

RadNet, Inc.  
Form 10-Q  
May 10, 2016

**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, 2016

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 5, 2016 was 47,270,751 shares.

**RADNET, INC.**

**Table of Contents**

	Page
<b>PART I – FINANCIAL INFORMATION</b>	
ITEM 1. Condensed Consolidated Financial Statements (unaudited)	3
Condensed Consolidated Balance Sheets at March 31, 2016 and December 31, 2015	3
Condensed Consolidated Statements of Operations for the Three Months Ended March 31, 2016 and 2015	4
Condensed Consolidated Statements of Comprehensive Loss for the Three Months Ended March 31, 2016 and 2015	5
Condensed Consolidated Statement of Stockholders’ Equity for the Three Months Ended March 31, 2016	6
Condensed Consolidated Statements of Cash Flows for the Three Months Ended March 31, 2016 and 2015	7
Notes to Condensed Consolidated Financial Statements	9
ITEM 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations	20
ITEM 3. Quantitative and Qualitative Disclosures About Market Risk	32
ITEM 4. Controls and Procedures	33
<b>PART II – OTHER INFORMATION</b>	
ITEM 1. Legal Proceedings	35
ITEM 1A. Risk Factors	35
ITEM 2. Unregistered Sales of Equity Securities and Use of Proceeds	35
ITEM 3. Defaults Upon Senior Securities	35
ITEM 4. Mine Safety Disclosures	35
ITEM 5. Other Information	35
ITEM 6. Exhibits	35

SIGNATURES	36
INDEX TO EXHIBITS	37

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

	March 31, 2016 (unaudited)	December 31, 2015
<b>ASSETS</b>		
<b>CURRENT ASSETS</b>		
Cash and cash equivalents	\$ 410	\$ 446
Accounts receivable, net	177,830	162,843
Current portion of deferred tax assets	22,278	22,279
Due from affiliates	3,725	4,815
Prepaid expenses and other current assets	33,698	38,986
Total current assets	237,941	229,369
<b>PROPERTY AND EQUIPMENT, NET</b>	<b>254,949</b>	<b>256,722</b>
<b>OTHER ASSETS</b>		
Goodwill	240,702	239,408
Other intangible assets	44,695	45,253
Deferred financing costs	2,486	2,841
Investment in joint ventures	34,119	33,584
Deferred tax assets, net of current portion	25,971	24,685
Deposits and other	4,847	4,565
Total assets	\$ 845,710	\$ 836,427
<b>LIABILITIES AND EQUITY</b>		
<b>CURRENT LIABILITIES</b>		
Accounts payable, accrued expenses and other	\$ 114,361	\$ 113,813
Due to affiliates	4,782	6,564
Deferred revenue	1,528	1,598
Current portion of notes payable	21,962	22,383
Current portion of deferred rent	2,593	2,563
Current portion of obligations under capital leases	9,280	10,038
Total current liabilities	154,506	156,959
<b>LONG-TERM LIABILITIES</b>		
Deferred rent, net of current portion	27,278	26,865
Line of credit	16,300	-
Notes payable, net of current portion	594,547	599,914
Obligations under capital lease, net of current portion	5,799	6,385

Edgar Filing: RadNet, Inc. - Form 10-Q

Other non-current liabilities	9,748	9,843
Total liabilities	808,178	799,966
EQUITY		
RadNet, Inc. stockholders' equity:		
Common stock - \$.0001 par value, 200,000,000 shares authorized; 47,270,751, and 46,281,189 shares issued and outstanding at March 31, 2016 and December 31, 2015, respectively	4	4
Paid-in-capital	199,955	197,297
Accumulated other comprehensive loss	(149 )	(153 )
Accumulated deficit	(166,294 )	(164,571)
Total RadNet, Inc.'s stockholders' equity	33,516	32,577
Noncontrolling interests	4,016	3,884
Total equity	37,532	36,461
Total liabilities and equity	\$ 845,710	\$ 836,427

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

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

	Three Months Ended March 31,	
	2016	2015
<b>NET REVENUE</b>		
Service fee revenue, net of contractual allowances and discounts	\$200,842	\$165,030
Provision for bad debts	(10,304)	(7,475)
Net service fee revenue	190,538	157,555
Revenue under capitation arrangements	25,850	23,712
Total net revenue	216,388	181,267
<b>OPERATING EXPENSES</b>		
Cost of operations, excluding depreciation and amortization	196,826	168,921
Depreciation and amortization	16,412	14,294
Gain on sale and disposal of equipment	-	(38)
Severance costs	167	36
Total operating expenses	213,405	183,213
<b>INCOME (LOSS) FROM OPERATIONS</b>	<b>2,983</b>	<b>(1,946)</b>
<b>OTHER INCOME AND EXPENSES</b>		
Interest expense	10,681	9,996
Meaningful use incentive	(2,808)	(3,270)
Equity in earnings of joint ventures	(2,279)	(1,102)
Other expenses (income)	2	(3)
Total other expenses	5,596	5,621
<b>LOSS BEFORE INCOME TAXES</b>	<b>(2,613)</b>	<b>(7,567)</b>
Benefit from income taxes	1,180	3,091
<b>NET LOSS</b>	<b>(1,433)</b>	<b>(4,476)</b>
Net income attributable to noncontrolling interests	290	78
<b>NET LOSS ATTRIBUTABLE TO RADNET, INC. COMMON STOCKHOLDERS</b>	<b>\$(1,723)</b>	<b>\$(4,554)</b>
<b>BASIC AND DILUTED LOSS PER SHARE ATTRIBUTABLE TO RADNET, INC. COMMON STOCKHOLDERS</b>	<b>\$(0.04)</b>	<b>\$(0.11)</b>
<b>WEIGHTED AVERAGE SHARES OUTSTANDING</b>		
Basic and Diluted	46,581,491	42,747,329

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





RADNET, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS

(IN THOUSANDS)

(unaudited)

