
| Net cash used in financing activities   | (2,110 )                                       | (2,263) |
| Net Increase in Cash and Cash Equivalents   | 710  | 1,367   |
| Cash and Cash Equivalents - Beginning of Period                                   | 9,952  | 7,871   |

|   |          |         |
|---|----------|---------|
| Cash and Cash Equivalents - End of Period | \$10,662 | \$9,238 |
|---|----------|---------|

See accompanying notes to condensed consolidated financial statements.

FONAR CORPORATION AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

SEPTEMBER 30, 2014 and 2013

(Amounts and shares in thousands, except per share amounts)

(UNAUDITED)

NOTE 1 - BASIS OF PRESENTATION & LIQUIDITY & CAPITAL RESOURCES

Basis of Presentation

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the three months ended September 30, 2014, are not necessarily indicative of the results that may be expected for the fiscal year ending June 30, 2015. For further information, refer to the consolidated financial statements and footnotes thereto included in the Company's Annual Report on Form 10-K filed on September 29, 2014 for the fiscal year ended June 30, 2014.

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Principles of Consolidation

The unaudited condensed consolidated financial statements include the accounts of FONAR Corporation, its majority and wholly-owned subsidiaries and partnerships (collectively the "Company"). All significant intercompany accounts and transactions have been eliminated in consolidation.

Earnings Per Share

Basic earnings per share ("EPS") is computed based upon the weighted average number of shares of common stock and stock equivalents outstanding, net of common stock. In accordance with ASC topic 260-10, "Participating Securities

and the Two-Class method”, the Company used the Two-Class method for calculating basic income per share and applied the if converted method in calculating diluted income per share for the three months ended September 30, 2014 and 2013.

Diluted EPS reflects the potential dilution from the exercise or conversion of all dilutive securities into common stock based on the average market price of common shares outstanding during the period. For the three months ended September 30, 2014 and 2013, diluted EPS for common shareholders includes 128 shares upon conversion of Class C Common.



## FONAR CORPORATION AND SUBSIDIARIES

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

SEPTEMBER 30, 2014 and 2013

(Amounts and shares in thousands, except per share amounts)

(UNAUDITED)

## NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Earnings Per Share (Continued)

|   | Three months ended<br>September 30, 2014 |                 |                         | Three months ended<br>September 30, 2013 |                 |                         |
|---|--|-----------------|-------------------------|--|-----------------|-------------------------|
|   | Total                                    | Common<br>Stock | Class C<br>Common Stock | Total                                    | Common<br>Stock | Class C<br>Common Stock |
| Basic   |  |                 |                         |  |                 |                         |
| Numerator:  |  |                 |                         |  |                 |                         |
| Net income available to<br>common stockholders      | \$2,535                                  | \$2,370         | \$42                    | \$2,437                                  | \$2,277         | \$41                    |
| Denominator:  |  |                 |                         |  |                 |                         |
| Weighted average shares<br>outstanding              | 6,050                                    | 6,050           | 383                     | 5,978                                    | 5,978           | 383                     |
| Basic income per common<br>share                    | \$0.42                                   | \$0.39          | \$0.11                  | \$0.41                                   | \$0.38          | \$0.11                  |
| Diluted   |  |                 |                         |  |                 |                         |
| Denominator:  |  |                 |                         |  |                 |                         |
| Weighted average shares<br>outstanding              |  | 6,050           | 383                     |  | 5,978           | 383                     |
| Convertible Class C Stock                           |  | 128             | —                       |  | 128             | —                       |
| Total Denominator for diluted<br>earnings per share |  | 6,178           | 383                     |  | 6,106           | 383                     |
| Diluted income per common<br>share                  |  | \$0.38          | \$0.11                  |  | \$0.37          | \$0.11                  |

Recent Accounting Pronouncements

-

The FASB has issued ASU No. 2014-09, *Revenue from Contracts with Customers*. This ASU supercedes the revenue recognition requirements in Accounting Standards Codification 605 - Revenue Recognition and most industry-specific guidance throughout the Codification. The standard requires that an entity recognizes revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the company expects to be entitled in exchange for those goods or services. This ASU is effective on January 1, 2017 and should be applied retrospectively to each prior reporting period presented or retrospectively with the cumulative effect of initially applying the ASU recognized at the date of initial application. The adoption of this standard is not expected to have a material impact on the Company's condensed consolidated financial position and results of operations.

FASB, the Emerging Issues Task Force and the SEC have issued certain other accounting standards, updates, and regulations as of September 30, 2014 that will become effective in subsequent periods; however, management does not believe that any of those updates would have significantly affected our financial accounting measures or disclosures had they been in effect during 2014 or 2013, and it does not believe that any of those pronouncements will have a significant impact on our consolidated financial statements at the time they become effective.

FONAR CORPORATION AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

SEPTEMBER 30, 2014 and 2013

(Amounts and shares in thousands, except per share amounts)

(UNAUDITED)

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Reclassifications

Certain prior year amounts have been reclassified to conform to the current year presentation. The reclassifications did not have any effect on reported consolidated net income for any periods presented.

NOTE 3 – ACCOUNTS RECEIVABLE, MEDICAL RECEIVABLE AND MANAGEMENT AND OTHER FEES RECEIVABLE

Accounts Receivable, Medical Receivable and Management and Other Fees Receivable

Receivables, net is comprised of the following at September 30, 2014, June 30, 2014:

|   | September 30, 2014  |                                    |          |
|---|---------------------|------------------------------------|----------|
|   | Gross<br>Receivable | Allowance for doubtful<br>accounts | Net      |
| Accounts receivable   | \$5,443             | \$257                              | \$5,186  |
| Accounts receivable - related party   | \$90                | —                                  | \$90     |
| Medical receivables   | \$24,843            | \$16,064                           | \$8,779  |
| Management and other fees receivable  | \$24,359            | \$11,407                           | \$12,952 |
| Management and other fees receivable from related<br>medical practices ("PC's") | \$3,656             | \$403                              | \$3,253  |

|   | June 30, 2014       |                                    |          |
|---|---------------------|------------------------------------|----------|
|   | Gross<br>Receivable | Allowance for doubtful<br>accounts | Net      |
| Accounts receivable   | \$4,707             | \$257                              | \$4,450  |
| Accounts receivable - related party   | \$—                 | —                                  | \$—      |
| Medical receivables   | \$21,726            | \$12,918                           | \$8,808  |
| Management and other fees receivable  | \$22,872            | \$10,902                           | \$11,970 |
| Management and other fees receivable from related<br>medical practices ("PC's") | \$3,830             | \$403                              | \$3,427  |

The Company's customers are concentrated in the healthcare industry.