	Three Months Ended March 31,	
	2016	2015
NET LOSS	\$(1,433)	\$(4,476)
Foreign currency translation adjustments	4	(37 )
COMPREHENSIVE LOSS	(1,429)	(4,513)
Less comprehensive income attributable to non-controlling interests	290	78
COMPREHENSIVE LOSS ATTRIBUTABLE TO RADNET, INC. COMMON STOCKHOLDERS	\$(1,719)	\$(4,591)

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 Capital	Accumulated Deficit	Accumulated Other Comprehensive Loss	Total Radnet, Inc.'s Equity	Noncontrolling Interests	Total
	Shares	Amount						
BALANCE - JANUARY 1, 2016	46,281,189	\$4	\$197,297	\$(164,571)	\$(153)	\$32,577	\$3,884	\$33,461
Issuance of common stock upon exercise of options	264,448	—	—	—	—	—	—	—
Stock-based compensation	—	—	2,658	—	—	2,658	—	2,658
Issuance of restricted stock and other awards	725,114	—	—	—	—	—	—	—
Distributions paid to noncontrolling interests	—	—	—	—	—	—	(158)	(158)
Change in cumulative foreign currency translation adjustment	—	—	—	—	4	4	—	4
Net (loss) income	—	—	—	(1,723)	—	(1,723)	290	(1,433)
BALANCE - MARCH 31, 2016	47,270,751	\$4	\$199,955	\$(166,294)	\$(149)	\$33,516	\$4,016	\$37,532

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

## RADNET, INC. AND SUBSIDIARIES

## CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(IN THOUSANDS)

(unaudited)

	Three Months Ended March 31,	
	2016	2015
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Net loss	\$(1,433 )	\$(4,476 )
Adjustments to reconcile net loss to net cash provided by operating activities:		
Depreciation and amortization	16,412	14,294
Provision for bad debts	10,304	7,475
Equity in earnings of joint ventures	(2,279 )	(1,102 )
Distributions from joint ventures	2,038	3,041
Deferred rent amortization	443	925
Amortization of deferred financing costs and loan discount	1,368	1,288
Gain on sale and disposal of equipment	–	(38 )
Stock-based compensation	2,733	3,554
Changes in operating assets and liabilities, net of assets acquired and liabilities assumed in purchase transactions:		
Accounts receivable	(25,291)	(12,498)
Other current assets	5,288	2,787
Other assets	856	(289 )
Deferred taxes	(1,286 )	(3,578 )
Deferred revenue	(70 )	(202 )
Accounts payable, accrued expenses and other	11,880	6,288
Net cash provided by operating activities	20,963	17,469
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Purchase of imaging facilities	(5,007 )	–
Purchase of property and equipment	(22,500)	(19,826)
Proceeds from sale of equipment	–	205
Equity contributions in existing joint ventures	(294 )	–
Net cash used in investing activities	(27,801)	(19,621)
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>		
Principal payments on notes and leases payable	(3,166 )	(2,030 )
Payments on Term Loan Debt/Senior Notes	(6,178 )	(5,190 )
Net proceeds on revolving credit facility	16,300	9,400
Dividends paid to noncontrolling interests	(158 )	(468 )
Proceeds from issuance of common stock upon exercise of options/warrants	–	324
Net cash provided by financing activities	6,798	2,036

Edgar Filing: RadNet, Inc. - Form 10-Q

EFFECT OF EXCHANGE RATE CHANGES ON CASH	4	(37	)	
NET DECREASE IN CASH AND CASH EQUIVALENTS	(36	)	(153	)
CASH AND CASH EQUIVALENTS, beginning of period	446	307		
CASH AND CASH EQUIVALENTS, end of period	\$410	\$154		
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION				
Cash paid during the period for interest	\$9,085	\$8,624		

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 \$20.5 million and \$12.3 million during the three months ended March 31, 2016 and 2015, respectively, which were not paid for as of March 31, 2016 and 2015, respectively. The offsetting amounts due were recorded in our consolidated balance sheet under accounts payable, accrued expenses and other.

During the three months ended March 31, 2016 we added capital lease debt of approximately \$1.3 million.

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

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

**(unaudited)**

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

We are a national provider of freestanding, fixed-site outpatient diagnostic imaging services. At March 31, 2016, we operated directly or indirectly through joint ventures with hospitals, 309 centers located in California, Delaware, Florida, Maryland, New Jersey, New York and Rhode Island. Our centers provide physicians with imaging capabilities to facilitate the diagnosis and treatment of diseases and disorders. Our services include magnetic resonance imaging (MRI), computed tomography (CT), positron emission tomography (PET), nuclear medicine, mammography, ultrasound, diagnostic radiology (X-ray), fluoroscopy and other related procedures. The vast majority of our centers offer multi-modality imaging services. Our multi-modality strategy diversifies revenue streams, reduces exposure to reimbursement changes and provides patients and referring physicians one location for multiple procedures. Our operations comprise a single segment for financial reporting purposes.

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

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

Howard G. Berger, M.D., is our President and Chief Executive Officer, a member of our Board of Directors, and also owns, indirectly, 99% of the equity interests in BRMG. BRMG provides all of the professional medical services at nearly all of our facilities located in California under a management agreement with us, and employs physicians or contracts with various other independent physicians and physician groups to provide the professional medical services at most of our 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.

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

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

We have determined that BRMG and the NY Groups are variable interest entities, and that we are the primary beneficiary, and consequently, we consolidate the revenue and expenses, assets and liabilities of each. BRMG and the NY Groups on a combined basis recognized \$34.0 million and \$25.5 million of revenue, net of management service fees to RadNet, for the three months ended March 31, 2016 and 2015, respectively, and \$34.0 million and \$25.5 million of operating expenses for the three months ended March 31, 2016 and 2015, respectively. RadNet recognized in its condensed consolidated statement of operations \$104.0 million and \$99.0 million of net revenues for the three months ended March 31, 2016, and 2015 respectively, for management services provided to BRMG and the NY Groups relating primarily to the technical portion of total billed revenue.