#### Accounts Receivable

Credit risk with respect to the Company's accounts receivable related to product sales and service and repair fees is limited due to the customer advances received prior to the commencement of work performed and the billing of amounts to customers as sub-assemblies are completed. Service and repair fees are billed on a monthly or quarterly basis and the Company does not continue providing these services if accounts receivable become past due. The Company controls credit risk with respect to accounts receivable from service and repair fees through its credit evaluation process, credit limits, monitoring procedures and reasonably short collection terms. The Company performs ongoing credit authorizations before a product sales contract is entered into or service and repair fees are provided.

FONAR CORPORATION AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

SEPTEMBER 30, 2014 and 2013

(Amounts and shares in thousands, except per share amounts)

(UNAUDITED)

NOTE 3 – ACCOUNTS RECEIVABLE, MEDICAL RECEIVABLE AND MANAGEMENT AND OTHER FEES RECEIVABLE (CONTINUED)

Medical Receivable

Medical receivables are due under fee-for-service contracts from third party payors, such as hospitals, government sponsored healthcare programs, patient's legal counsel and directly from patients. Substantially all the revenue relates to patients residing in Florida. The carrying amount of the medical receivable is reduced by an allowance that reflects management's best estimate of the amounts that will not be collected. The Company continuously monitors collections from its clients and maintains an allowance for bad debts based upon the Company's historical collection experience. The Company determines allowances for contractual adjustments and uncollectible accounts based on specific agings, specific payor collection issues that have been identified and based on payor classifications and historical experience at each site.

Management and Other Fees Receivable

The Company's receivables from the related and non-related professional corporations (PC's) substantially consist of fees outstanding under management agreements. Payment of the outstanding fees is dependent on collection by the PC's of fees from third party medical reimbursement organizations, principally insurance companies and health management organizations.

Payment of the management fee receivables from the PC's may be impaired by the inability of the PC's to collect in a timely manner their medical fees from the third party payors, particularly insurance carriers covering automobile no-fault and workers compensation claims due to longer payment cycles and rigorous informational requirements and certain other disallowed claims. Approximately 54% and 51% of the PC's' net revenues for the three months ended September 30, 2014 and 2013, respectively, were derived from no-fault and personal injury protection claims. The Company considers the aging of its accounts receivable in determining the amount of allowance for doubtful accounts. The Company generally takes all legally available steps to collect its receivables. Credit losses associated with the

receivables are provided for in the condensed consolidated financial statements and have historically been within management's expectations.

Net revenues from management and other fees charged to the related PCs accounted for approximately 10.1% and 13.9% of the consolidated net revenues for the three months ended September 30, 2014 and 2013, respectively.

Tallahassee Magnetic Resonance Imaging, PA, Stand Up MRI of Boca Raton, PA and Stand Up MRI & Diagnostic Center, PA (all related medical practices) entered into a guaranty agreement, pursuant to which they cross guaranteed all management fees which are payable to the Company, which have arisen under each individual management agreement.

The Company's patient fee revenue, net of contractual allowances and discounts less the provision for bad debts for the three months ended September 30, 2014 and 2013 are summarized in the following table.

|  | For the Three<br>Months Ended<br>September 30, |         |
|--|--|---------|
|  | 2014   | 2013    |
| Commercial Insurance/ Managed Care                               | \$1,080  | \$1,100 |
| Medicare/Medicaid  | 297  | 379     |
| Workers' Compensation/Personal Injury                            | 3,695  | 2,895   |
| Other  | 1,715  | 1,453   |
| Patient Fee Revenue, net of contractual allowances and discounts | 6,787  | 5,827   |
| Provision for Bad Debts  | (3,146)  | (2,040) |
| Net Patient Fee for Revenue                                      | \$3,641  | \$3,787 |

FONAR CORPORATION AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

SEPTEMBER 30, 2014 and 2013

(Amounts and shares in thousands, except per share amounts)

(UNAUDITED)

NOTE 4 - INVENTORIES

Inventories included in the accompanying condensed consolidated balance sheets consist of the following:

|  | September<br>30, 2014 | June<br>30,<br>2014 |
|--|-----------------------|---------------------|
| Purchased parts, components and supplies | \$ 2,131              | \$2,094             |
| Work-in-process                          | 291                   | 350                 |
| <b>TOTAL INVENTORIES</b>                 | <b>\$ 2,422</b>       | <b>\$2,444</b>      |

NOTE 5 - COSTS AND ESTIMATED EARNINGS ON UNCOMPLETED CONTRACTS

Information relating to uncompleted contracts as of September 30, 2014 is as follows:

|  | September 30,<br>2014 | June 30,<br>2014 |
|--|-----------------------|------------------|
| Costs incurred on uncompleted contracts  | \$2,860               | \$1,885          |
| Estimated earnings   | 2,039                 | 1,746            |
| Subtotal   | 4,899                 | 3,631            |
| Less: Billings to date   | 3,421                 | 3,013            |
| <b>Total Costs and estimated earnings in excess of billings on uncompleted contracts</b> | <b>\$1,478</b>        | <b>\$618</b>     |

Included in the accompanying condensed consolidated balance sheets under the following captions:

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|   | September 30,<br>2014 | June 30,<br>2014 |
|---|-----------------------|------------------|
| Costs and estimated earnings in excess of billings on uncompleted contracts       | \$1,620               | \$760            |
| Less: Billings in excess of costs and estimated earnings on uncompleted contracts | 142                   | 142              |
| Total Costs and estimated earnings in excess of billings on uncompleted contracts | \$1,478               | 618              |