The cash flows of BRMG and the NY Groups are included in the accompanying consolidated statements of cash flows. All intercompany balances and transactions have been eliminated in consolidation. In our consolidated balance sheets at March 31, 2016 and December 31, 2015, we have included approximately \$110.5 million and \$89.8 million, respectively, of accounts receivable and approximately \$9.1 million and \$8.5 million of accounts payable and accrued liabilities related to BRMG and the NY Groups.

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

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

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

## **NOTE 2 – ADOPTION OF NEW ACCOUNTING PRONOUNCEMENT**

### *Presentation of Deferred Financing Costs*

Edgar Filing: RadNet, Inc. - Form 10-Q

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

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

**NOTE 3 –SIGNIFICANT ACCOUNTING POLICIES**

During the period covered in this report, there have been no material changes to the significant accounting policies we use, except as stated in Note 2 above, and have explained, in our annual report on Form 10-K for the fiscal year ended December 31, 2015, as amended. The information below is intended only to supplement the disclosure in our annual report on Form 10-K for the fiscal year ended December 31, 2015, as amended.

*Revenues*

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

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

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

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

	Three Months Ended March 31,	
	2016	2015
Commercial insurance	\$126,397	\$99,885

Edgar Filing: RadNet, Inc. - Form 10-Q

Medicare	45,820	37,036
Medicaid	7,023	5,470
Workers' compensation/personal injury	9,514	7,400
Other	12,088	15,239
Service fee revenue, net of contractual allowances and discounts	200,842	165,030
Provision for bad debts	(10,304 )	(7,475 )
Net service fee revenue	190,538	157,555
Revenue under capitation arrangements	25,850	23,712
Total net revenue	\$216,388	\$181,267

### *Provision for Bad Debts*

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

### *Deferred Tax Assets*

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

### *Deferred Financing Costs*

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

### *Meaningful Use Incentive*

Under the American Recovery and Reinvestment Act of 2009, a program was enacted that provides financial incentives for providers that successfully implement and utilize electronic health record technology to improve patient care. Our software development team in Canada established an objective to build a Radiology Information System (RIS) software platform that has been awarded Meaningful Use certification. As this certified RIS system is implemented throughout our imaging centers, the radiologists that utilize this software can be eligible for the available financial incentives. In order to receive such incentive payments providers must attest that they have demonstrated

meaningful use of the certified RIS in each stage of the program. We account for this meaningful use incentive under the Gain Contingency Model outlined in ASC 450-30. Under this model, we record within non-operating income, meaningful use incentive only after Medicare accepts an attestation from the qualified eligible professional demonstrating meaningful use. We recorded approximately \$2.8 million and \$3.3 million during the three months ended March 31, 2016, and 2015, respectively, relating to this incentive.

*Liquidity and Capital Resources*

We had cash and cash equivalents of \$410,000 and accounts receivable of \$177.8 million at March 31, 2016, compared to cash and cash equivalents of \$446,000 and accounts receivable of \$162.8 million at December 31, 2015. We had a working capital balance of \$83.4 million and \$72.4 million at March 31, 2016 and December 31, 2015, respectively. We had net loss attributable to RadNet, Inc. common stockholders for the three months ended March 31, 2016 and 2015 of \$1.7 million and \$4.6 million respectively. We also had stockholders' equity of \$33.5 million and \$32.6 million at March 31, 2016 and December 31, 2015, respectively.

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

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

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

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

Included in our condensed consolidated balance sheet at March 31, 2016 is \$614.2 million of senior secured term loan debt (net of unamortized discounts of \$10.6 million), broken down by loan agreement as follows (in thousands):

	Face Value	Discount	Total Carrying Value
First Lien Term Loans	\$373,792	\$(7,461 )	\$366,331
2015 Incremental First	\$71,053	\$(834 )	\$70,219
Second Lien Term Loans	\$180,000	\$(2,311 )	\$177,689
Total	\$624,845	\$(10,606)	\$614,239

Our \$101.25 million revolving credit facility had a \$16.3 million aggregate principal amount outstanding as of March 31, 2016.

As of March 31, 2016, we were in compliance with all covenants under the Original Credit Agreement (as amended by the 2013 Amendment, the 2014 Amendment, and the 2015 Joinder) and the Second Lien Credit Agreement.

The following describes our 2015 financing activities:

2015 Incremental First Lien Term Loans:

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

*Interest.* The interest rates payable on the 2015 Incremental First Lien Term Loans are the same rates currently payable on the existing tranche B term loans under the Credit Agreement, which are (a) the Adjusted Eurodollar Rate (as defined in the Credit Agreement) plus 3.25% per annum or (b) the Base Rate (as defined in the Credit Agreement) plus 2.25% per annum. As applied to the first lien tranche B term loans, the Adjusted Eurodollar Rate has a minimum floor of 1.0%. The Adjusted Eurodollar Rate at March 31, 2016 was 0.90%.

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

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

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



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

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

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

The following describes our 2014 financing activities:

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

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

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

*Second Lien Credit and Guaranty Agreement.* We entered into the Second Lien Credit Agreement to provide for, among other things, the borrowing of \$180.0 million of second lien term loans (the “Second Lien Term Loans”). The proceeds from the Second Lien Term Loans and the 2014 First Lien Term Loans were used to redeem the 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 Agreement was unaltered by the agreements above and remains in place. The termination date for the \$101.25 million revolving credit facility is the earliest to occur of (i) October 10, 2017, (ii) the date the revolving credit facility is permanently reduced to zero pursuant to section 2.13(b) of the Credit Agreement, which addresses voluntary commitment reductions and (iii) the date of the termination of the revolving credit facility due to specific events of default pursuant to section 8.01 of the Credit Agreement. The revolving credit facility bears interest based on types of borrowings as follows: (i) unpaid principal at the Adjusted Eurodollar Rate (as defined in the Credit Agreement) plus 4.25% per annum or the Base Rate (as defined in the Credit Agreement) plus 3.25% per annum, (ii) letter of credit and fronting fees at 4.5% per annum, and (iii) commitment fee of 0.5% per annum on the unused revolver balance. The Adjusted Eurodollar Rate at March 31, 2016 was 0.90%.