Page 12



FONAR CORPORATION AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

SEPTEMBER 30, 2014 and 2013

(Amounts and shares in thousands, except per share amounts)

(UNAUDITED)

NOTE 6 – OTHER INTANGIBLE ASSETS

Other intangible assets, net of accumulated amortization, in the accompanying condensed consolidated balance sheets consist of the following:

|  | September<br>30,<br>2014 | June 30,<br>2014 |
|--|--------------------------|------------------|
| Capitalized software development costs | \$ 7,418                 | \$ 7,418         |
| Patents and copyrights                 | 4,454                    | 4,408            |
| Non-compete                            | 4,100                    | 4,100            |
| Customer relationships                 | 3,800                    | 3,800            |
| Gross Other intangible assets          | 19,772                   | 19,726           |
| Less: Accumulated amortization         | 9,539                    | 9,217            |
| Other Intangible Assets                | \$ 10,233                | \$ 10,509        |

Amortization of patents and copyrights for the three months ended September 30, 2014 and 2013 amounted to \$45 and \$44, respectively.

Amortization of capitalized software development costs for the three months ended September 30, 2014 and 2013 amounted to \$83 and \$109, respectively.

Amortization of non-compete for the three months ended September 30, 2014 and 2013 amounted to \$146 and \$146, respectively.

Amortization of customer relationships for the three months ended September 30, 2014 and 2013 amounted to \$48 and \$44, respectively.

NOTE 7 – OTHER CURRENT LIABILITIES

Other current liabilities in the accompanying condensed consolidated balance sheets consist of the following:

|   | September 30,<br>30, 2014 | June<br>2014   |
|---|---------------------------|----------------|
| Accrued salaries, commissions and payroll taxes | \$ 1,124                  | \$835          |
| Accrued interest                                | 117                       | 117            |
| Litigation accruals                             | 627                       | 664            |
| Sales tax payable                               | 2,623                     | 2,665          |
| Legal and other professional fees               | 442                       | 439            |
| Accounting fees                                 | 127                       | 325            |
| Self-funded health insurance reserve            | 354                       | 306            |
| Interest and penalty - sales tax                | 2,420                     | 2,374          |
| Purchase scanners                               | 785                       | 450            |
| Other   | 623                       | 849            |
| <b>TOTAL OTHER CURRENT LIABILITIES</b>          | <b>\$ 9,242</b>           | <b>\$9,024</b> |

FONAR CORPORATION AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

SEPTEMBER 30, 2014 and 2013

(Amounts and shares in thousands, except per share amounts)

(UNAUDITED)

NOTE 8 – STOCKHOLDERS EQUITY

During the three months ended September 30, 2014, the Company issued 5 shares of common stock to employees and consultants as compensation valued at \$53 under a stock bonus plan.

NOTE 9 - SEGMENT AND RELATED INFORMATION

The Company operates in two industry segments - manufacturing and the servicing of medical equipment and management of diagnostic imaging centers.

The accounting policies of the segments are the same as those described in the summary of significant accounting policies as disclosed in the Company's 10-K as of June 30, 2014. All inter-segment sales are market-based. The Company evaluates performance based on income or loss from operations.

Summarized financial information concerning the Company's reportable segments is shown in the following table:

| Medical<br>Equipment | Management<br>Of<br>Diagnostic<br>Imaging<br>Centers | Totals |
|----------------------|--|--------|
|----------------------|--|--------|

For the three months ended Sept. 30, 2014

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|                                      |          |           |          |
|--------------------------------------|----------|-----------|----------|
| Net revenues from external customers | \$ 3,790 | \$ 14,195 | \$17,985 |
| Inter-segment net revenues           | \$ 501   | \$ —      | \$501    |
| Income from operations               | \$ 378   | \$ 3,060  | \$3,438  |
| Depreciation and amortization        | \$ 76    | \$ 812    | \$888    |
| Capital expenditures                 | \$ 46    | \$ 26     | \$72     |

For the three months ended Sept. 30, 2013

|                                      |          |           |          |
|--------------------------------------|----------|-----------|----------|
| Net revenues from external customers | \$ 2,568 | \$ 14,263 | \$16,831 |
| Inter-segment net revenues           | \$ 495   | \$ —      | \$495    |
| Income from operations               | \$ 162   | \$ 3,891  | \$4,053  |
| Depreciation and amortization        | \$ 108   | \$ 874    | \$982    |
| Capital expenditures                 | \$ 47    | \$ 182    | \$229    |

NOTE 10 – SUPPLEMENTAL CASH FLOW INFORMATION

During the three months ended September 30, 2014 and September 30, 2013, the Company paid \$159 and \$189 for interest, respectively.

During the three months ended September 30, 2014 and September 30, 2013, the Company paid \$40 and \$120 for income taxes, respectively.

FONAR CORPORATION AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

SEPTEMBER 30, 2014 and 2013

(Amounts and shares in thousands, except per share amounts)

(UNAUDITED)

NOTE 11 – COMMITMENTS AND CONTINGENCIES

Litigation

The Company is subject to legal proceedings and claims arising from the ordinary course of its business, including personal injury, customer contract and employment claims. In the opinion of management, the aggregate liability, if any, with respect to such actions, will not have a material adverse effect on the consolidated financial position or results of operations of the Company.

There were no material changes in litigation from that reported in our Form 10-K for the fiscal year ended June 30, 2014.

Other Matters

The Company is also delinquent in filing sales tax returns for certain states, for which the Company has transacted business. As of September 30, 2014, the Company has recorded tax obligations of approximately \$2,623 plus interest and penalties of approximately \$2,420. The Company is in the process of determining the regulatory requirements in order to become compliant.

The Company maintains a self-funded health insurance program with a stop-loss umbrella policy with a third party insurer to limit the maximum potential liability for individual claims to \$100 per person and for a maximum potential claim liability based on member enrollment. With respect to this program, the Company considers historical and

projected medical utilization data when estimating its health insurance program liability and related expense. As of September 30, 2014 and June 30, 2014, the Company had approximately \$354 and \$306, respectively, in reserve for its self-funded health insurance programs. The reserves are included in "Other current liabilities" in the consolidated balance sheets.