The 2014 Amendment provided for the following:

*Interest.* The interest rates payable on the 2014 First Lien Term Loans are the same as the rates currently payable under the Original Credit Agreement, as amended by the 2013 Amendment, which are (a) the Adjusted Eurodollar Rate (as defined in the Credit Agreement) plus 3.25% or (b) the Base Rate (as defined in the Credit Agreement) plus 2.25%. With respect to all of the term loans under the Credit Agreement, the Adjusted Eurodollar Rate has a minimum floor of 1.0%. The Adjusted Eurodollar Rate at March 31, 2016 was 0.90%.

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

The Second Lien Credit Agreement provides for the following:

*Interest.* The interest rates payable on the Second Lien Term Loans are (a) the Adjusted Eurodollar Rate (as defined in the Second Lien Credit Agreement) plus 7.0% or (b) the Base Rate (as defined in the Second Lien Credit Agreement) plus 6.0%. The Adjusted Eurodollar Rate has a minimum floor of 1.0% on the Second Lien Term Loans. The Adjusted Eurodollar Rate at March 31, 2016 was 0.90%. The rate paid on the Second Lien Credit Agreement at March 31, 2016 was 8%.

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

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

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

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

The following describes our key financing activities prior to 2014:

2013 Amendment to the Credit Agreement

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

2012 Refinancing and Original Credit Agreement

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

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

**NOTE 4 – RECENT ACCOUNTING STANDARDS**

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

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

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

In February 2015, the 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 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 was effective for fiscal years (and interim reporting periods within fiscal years) beginning after December 15, 2016, which has recently been extended to December 31, 2017. We are currently evaluating the impact of the GAAP update on our results of operations and cash flows.

**NOTE 5 – 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):

	Three Months Ended March 31,	
	2016	2015
Net loss attributable to RadNet, Inc. common stockholders	\$(1,723	) \$(4,554
<b>BASIC AND DILUTED NET LOSS PER SHARE ATTRIBUTABLE TO RADNET, INC. COMMON STOCKHOLDERS</b>		
Weighted average number of common shares outstanding during the period	46,581,491	42,747,329
Basic and diluted net loss per share attributable to RadNet, Inc. common stockholders	\$(0.04	) \$(0.11

For the three months ended March 31, 2016 and 2015 we excluded all outstanding options and restricted stock awards in the calculation of diluted earnings per share because their effect would be antidilutive.

**NOTE 6 – ACQUISITIONS**

On March 1, 2016 we completed our acquisition of certain assets of Advanced Radiological Imaging – Astoria P.C. consisting of two multi-modality imaging centers located in Astoria, NY for cash consideration of \$5.0 million. The facility provides MRI, PET/CT, Ultrasound and X-ray services. We have made a preliminary fair value determination of the acquired assets and approximately \$3.6 million of fixed assets, \$47,000 of prepaid assets, \$100,000 covenant not to compete, and \$1.3 million of goodwill were recorded.

**NOTE 7 – 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, 2016 (in thousands):

Balance as of December 31, 2015	\$33,584
Equity in earnings in these joint ventures	2,279
Distribution of earnings	(2,038 )
Contributions paid	294
Balance as of March 31, 2016	\$34,119

We earned management service fees from the centers underlying these joint ventures of approximately \$2.9 million and \$2.4 million for the three months ended March 31, 2016 and 2015, 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, 2016 and for the three months ended March 2016 and 2015 (in thousands):

Balance Sheet Data:	March
	31, 2016
Current assets	\$23,511
Noncurrent assets	90,320

Edgar Filing: RadNet, Inc. - Form 10-Q

Current liabilities	(9,900 )
Noncurrent liabilities	(42,122)
Total net assets	\$61,809

Book value of RadNet joint venture interests	\$29,148
Cost in excess of book value of acquired joint venture interests	4,971
Total value of Radnet joint venture interests	\$34,119

Total book value of other joint venture partner interests	\$32,661
---	----------

Income statement data for the three months ended March 31,	2016	2015
Net revenue	\$39,220	\$26,442
Net income	\$5,614	\$3,030



**NOTE 8 – STOCK-BASED COMPENSATION****Stock Incentive Plans*****Options***

We have one long-term equity incentive plan which we refer to as the 2006 Equity Incentive Plan, which we amended and restated as of April 20, 2015 (the “Restated Plan”). The Restated Plan was approved by our stockholders at our annual stockholders meeting on June 11, 2015. As of March 31, 2016, we have reserved for issuance under the Restated Plan 12,000,000 shares of common stock. We can issue options, stock awards, stock appreciation rights and cash awards under the Restated Plan. Certain options granted under the Restated Plan to employees are intended to qualify as incentive stock options under existing tax regulations. Stock options generally vest over two to five years and expire five to ten years from the date of grant.

As of March 31, 2016, we had outstanding options to acquire 475,626 shares of our Common Stock, of which options to acquire 291,667 shares were exercisable. During the three months ended March 31, 2016, we granted stock options under our Restated Plan in the amount of 170,626 shares.

The following summarizes all of our option transactions during the quarter ended March 31, 2016:

<b>Outstanding Options Under the 2006 Plan</b>	<b>Shares</b>	<b>Weighted Average Exercise Price per Common Share</b>	<b>Weighted Average Remaining Contractual Life (in years)</b>	<b>Aggregate Intrinsic Value</b>
Balance, December 31, 2015	931,667	\$ 4.69		
Granted	170,626	6.01		
Exercised	(526,667)	2.95		
Canceled, forfeited or expired	(100,000)	9.03		
Balance, March 31, 2016	475,626	6.18	4.18	\$ 220,100
Exercisable at March 31, 2016	291,667	6.47	1.18	182,900

Aggregate intrinsic value in the table above represents the total pretax intrinsic value (the difference between our closing stock price on March 31, 2016 and the exercise price, multiplied by the number of in-the-money options) that would have been received by the holder had all holders exercised their options on March 31, 2016. Total intrinsic value of options exercised during the three months ended March 31, 2016 and 2015 was approximately \$1.6 million and \$1.9 million, respectively. As of March 31, 2016, total unrecognized stock-based compensation expense related to non-vested employee option awards was \$557,000, which is expected to be recognized over a weighted average period of approximately 3.7 years.