The Company regularly analyzes its reserves for incurred but not reported claims, and for reported but not paid claims related to its reinsurance and self-funded insurance programs. The Company believes its reserves are adequate. However, significant judgment is involved in assessing these reserves such as assessing historical paid claims, average lags between the claims' incurred date, reported dates and paid dates, and the frequency and severity of claims. There may be differences between actual settlement amounts and recorded reserves and any resulting adjustments are included in expense once a probable amount is known. There were no significant adjustments recorded in the periods covered by this report.

FONAR CORPORATION AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

SEPTEMBER 30, 2014 and 2013

(Amounts and shares in thousands, except per share amounts)

(UNAUDITED)

NOTE 12 - INCOME TAXES

ASC topic 740 prescribes a recognition threshold and a measurement attribute for the financial statement recognition and measurement of tax positions taken or expected to be taken in a corporate tax return. For those benefits to be recognized, a tax position must be more-likely-than-not to be sustained upon examination by taxing authorities. Differences between tax positions taken or expected to be taken in a tax return and the benefit recognized and measured pursuant to the interpretation are referred to as “unrecognized benefits”. A liability is recognized (or amount of net operating loss carryforward or amount of tax refundable is reduced) for an unrecognized tax benefit because it represents an enterprise’s potential future obligation to the taxing authority for a tax position that was not recognized as a result of applying the provisions of ASC topic 740.

In accordance with ASC topic 740, interest costs related to unrecognized tax benefits are required to be calculated (if applicable) and would be classified as “Interest expense, net”. Penalties if incurred would be recognized as a component of “Selling, general and administrative” expenses.

The Company files corporate income tax returns in the United States (federal) and in various state and local jurisdictions. In most instances, the Company is no longer subject to federal, state and local income tax examinations by tax authorities for years prior to 2009.

The Company recorded a deferred tax asset of \$5,740 and a deferred tax liability of \$584 as of September 30, 2014, primarily relating to net operating loss carryforwards of approximately \$137,252 available to offset future taxable income through 2034. The net operating losses begin to expire in 2019 for federal tax purposes and in 2014 for state income tax purposes.

The ultimate realization of deferred tax assets is dependent on the generation of future taxable income during the periods in which those temporary differences become deductible. The Company considers projected future taxable income and tax planning strategies in making this assessment. At present, the Company does have a sufficient history of income and anticipates profitability in the coming years and has concluded that it is more-likely-than-not that the

Company will be able to realize a portion of its tax benefits in the near future and therefore a valuation allowance was established for the partial value of the deferred tax asset.

A valuation allowance will be maintained until sufficient positive evidence exists to support the reversal of the remainder of the valuation. Should the Company continue to remain profitable in future periods with supportable trends, the valuation allowance will be reversed accordingly.

#### NOTE 13 – SUBSEQUENT EVENTS

The Company has evaluated events that occurred subsequent to September 30, 2014 and through the date the condensed consolidated financial statements were issued.



FONAR CORPORATION AND SUBSIDIARIES

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

For the three month period ended September 30, 2014, we reported a net income of \$3.3 million on revenues of \$18.0 million as compared to net income of \$3.6 million on revenues of \$16.8 million for the three month period ended September 30, 2013. Operating income declined, by 15.2% from \$4.1 million for the three month period ended September 30, 2013 to \$3.4 million for the three month period ended September 30, 2014.

The revenue increase of 6.9%, from \$16.8 million for the first three months of fiscal 2014 to \$18.0 million for the first three months of fiscal 2015, was due to an increase in product sales from \$28,000 for the first three months of fiscal 2014 to \$1.3 million for the first three months of fiscal 2015, and an increase in management fees by 0.7%, from \$10.5 million for the three months of fiscal 2014 to \$10.6 million for the first three months of fiscal 2015.

Offsetting these increases, however, was a decline in net patient fees from \$3.8 million for the first three months of fiscal 2014, to \$3.6 million for the first three months of fiscal 2015 (patient fees less the provision for bad debts for patient fees). Patient fees represent fees for services paid directly by patients to facilities owned by us. All patient fees are derived from our Florida facilities.

Service and repair fees remained constant at \$2.5 million for the first three months of both fiscal 2015 and fiscal 2014.

The increase in our revenues was smaller than the increase in our costs and expenses, and as a result, our operating income decreased by 15.2% to \$3.4 million for the three months ended September 30, 2014, from \$4.1 million for the three months ended September 30, 2013. Costs and expenses increased 13.9% from \$12.8 million in the first three months of fiscal 2014 to \$14.5 million in the first three months of fiscal 2015, while in revenues increased only 6.9%, from \$16.8 million in the first three months of fiscal 2014 to \$18.0 million in the first three months of fiscal 2015.

Fonar's wholly-owned subsidiary, Health Management Corporation of America ("HMCA"), is the controlling, but not sole owner of two limited liability companies, Imperial Management Services, LLC ("Imperial") and Health Diagnostics Management, LLC ("HDM"), through which HMCA conducts its business. The outside investors are passive investors, and do not have the right to participate in the management of either company. For the sake of simplicity, HMCA, Imperial and HDM are, unless otherwise indicated, referred to as "HMCA".

## Forward Looking Statements

Certain statements made in this Quarterly Report on Form 10-Q are "forward-looking statements" (within the meaning of the Private Securities Litigation Reform Act of 1995) regarding the plans and objectives of Management for future operations. Such statements involve known and unknown risks, uncertainties and other factors that may cause our actual results, performance or achievements to be materially different from any future results, performance or achievements expressed or implied by such forward-looking statements. The forward-looking statements included herein are based on current expectations that involve numerous risks and uncertainties. Our plans and objectives are based, in part, on assumptions involving the expansion of business. Assumptions relating to the foregoing involve judgments with respect to, among other things, future economic, competitive and market conditions and future business decisions, all of which are difficult or impossible to predict accurately and many of which are beyond our control. Although we believe that our assumptions underlying the forward-looking statements are reasonable, any of the assumptions could prove inaccurate and, therefore, there can be no assurance that the forward-looking statements included in this Report will prove to be accurate. In light of the significant uncertainties inherent in the forward-looking statement included herein, the inclusion of such information should not be regarded as a representation by us or any other person that our objectives and plans will be achieved.