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

The 2006 Plan permits the award of restricted stock. As of March 31, 2016, we have issued a total of 4,186,322 RSA's of which 610,962 were unvested.

The following summarizes all unvested RSA's activities during the three months ended March 31, 2016:

	<b>RSA's</b>	<b>Weighted- Average Remaining Contractual Term (Years)</b>	<b>Weighted- Average Fair Value</b>
RSA's outstanding at December 31, 2015	771,342		\$ 5.17
Changes during the period			
Granted	725,114		\$ 5.90
Vested	(885,492)		\$ 5.18
RSA's unvested at March 31, 2016	610,962	1.23	\$ 6.02

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

**Other stock bonus awards**

The Restated Plan also permits the award of stock bonuses not subject to any future service period. These awards are valued and expensed based on the closing price of our common stock on the date of award. During the quarter ended March 31, 2016 no stock bonus awards were issued under the Restated Plan.

**Plan Summary**

In sum, of the 12,000,000 shares of common stock reserved for issuance under the Restated Plan, at March 31, 2016, we had issued 11,955,698 total shares between options, RSA's and other stock awards. With options cancelled and RSA's forfeited amounting to 2,925,009 and 59,053 shares, respectively, there remain 3,028,364 shares available under the Restated Plan for future issuance.

**NOTE 9 – 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):

	As of March 31, 2016				
	Level 1	Level 2	Level 3	Total	
				Fair	
				Value	
				Total	
				Face	
				Value	
First Lien Term Loans	\$–	\$433,724	\$ –	\$433,724	\$444,845

Second Lien Term Loans \$- \$162,900 \$ - 162,900 \$180,000

As of December 31, 2015

	Level 1	Level 2	Level 3	Total	Total Face Value
First Lien Term Loans	\$-	\$444,258	\$	\$444,258	\$451,023
Second Lien Term Loans	-	173,700	-	173,700	180,000

The carrying value of our revolving credit facility at March 31, 2016 was \$16.3 million, which approximated its fair value. There was no balance outstanding under the revolving credit facility at December 31, 2015.

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 10 – SUBSEQUENT EVENTS**

On April 18, 2016, RadNet formed Glendale Advanced Imaging LLC, and on May 9, 2016, utilized the LLC to enter into a joint venture with Dignity Health, a California nonprofit public benefit corporation. Total agreed combined contribution to the venture is expected to be \$3.9 million of cash and assets, with RadNet contributing \$2.2 million (a 55% stake) and Dignity Health contributing \$1.7 million (a 45% stake). The transaction is scheduled to close June 1, 2016. Initial operations at two imaging centers in Glendale, CA are expected to begin by the end of the second quarter of 2016. The venture will explore opportunities to expand both geographically and in its medical service offerings.

## **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, 2015, 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 a national provider of freestanding, fixed-site outpatient diagnostic imaging services. At March 31, 2016, we operated directly or indirectly through joint ventures with hospitals, 309 centers located in California, Delaware, Florida, Maryland, New Jersey, New York and Rhode Island. Our centers provide physicians with imaging capabilities to facilitate the diagnosis and treatment of diseases and disorders. Our services include magnetic resonance imaging (MRI), computed tomography (CT), positron emission tomography (PET), nuclear medicine, mammography, ultrasound, diagnostic radiology (X-ray), fluoroscopy and other related procedures. The vast majority of our centers offer multi-modality imaging services. Our multi-modality strategy diversifies revenue streams, reduces exposure to reimbursement changes and provides patients and referring physicians one location for multiple procedures. Our operations comprise a single segment for financial reporting purposes.

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, 2016 and 2015, we performed 1,496,909 and 1,211,797 diagnostic imaging procedures, respectively, and generated total net revenue of \$216.4 million and \$181.3 million, respectively.

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

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

Howard G. Berger, M.D., is our President and Chief Executive Officer, a member of our Board of Directors, and also owns, indirectly, 99% of the equity interests in BRMG. BRMG provides all of the professional medical services at nearly all of our facilities located in California under a management agreement with us, and employs physicians or contracts with various other independent physicians and physician groups to provide the professional medical services at most of our 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.

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

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

We have determined that BRMG and the NY Groups are variable interest entities, and that we are the primary beneficiary, and consequently, we consolidate the revenue and expenses, assets and liabilities of each. BRMG and the NY Groups on a combined basis recognized \$34.0 million and \$25.5 million of revenue, net of management service fees to RadNet, for the three months ended March 31, 2016 and 2015, respectively, and \$34.0 million and \$25.5 million of operating expenses for the three months ended March 31, 2016 and 2015, respectively. RadNet recognized in its condensed consolidated statement of operations \$104.0 million and \$99.0 million of net revenues for the three months ended March 31, 2016, and 2015 respectively, for management services provided to BRMG and the NY Groups relating primarily to the technical portion of total billed revenue.

The cash flows of BRMG and the NY Groups are included in the accompanying consolidated statements of cash flows. All intercompany balances and transactions have been eliminated in consolidation. In our consolidated balance sheets at March 31, 2016 and December 31, 2015, we have included approximately \$110.5 million and \$89.8 million, respectively, of accounts receivable and approximately \$9.1 million and \$8.5 million of accounts payable and accrued liabilities related to BRMG and the NY Groups.

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

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



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, 2015, 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, 2015, as amended.