## FONAR CORPORATION AND SUBSIDIARIES

### Results of Operations

We operate in two industry segments: the manufacture and servicing of medical (MRI) equipment, our traditional business, which is conducted directly by Fonar, and diagnostic facilities management services, which is conducted through HMCA and its subsidiaries.

Effective May 2, 2011, HMCA contributed all of its assets, liabilities and business to Imperial Management Services, LLC (“Imperial”), which is controlled but not wholly-owned by HMCA. Imperial is conducting the business of HMCA utilizing the same facilities, equipment and personnel. This transaction did not result in a change of control or policy, but was solely a means to raise capital. The membership interests of the non-controlling investors in Imperial are redeemable over a five year period.

Effective March 5, 2013, HDM, in which HMCA has a 50.5% interest, acquired twelve (12) Stand-Up® MRI Centers and two (2) other scanning centers from Health Diagnostics, LLC. The contribution of these new scanning centers to the operating results of the Company are reflected in both the first three months of fiscal 2015, and the first three months of fiscal 2014.

### Manufacturing and Service of MRI Equipment

Revenues from MRI product sales increased to \$1.3 million for the first three months of fiscal 2015 from \$28,000 for the first three months of fiscal 2014. Continuing tight credit and economic uncertainty, including lower reimbursement rates for MRI scans, have depressed the market for our MRI scanner products.

Costs related to product sales also increased from \$48,000 for the three month period ended September 30, 2013 to \$1.1 million for the three month period ended September 30, 2014.

The volatility in the product sales figures reflect the low sales volume. The greater revenues in the first quarter of fiscal 2015, as a case in point, reflect the recognition of revenues from the sale of one MRI scanner. We do not regard the changes as indicative of a material trend.

Service revenues for the three month period ended September 30, 2014 as compared to the three month period ended September 30, 2013 remained constant at \$2.5 million.

Costs relating to providing service for the first three months of fiscal 2015 decreased by 6.8% from \$550,000 in the first three months of fiscal 2014 to \$513,000 in the first three months of fiscal 2015. We believe that an important factor in controlling our service costs is our ability to monitor the performance of customers' scanners from our facilities in Melville, New York on a daily basis, and to detect and repair any irregularities before more serious problems result.

There were approximately \$1.5 million in foreign revenues for the first three months of fiscal 2015 as compared to approximately \$229,000 in foreign revenues for the first three months of fiscal 2014, representing an increase in foreign revenues of 555%. We do not regard this as a material trend, but as part of a normal although sometimes volatile variation resulting from low volumes of foreign sales.

We recognize MRI scanner sales revenues on the "percentage of completion" basis, which means the revenues are recognized as the scanner is manufactured. Revenues recognized in a particular quarter do not necessarily reflect new orders or progress payments made by customers in that quarter. We build the scanner as the customer meets certain benchmarks in its site preparation in order to minimize the time lag between incurring costs of manufacturing and our receipt of the cash progress payments from the customer which are due upon delivery. Consequently, there can be a disparity between the revenues recognized in a fiscal period and the number of product sales. Generally, the recognized revenue results from revenues from a scanner sale that are recognized in a fiscal quarter or quarters following the quarter in which the sale was made.

## FONAR CORPORATION AND SUBSIDIARIES

Revenues for the medical equipment segment as a whole increased by 48.2% to \$3.8 million for the three months of fiscal 2015 from \$2.6 million for the first three months of fiscal 2014. Operating results for our medical equipment segment increased to an operating income of \$378,000 for the first three months of fiscal 2015 as compared to an operating income of \$162,000 for the first three months of fiscal 2014. For the first quarter of fiscal 2015, our medical equipment segment recognized a net income of \$342,000, compared to net loss of \$96,000 in the first quarter of fiscal 2014.

### Diagnostic Facilities Management Services

HMCA revenues decreased slightly in the first quarter of fiscal 2015 by 0.5% to \$14.2 million from \$14.3 million for the first quarter of fiscal 2014. The percentage of our revenues derived from our diagnostic facilities management segment relative to the percentage of our revenues derived from our medical equipment segment decreased slightly (78.9% for the first three months of fiscal 2015 compared to 84.7% for the first three months of fiscal 2014).

The decrease in HMCA revenues is principally due to the decrease in reimbursement rates paid by insurers, Medicare and other government programs for MRI scans to HMCA's clients and scanning centers. These developments are not unique to HMCA or HMCA's clients but are being experienced by the industry in general.

HMCA has been able to limit the effect of lower reimbursement rates by increasing the scan volume of the facilities it manages.

As a result of our vigorous marketing efforts, which increased the number of scans performed at our centers and at our client's centers from 32,342 in the first quarter of fiscal 2014 to 35,484 in the first quarter of fiscal 2015, there was only a small decrease in scanning center and HMCA revenue.

We manage twenty-four sites, twenty-three of which are equipped with Fonar Upright® MRI scanners (our Stand-Up® MRI Scanners are also called Upright® MRI Scanners). HMCA experienced an operating income of \$3.1 million for the first three months of fiscal 2015 compared to operating income of \$3.9 million for the first three months of fiscal 2014.

HMCA cost of revenues for the first three months of fiscal 2015 as compared to the first three months of fiscal 2014 increased by 4.0% from \$8.1 million to \$8.5 million. HMCA's cost of revenues includes expenditures we have been making to strengthen our marketing efforts, which focus on the unique capability of our Upright® MRI Scanners to scan patients in different positions. The increase in the cost of revenues is attributable to the acquisition of HDM in March 2013.

Revenues, costs and expenses for the three month period ended September 30, 2014 attributable to the HDM acquisition include revenues of \$9.0 million, and costs and expenses of \$7.1 million as compared to revenues of \$9.2 million and costs and expenses of \$6.6 million for the three month period ended September 30, 2013.