### ***Revenues***

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

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

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

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

	Three Months Ended	
	March 31, 2016	2015
Commercial insurance	\$126,397	\$99,885
Medicare	45,820	37,036
Medicaid	7,023	5,470
Workers' compensation/personal injury	9,514	7,400
Other	12,088	15,239
Service fee revenue, net of contractual allowances and discounts	200,842	165,030
Provision for bad debts	(10,304 )	(7,475 )
Net service fee revenue	190,538	157,555
Revenue under capitation arrangements	25,850	23,712
Total net revenue	\$216,388	\$181,267

### ***Provision for Bad Debts***

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

### ***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.

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

Goodwill at March 31, 2016 totaled \$240.7 million. Indefinite Lived Intangible Assets at March 31, 2016 totaled \$8.7 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, 2015, noting no impairment, and have not identified any indicators of impairment through March 31, 2016.

### ***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, 2016.

### **Recent Accounting Standards**

In March 2016, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2016-09 ("ASU 2016-09"), *Compensation—Stock Compensation*, (Topic 718): Improvements to Employee Share-Based Payment Accounting. ASU 2016-09 requires excess tax benefits and tax deficiencies, which arise due to differences between the measure of compensation expense and the amount deductible for tax purposes, to be recorded directly through the statement of operations as a component of income tax expense. Under current GAAP, these differences are generally recorded in additional paid-in capital and thus have no impact on income. The change in treatment of excess tax benefits and tax deficiencies will also impact the computation of diluted earnings per share, and the cash flows associated with those items will be classified as operating activities on the statement of cash flows. The ASU will permit certain elective changes associated with stock compensation accounting. For example, companies can elect to account for forfeitures of awards as they occur rather than projecting forfeitures in the accrual of compensation

expense. In addition, the ASU increases the proportion of shares an employer is permitted (though not required) to withhold on behalf of an employee to satisfy the employee's income tax burden on a share-based award without causing the award to become subject to liability accounting. The amendments in this update are effective for fiscal years (and interim reporting periods within fiscal years) beginning after December 15, 2016, with early adoption permitted. We are currently evaluating the impact of the GAAP update on our results of operations and cash flows.

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

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

In February 2015, the 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 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 was effective for fiscal years (and interim reporting periods within fiscal years) beginning after December 15, 2016, which has recently been extended to December 31, 2017. We are currently evaluating the impact of the GAAP update on our 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

#### CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(IN THOUSANDS EXCEPT SHARE DATA)

(unaudited)

	Three Months Ended March 31,	
	2016	2015
NET REVENUE		
Service fee revenue, net of contractual allowances and discounts	88.6%	87.4%
Provision for bad debts	-4.5%	-4.0%
Net service fee revenue	84.1%	83.5%
Revenue under capitation arrangements	11.4%	12.6%

Edgar Filing: RadNet, Inc. - Form 10-Q

Total net revenue	95.5%	96.0%
<b>OPERATING EXPENSES</b>		
Cost of operations, excluding depreciation and amortization	86.8%	89.5%
Depreciation and amortization	7.2%	7.6%
Gain on sale and disposal of equipment	0.0%	0.0%
Severance costs	0.1%	0.0%
Total operating expenses	94.1%	97.1%
<b>INCOME (LOSS) FROM OPERATIONS</b>	1.3%	-1.0%
<b>OTHER INCOME AND EXPENSES</b>		
Interest expense	4.7%	5.3%
Meaningful use incentive	-1.2%	-1.7%
Equity in earnings of joint ventures	-1.0%	-0.6%
Other expenses (income)	0.0%	0.0%
Total other expenses	2.5%	3.0%
<b>LOSS BEFORE INCOME TAXES</b>	-1.2%	-4.0%
Benefit from income taxes	0.5%	1.6%
<b>NET LOSS</b>	-0.6%	-2.4%
Net income attributable to noncontrolling interests	0.1%	0.0%
<b>NET LOSS ATTRIBUTABLE TO RADNET, INC. COMMON STOCKHOLDERS</b>	-0.8%	-2.4%



***Three Months Ended March 31, 2016 Compared to the Three Months Ended March 31, 2015***

***Service Fee Revenue***

Service fee revenue for the three months ended March 31, 2016 was \$200.8 million compared to \$165.0 million for the three months ended March 31, 2015, an increase of \$35.8 million, or 21.7%.

Inclusive of only centers in operation over the first quarters of 2016 and 2015, service fee revenue increased \$5.2 million or 3.3%. This 3.3% increase primarily resulted from milder weather on the eastern seaboard that did not affect our operations as had in the first quarter of 2015 in addition to increased market awareness that supported additional volumes. This comparison excludes revenue contributions from centers that were acquired or divested subsequent to January 1, 2015. For the three months ended March 31, 2016, service fee revenue from centers that were acquired or divested subsequent to January 1, 2015 and excluded from the above comparison was \$37.5 million. For the three months ended March 31, 2015, service fee revenue from centers that were acquired or divested subsequent to January 1, 2015 and excluded from the above comparison was \$6.9 million.

***Provision for Bad Debts***

Provision for bad debts increased \$2.8 million, or 37.9%, to approximately \$10.3 million, or 4.5% of revenue, for the three months ended March 31, 2016 compared to \$7.5 million, or 4.0% of service fee revenue, for the three months ended March 31, 2015. The increase in the provision from 4% of revenue for the first three months of 2015 to 4.5% of revenue for the first three months of 2016 was due to the growing popularity of high-deductible insurance plans as of result of the Affordable Care Act

***Revenue Under Capitation Arrangements***

Revenue under capitation arrangements for the three months ended March 31, 2016 was \$25.9 million compared to \$23.7 million for the three months ended March 31, 2015, an increase of \$2.1 million or 9.0%. Overall increase was mainly related to new and acquired capitation contracts and amounted to \$1.9 million of the total year over year gain, while \$181,00 was related to same store growth.

Revenue under capitation arrangements, limited to centers which were in operation throughout the first quarters of 2016 and 2015 increased \$181,000, or 0.8%. This comparison excludes revenue contributions from centers that were acquired or divested subsequent to January 1, 2015. For the three months ended March 31, 2016, revenue under capitation arrangements from centers that were acquired or divested subsequent to January 1, 2015 and excluded from the above comparison was \$1.9 million. For the three months ended March 31, 2015, capitation revenue from centers that were acquired or divested subsequent to January 1, 2015 and excluded from the above comparison was inconsequential.