#### Consolidated

For the first three months of fiscal 2015, our consolidated net revenues increased by 6.9% to \$18.0 million from \$16.8 million for the first three months of fiscal 2014, while total costs and expenses increased by 13.8% to \$14.5 million for the first three months of fiscal 2015 from \$12.8 million for the first three months of fiscal 2014. As a result, our operating income of \$4.1 million in the first three months of fiscal 2014 decreased to \$3.4 million in the first three months of fiscal 2015.

Selling, general and administrative expenses decreased by 4.3% to \$3.6 million in the first three months of fiscal 2015 from \$3.7 million in the first three months of fiscal 2014 as we continued our cost-cutting policies. The compensatory element of stock issuances, however, which is included in selling, general and administrative expenses, increased 64.3% to \$53,200 for the first three months of fiscal 2015 from \$19,000 for the first three months of fiscal 2014. We do not regard this as reflecting a trend, since the expenses are relatively small in either case.

FONAR CORPORATION AND SUBSIDIARIES

Research and development expenses increased by 0.5% to \$397,000 for the first three months of fiscal 2015 as compared to \$395,000 for the first three months of fiscal 2014.

Interest expense in the first three months of fiscal 2015 decreased by 16.0% to \$204,000 from \$243,000 in the first three months of fiscal 2014. The decrease was due to the repayment of debt incurred by Fonar in connection with the acquisition of HDM.

Inventories remained constant at \$2.4 million at September 30, 2014 compared to June 30, 2014. This represents our purchase of raw materials and components which have not yet been used to fill orders.

Net Management fee and medical receivables increased by 3.2% to \$25.0 million at September 30, 2014 from \$24.2 million at June 30, 2014.

The results of operations for the first three months of fiscal 2015 reflect a slight decrease in revenues from management and other fees, as compared to the first three months of fiscal 2014 (\$14.2 million for the first three months of fiscal 2015 as compared to \$14.3 million for the first three months of fiscal 2014), and an increase in MRI equipment segment revenues (\$1.3 million as compared to \$28,000). Revenues were 21.1% from the MRI equipment segment as compared to 78.9% from HMCA, for the first three months of fiscal 2015, as compared to 15.3% from the MRI equipment segment and 84.7% from HMCA for the first three months of fiscal 2014. It is too early to determine whether these variations constitute a trend.

The implementation of the Patient Protection and Affordable Care Act (PPACA) is likely to have a profound impact on the healthcare industry. We are beginning to see some impact of the Act on our business, in the reduction of reimbursement rates, but are unable to predict the degree of the effect of the new legislative mandates and regulations on our MRI equipment segment or HMCA in the future.

We are committed to improving our operating results and dealing with the challenges posed by new legislative and regulatory requirements. Nevertheless, factors beyond our control, such as the timing and rate of market growth which depend on economic conditions, including the availability of credit, payor reimbursement rates and policies, and unexpected expenditures or the timing of such expenditures, make it problematical to forecast future operating results.

As mentioned, one of the effects of the PPACA on our business has been the reduction in Medicare reimbursement rates for MRI scans. This also has resulted in a reduction in the reimbursement rates by commercial insurers and government programs which tie their reimbursement rates to those of Medicare. Nevertheless, the increased patient volume of the scanning centers has enabled us to maintain a healthy profitability in spite of these challenges. We believe we are pursuing the correct policies to cope with these problems and to improve the Company's operating results.

Our Upright® MRI (also referred to as the Stand-Up® MRI), together with our works-in-progress, are intended to significantly improve our competitive position.

The Upright® MRI scanner, which operates at 6000 gauss (.6 Tesla) field strength, allows patients to be scanned while standing, sitting, reclining and in multiple flexion and extension positions. It is common in visualizing the spine that abnormalities are visualized in some positions and not others. This enables surgical corrections that heretofore would be unaddressable for lack of visualizing the symptom causing the pathology and therefore, in general enables the treating physician to achieve a better treatment OUTCOME for his patient. A floor-recessed elevator brings the patient to the height appropriate for the targeted image region. A custom-built adjustable bed will allow patients to sit or lie on their backs, sides or stomachs at any angle. Full-range-of-motion studies of the joints in virtually any direction are possible, a particularly promising feature for sports injuries.



## FONAR CORPORATION AND SUBSIDIARIES

Fonar has announced a major diagnostic breakthrough in multiple sclerosis achieved with advanced Upright® MRI. Medical researchers at FONAR published a paper reporting a diagnostic breakthrough in multiple sclerosis (MS), based on observations made possible by the Company's unique Upright® Multi-Position™ MRI scanner. The findings reveal that the cause of multiple sclerosis may be biomechanical and related to earlier trauma to the neck, which can result in obstruction of the flow of cerebrospinal fluid (CSF), which is produced and stored in the central anatomic structures of the brain known as the ventricles. Since the ventricles produce a large volume of CSF each day (500 cc), the obstruction can result in a build up of pressure within the ventricles, resulting in leakage of the CSF and the antigenic polypeptides it contains into the surrounding brain tissue. This leakage could be responsible for generating the brain lesions of multiple sclerosis.

The paper, titled "The Possible Role of Cranio-Cervical Trauma and Abnormal CSF Hydrodynamics in the Genesis of Multiple Sclerosis," appears in the journal *Physiological Chemistry and Physics and Medical NMR* (Sept. 20, 2011).

This capability of the Fonar Upright® technology has demonstrated its key value on patients with the Arnold-Chiari syndrome, which is believed to affect 200,000 to 500,000 Americans. In this syndrome, brain stem compression and subsequent severe neurological symptoms occur in these patients, because the brain stem descends and is compressed at the base of the skull in the foramen magnum, which is the circular bony opening at the base of the skull where the spinal cord exits the skull. Conventional lie-down MRI scanners cannot make an adequate evaluation of this pathology since the patient's pathology is most visible and the symptoms most acute when the patient is scanned in the upright fully weight-bearing position.

A combined study of 1,200 neck pain patients published in "Brain Injury" (July 2010) by eight university medical centers reported that cerebellar tonsil ectopia (CTE) of 1mm or greater was found and visualized 2.5 times (250%) more frequently when patients who had sustained automobile whiplash injuries were scanned upright rather than lying down.

The Upright® MRI has also demonstrated its value for patients suffering from scoliosis. Scoliosis patients have been typically subjected to routine x-ray exams for years and must be imaged upright for an adequate evaluation of their scoliosis. Because the patient must be standing for a complete evaluation of the extent of the patient's scoliosis, an x-ray machine has been the only modality that could provide that service. The Upright® MRI is the only MRI scanner which allows the patient to stand during the MRI exam. Fonar has developed an RF receiver and scanning protocol that for the first time allows scoliosis patients to obtain diagnostic pictures of their spines without the risks of x-rays. A study by the National Cancer Institute (2000) of 5,466 women with scoliosis reported a 70% increase in breast cancer resulting from 24.7 chest x-rays these patients received on the average in the course of their scoliosis treatment. The Upright® MRI examination of scoliosis enables the needed imaging evaluation of the degree of spine scoliosis without exposing the patient to the risk of breast cancer from x-radiation. Currently scoliosis affects more than

3,000,000 American women.

In addition, the University of California, Los Angeles (UCLA) reported their results of their study of 1,302 patients utilizing the Fonar Upright® MRI at the 22nd Annual Meeting of the North American Spine Society on October 23, 2007. The UCLA study showed the superior ability of the Fonar Upright® MRI to detect spine pathology, including spondylolisthesis, disc herniations and disc degeneration, as compared to visualizations of the spine produced by traditional single position static MRIs.

The UCLA study by MRI of 1,302 back pain patients when they were in the Fonar Upright® MRI and examined in a full range of flexion and extension positions made possible by Fonar's new Upright® technology established that significant "misses" of pathology were occurring with static single position MRI imaging. At L4-5, the vertebral level responsible for 49.8% of lumbar disc herniations, 35.1% of the spondylolistheses (vertebral instabilities) visualized by the Upright® MRI, were being missed by static single position MRI (510 patients). Since this vertebral segment is responsible for the majority of all disc herniations, the finding may reveal a significant cause of failed back surgeries. The UCLA study further showed the "miss-rate" of vertebral instabilities by static only MRI was even higher, 38.7%, at the L3-4 vertebral segment. Additionally, the UCLA study showed that MRI examinations of the cervical spine that did not perform extension images of the neck "missed" disc bulges 23.75% of the time (163 patients).

## FONAR CORPORATION AND SUBSIDIARIES

The UCLA study further reported that they were able to quantitatively measure the dimensions of the central spinal canal with the “highest accuracy” using the FONAR Upright® MRI thereby enabling the extent of spinal canal stenosis that existed in patients to be measured. Spinal canal stenosis gives rise to the symptom complex intermittent neurogenic claudication manifest as debilitating pain in the back and lower extremities, weakness and difficulties in ambulation and leg paresthesias. Spinal canal stenosis is a spinal compression syndrome separate and distinct from the more common nerve compression syndrome of the spinal nerves as they exit the vertebral column through the bony neural foramen.

The Fonar Upright® MRI can also be useful for MRI directed emergency neuro-surgical procedures as the surgeon would have unhindered access to the patient’s head when the patient is supine with no restrictions in the vertical direction. This easy-entry, mid-field-strength scanner could prove ideal for trauma centers where a quick MRI-screening within the first critical hour of treatment will greatly improve patients’ chances for survival and optimize the extent of recovery.

### Liquidity and Capital Resources

Cash and cash equivalents increased by 7.1% from \$10.0 million at June 30, 2014 to \$10.7 million at September 30, 2014, primarily as a result of collections.

Cash provided by operating activities for the first three months of fiscal 2015 was \$2.9 million. Cash provided by operating activities was attributable principally to net income of \$3.3 million, an increase of other current liabilities of \$865,000, depreciation and amortization of \$888,000, provision for bad debt of \$506,000, offset by an increase in accounts, management fee and medical receivables of \$2.1 million.

Cash used in investing activities for the first three months of fiscal 2015 was \$72,000. The principal uses of cash used in investing activities during the first three months of fiscal 2015 consisted of patent costs of \$46,000 and the purchase of property and equipment of \$26,000.

Cash used by financing activities for the first three months of fiscal 2015 was \$2.1 million. The principal uses of cash in financing activities during the first three months of fiscal 2015 were the repayment of principal on long-term debt and capital lease obligations of \$921,000, along with distributions to non-controlling interests of \$1.2 million.

Total liabilities decreased by 0.7% to \$30.7 million at September 30, 2014 from \$30.9 million at June 30, 2014. Other current liabilities increased from \$9.0 million at June 30, 2014 to \$9.2 million at September 30, 2014 along with a decrease in long-term debt and capital lease obligations from \$8.5 million to \$7.6 million, an increase in the current portion of our unearned revenue on service contracts from \$4.7 million to \$5.3 million. Customer deposits decreased to \$1.6 million at September 30, 2014 as compared to \$1.9 million at June 30, 2014.

As of September 30, 2014, the total of \$22.0 million in other current liabilities included accrued salaries and payroll taxes of \$1.1 million, and sales taxes of \$2.6 million plus accrued interest and penalties of \$2.4 million.

Our working capital increased to \$23.6 million at September 30, 2014 from \$21.6 million at June 30, 2014. This resulted from an increase in current assets (\$42.8 million at June 30, 2014 as compared to \$45.6 million at September 30, 2014), but a smaller increase in current liabilities from \$21.2 million at June 30, 2014 to \$22.0 million at September 30, 2014.

Fonar has not committed to making any significant capital expenditures for the remainder of the 2015 fiscal year.

Our business plan calls for a continuing emphasis on providing our customers with enhanced equipment service and maintenance capabilities and delivering state-of-the-art, innovative and high quality equipment and upgrades at competitive prices.

## FONAR CORPORATION AND SUBSIDIARIES

Critical to our business plan are improvement and expansion of the MRI facilities managed by HMCA, and increasing the number of scans performed at those facilities. In addition, our business plan calls for a continuing emphasis on providing our customers with enhanced equipment service and maintenance capabilities and delivering state-of-the-art, innovative and high quality equipment and upgrades at competitive prices.