### *Operating Expenses*

Cost of operations for the three months ended March 31, 2016 increased approximately \$30.2 million, or 16.5%, from \$183.2 million for the three months ended March 31, 2015 to \$213.4 million for the three months ended March 31, 2016. The following table sets forth our cost of operations and total operating expenses for the three months ended March 31, 2016 and 2015 (in thousands):

	2016	2015
Salaries and professional reading fees, excluding stock-based compensation	\$104,946	\$90,200
Stock-based compensation	2,733	3,554
Building and equipment rental	19,179	17,117
Medical supplies	13,417	11,503
Other operating expenses *	56,551	46,547
Cost of operations	196,826	168,921
Depreciation and amortization	16,412	14,294
(Gain) loss on sale and disposal of equipment	–	(38 )
Severance costs	167	36
Total operating expenses	\$213,405	\$183,213

\* 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 \$14.7 million, or 16.4%, to \$104.9 million for the three months ended March 31, 2016 compared to \$90.2 million for the three months ended March 31, 2015.

Salaries and professional reading fees, limited to centers which were in operation throughout the first quarters of both 2016 and 2015, decreased \$3.0 million, or 3.3%. The 3.3% decrease is a result of improved operational efficiencies that included head count reduction. This comparison excludes expenses from centers that were acquired or divested subsequent to January 1, 2015. For the three months ended March 31, 2016, salaries and professional reading fees from centers that were acquired or divested subsequent to January 1, 2015 and excluded from the above comparison was \$19.5 million. For the three months ended March 31, 2015, salaries and professional reading fees from centers that were acquired or divested subsequent to January 1, 2015 and excluded from the above comparison was approximately \$1.8 million.

### **Stock-based compensation**

Stock-based compensation decreased \$821,000, or 23.1%, to approximately \$2.7 million for the three months ended March 31, 2016 compared to \$3.5 million for the three months ended March 31, 2015. This decrease was driven by the lower fair value of RSA's awarded and vested in the first quarter of 2016 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 \$2.1 million or 12.1%, to \$19.2 million for the three months ended March 31, 2016 compared to \$17.1 million for the three months ended March 31, 2015.

Building and equipment rental expenses, including only those centers which were in operation throughout the first quarters of both 2016 and 2015, decreased \$907,000, or 5.5%. This 5.5% decrease is mainly related to radiology equipment operating leases completing their contractual terms. This comparison excludes expenses from centers that were acquired or divested subsequent to January 1, 2015. For the three months ended March 31, 2016, building and equipment rental expenses from centers that were acquired or divested subsequent to January 1, 2015 and excluded from the above comparison was \$3.7 million. For the three months ended March 31, 2015, building and equipment rental expenses from centers that were acquired or divested subsequent to January 1, 2015 and excluded from the

above comparison was approximately \$739,000.

### **Medical supplies**

Medical supplies expense increased \$1.9 million, or 16.6%, to \$13.4 million for the three months ended March 31, 2016 compared to \$11.5 million for the three months ended March 31, 2015.

Medical supplies expenses, including only those centers which were in operation throughout the first quarters of both 2016 and 2015, increased \$118,000, or 1.1%. This comparison excludes expenses from centers that were acquired or divested subsequent to January 1, 2015. For the three months ended March 31, 2016, medical supplies expenses from centers that were acquired or divested subsequent to January 1, 2015 and excluded from the above comparison was \$2.1 million. For the three months ended March 31, 2015, medical supplies expense from centers that were acquired or divested subsequent to January 1, 2015 and excluded from the above comparison was \$302,000.

### **Other operating expenses**

Other operating expenses increased \$10.0 million, or 21.5%, to \$56.6 million for the three months ended March 31, 2016 compared to \$46.5 million for the three months ended March 31, 2015.

Other operating expenses, including only those centers which were in operation throughout the first quarters of both 2016 and 2015, increased \$3.1 million, or 6.9%. This 6.9% increase is due in part to higher insurance and technology licensing costs. This comparison excludes expenses from centers that were acquired or divested subsequent to January 1, 2015. For the three months ended March 31, 2016, other operating expense from centers that were acquired or divested subsequent January 1, 2015 and excluded from the above comparison was \$8.7 million. For the three months ended March 31, 2015, other operating expense from centers that were acquired or divested subsequent to January 1, 2015 was \$1.8 million.

### **Depreciation and amortization**

Depreciation and amortization increased \$2.1 million, or 14.8%, to \$16.4 million for the three months ended March 31, 2016 compared to \$14.3 million for the three months ended March 31, 2015.

Depreciation and amortization, including only those centers which were in operation throughout the first quarters of both 2016 and 2015, increased \$219,000, or 1.6%. This comparison excludes expenses from centers that were acquired or divested subsequent to January 1, 2015. For the three months ended March 31, 2016, depreciation expense from centers that were acquired or divested subsequent to January 1, 2015 and excluded from the above comparison was \$2.6 million. For the three months ended March 31, 2015, depreciation and amortization from centers that were acquired or divested subsequent to January 1, 2015 and excluded from the above comparison was \$741,000.

### **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, 2016 increased approximately \$685,000, or 6.9%, to \$10.7 million for the three months ended March 31, 2016 compared to \$10.0 million for the three months ended March 31, 2015. Interest expense for the three months ended March 31, 2016 included \$1.4 million of combined non-cash amortization of deferred loan costs, discount on issuance of debt, and incidental financing charges. Interest expense for the three months ended March 31, 2015 included \$1.3 million of non-cash amortization of deferred loan costs, discount on issuance of debt and incidental financing charges. Excluding these non-cash amounts for each period, interest expense increased approximately \$627,000 for the three months ended March 31, 2016 compared to the three months ended March 31, 2015. This increase was primarily due to interest paid on the 2015 incremental first lien loan taken out in April 2015. See “Liquidity and Capital Resources” below for more details on our debt refinancing.