The Company continues to focus its efforts on increased marketing campaigns to strengthen the demand for its products and services. Management is seeking to promote wider market recognition of Fonar's scanner products, and to increase demand for Upright® scanning at the facilities HMCA manages. Given the liquidity and credit constraints in the markets, and the uncertainty resulting for the Patient Protection and Affordable Care Act, the sale of medical equipment has and may continue to suffer.

Management anticipates that Fonar's capital resources will continue to improve if (1) Fonar's MRI scanner products gain wider market recognition and acceptance resulting in increased product sales, (2) service and maintenance revenues increase as warranties on scanners expire and (3) HMCA revenues are increased through the Company's vigorous marketing efforts and the installation or acquisition of more HMCA managed Upright® MRI scanners. If our marketing efforts to increase revenues fail, and we are unable to raise debt or equity capital, we may experience a shortfall in cash, and it may be necessary to reduce operating expenses to attempt to avoid the need to curtail our operations. Current economic, credit and political conditions have contributed to a challenging business environment for our company. The precise impact of these conditions can not be fully predicted. There can be no assurance that we would be able to secure additional funds if needed.

The Company believes that its business plan has been responsible for the past three consecutive fiscal years and past fiscal quarter of profitability (fiscal 2012, fiscal 2013, fiscal 2014 and the first quarter of fiscal 2015) and that its capital resources will be adequate to support operations at current levels through at least September 30, 2015. In the past, the Company experienced periods of working capital deficits and prior to fiscal 2011, losses. The future effects on our business of healthcare reform legislation, the Deficit Reduction Act, the 2.3% excise tax on sales of medical equipment, and the general economic and business climate are not known at the present time. Nevertheless, there is a possibility of adverse consequences to our business operations from these causes.

### Item 3. Quantitative and Qualitative Disclosures About Market Risk

The Company maintains its funds in liquid accounts. None of our investments are in fixed rate instruments.

All of our revenue, expense and capital purchasing activities are transacted in United States dollars.

#### Item 4. Controls and Procedures

##### Evaluation of Disclosure Controls and Procedures

The Company maintains “disclosure controls and procedures,” as such term is defined under Rule 13a-15(e) of the Exchange Act, that are designed to provide reasonable assurance that information required to be disclosed in the Company’s Exchange Act reports is recorded, processed, summarized and reported within the time periods specified in the SEC’s rules and forms, and that such information is accumulated and communicated to the Company’s management, including its Principal Executive Officer and Acting Principal Financial Officer, as appropriate, to allow timely decisions regarding required disclosure. In designing and evaluating the disclosure controls and procedures, management recognized that any control and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objective.

## FONAR CORPORATION AND SUBSIDIARIES

As required by SEC Rule 13a-15(b), the Company carried out an evaluation, under the supervision and with the participation of the Company's management, including the Company's Principal Executive Officer and Acting Principal Financial Officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures as of September 30, 2014. Based on this evaluation, the Company's Principal Executive Officer and Acting Principal Financial Officer concluded that the Company's disclosure controls and procedures were not effective as of September 30, 2014 because of the material weakness in our internal control over financial reporting described in our Annual Report on Form 10-K. The Company has started the remediation process of implementing changes in information technology general controls in order to improve controls over segregation of duties, restricted access to programs and data, and change management activities in order to address the previously reported internal control deficiencies in our Form 10-K. The Company will continue to take measures that may be necessary and advisable so as to institute measures to address the material weakness.

### Changes in Internal Control Over Financial Reporting

There have been no changes in the Company's internal control over financial reporting, during the fiscal quarter ended September 30, 2014, that has materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

## PART II – OTHER INFORMATION

Item 1 – Legal Proceedings: There were no material changes in litigation from that reported in our Form 10-K for the fiscal year ended June 30, 2014.

Item 1A – Risk Factors: An investment in the securities of the Company is subject to various risks, the most significant of which are summarized below.

1. **Reduced Reimbursement Rates.** Most of our revenues are derived from our scanning center business conducted by HCMA (including HMCA's subsidiary HDM). Already we are experiencing lower reimbursement rates from Medicare, other government programs and private insurance companies. To date, we have been able to counter the impact of these reductions by increasing our volume of scans, maintaining a high level of profitability in this business segment.

2. Demand for MRI Scanners. The reduced reimbursement rates also may affect our sales of MRI scanners negatively. With lower revenue projections, fewer prospective customers may be able to operate a profitable scanning center business, resulting in a lower demand and lower prices for scanners. Although the reduced reimbursements may not affect foreign demand, a lower demand and number of sales in the aggregate could reduce economies of scale and consequently, profit margins.

3. Competition. Many if not most of our competing scanner manufacturers have significantly greater financial resources, production capacity, and other resources than we do. Such competitors would include General Electric, Siemens, Hitachi and Phillips. Although Fonar is the only company which can manufacture and sell the unique Stand-Up® (Upright®) MRI scanner, potential customers must be convinced that the purchase of a Fonar scanner is their best choice. We believe that with time, that objective will be reached, particularly with customers scanning patients having neck, back, knee and various orthopedic issues who would benefit from being scanned in weight-bearing positions.

Item 2 – Unregistered Sales of Equity Securities and Use of Proceeds: The Company has not issued any unregistered shares of its Common Stock during the first quarter of fiscal 2015.

Item 3 - Defaults Upon Senior Securities: None

Item 4 - Mine Safety Disclosure: Not Applicable

Item 5 - Other Information: None

Page 24



FONAR CORPORATION AND SUBSIDIARIES

Item 6 - Exhibits and Reports on Form 8-K:

- a) Exhibit 31.1 Certification. See Exhibits
- b) Exhibit 32.1 Certification. See Exhibits
- c) Report on Form 8-K filed on September 16, 2014, Item 2.02: Results of Operations and Financial Condition for the fiscal year ended June 30, 2014.

SIGNATURES

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

FONAR CORPORATION

(Registrant)

By: /s/ Raymond V. Damadian

Raymond V. Damadian

President & Chairman

Dated: November 10, 2014