### ***Meaningful use incentive***

For the three months ended March 31, 2016 and March 31, 2015, we recognized other income from meaningful use incentive in the amount of \$2.8 million and \$3.3 million, respectively. These amounts were earned under a Medicare program to promote the use of electronic health record technology. See Note 3 to the condensed consolidated financial statements contained herein for more detail regarding this meaningful use incentive.

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

For the period ending March 31, 2016 we recognized equity in earnings from unconsolidated joint ventures in the amount of \$2.3 million. For the period ending March 31, 2015 we recognized equity in earnings from unconsolidated joint ventures of \$1.1 million.

***Benefit from income taxes***

We had an income tax benefit for the three months ended March 31, 2016 of \$1.2 million or 45.2% of loss before income taxes, compared to the three months ended March 31, 2015 with income tax benefit of \$3.1 million or 40.1% of loss before income taxes. The effective tax rate changed due the period net loss position, permanent differences, and ISO disqualifying dispositions.

***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, 2016 and 2015, respectively:

	Three Months Ended March 31,	
	2016	2015
Net income attributable to RadNet, Inc. common stockholders	\$(1,723 )	\$(4,554 )
Less benefit from income taxes	(1,180 )	(3,091 )
Plus (less) other expenses (income)	2	(3 )
Plus interest expense	10,681	9,996
Plus severance costs	167	36
Less gain on sale and disposal of equipment	–	(38 )
Plus depreciation and amortization	16,412	14,294
Plus non-cash employee stock-based compensation	2,733	3,554
<b>Adjusted EBITDA</b>	<b>\$27,092</b>	<b>\$20,194</b>

### Liquidity and Capital Resources

We had cash and cash equivalents of \$410,000 and accounts receivable of \$177.8 million at March 31, 2016, compared to cash and cash equivalents of \$446,000 and accounts receivable of \$162.8 million at December 31, 2015. We had a working capital balance of \$83.4 million and \$72.9 million at March 31, 2016 and December 31, 2015, respectively. We had net loss attributable to RadNet, Inc. common stockholders for the three months ended March 31, 2016 and 2015 of \$1.7 million and \$4.6 million respectively. We also had stockholders' equity of \$33.5 million and \$32.6 million at March 31, 2016 and December 31, 2015, respectively.

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

Our \$101.25 million revolving credit facility had a \$16.3 million aggregate principal amount outstanding as of March 31, 2016. 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, 2016 is \$614.2 million of senior secured term loan debt (net of unamortized discounts of \$10.6 million), broken down by loan agreement as follows (in thousands):

	Face Value	Discount	Total Carrying Value
First Lien Term Loans	\$373,792	\$(7,461 )	\$366,331
2015 Incremental First	\$71,053	\$(834 )	\$70,219
Second Lien Term Loans	\$180,000	\$(2,311 )	\$177,689
Total	\$624,845	\$(10,606)	\$614,239

### Sources and Uses of Cash

Cash provided by operating activities was \$21.0 million and \$17.5 million for the three months ended March 31, 2016 and March 31, 2015, respectively.

Cash used in investing activities was \$27.8 million and \$19.6 million for the three months ended March 31, 2016 and 2015, respectively. For the three months ended March 31, 2016, we purchased property and equipment for approximately \$22.5 million and acquired imaging facilities for \$5.0 million.

Cash provided by financing activities was \$6.8 million and \$2.0 million for the three months ended March 31, 2016 and 2015, respectively. The cash provided by financing activities for the three months ended March 31, 2016, was primarily due to amounts received from borrowings under our revolving line of credit, offset by principal payments on our \$444.8 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, 2016, we were in compliance with all covenants under the Original Credit Agreement (as amended by the 2013 Amendment, the 2014 Amendment, and the 2015 Joinder) and the Second Lien Credit Agreement.

The following describes our 2015 financing activities:

#### 2015 Incremental First Lien Term Loans:

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

*Interest.* The interest rates payable on the 2015 Incremental First Lien Term Loans are the same rates currently payable on the existing tranche B term loans under the Credit Agreement, which are (a) the Adjusted Eurodollar Rate (as defined in the Credit Agreement) plus 3.25% per annum or (b) the Base Rate (as defined in the Credit Agreement) plus 2.25% per annum. As applied to the first lien tranche B term loans, the Adjusted Eurodollar Rate has a minimum floor of 1.0%. The Adjusted Eurodollar Rate at March 31, 2016 was 0.90%.

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

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

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

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

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

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

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

The following describes our 2014 financing activities:

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

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

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

*Second Lien Credit and Guaranty Agreement.* We entered into the Second Lien Credit Agreement to provide for, among other things, the borrowing of \$180.0 million of second lien term loans (the “Second Lien Term Loans”). The proceeds from the Second Lien Term Loans and the 2014 First Lien Term Loans were used to redeem the 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 Agreement was unaltered by the agreements above and remains in place. The termination date for the \$101.25 million revolving credit facility is the earliest to occur of (i) October 10, 2017, (ii) the date the revolving credit facility is permanently reduced to zero pursuant to section 2.13(b) of the Credit Agreement, which addresses voluntary commitment reductions and (iii) the date of the termination of the revolving credit facility due to specific events of default pursuant to section 8.01 of the Credit Agreement. The revolving credit facility bears interest based on types of borrowings as follows: (i) unpaid principal at the Adjusted Eurodollar Rate (as defined in the Credit Agreement) plus 4.25% per annum or the Base Rate (as defined in the Credit Agreement) plus 3.25% per annum, (ii) letter of credit and fronting fees at 4.5% per annum, and (iii) commitment fee of 0.5% per annum on the unused revolver balance. The Adjusted Eurodollar Rate at March 31, 2016 was 0.90%.

The 2014 Amendment provided for the following:

*Interest.* The interest rates payable on the 2014 First Lien Term Loans are the same as the rates currently payable under the Original Credit Agreement, as amended by the 2013 Amendment, which are (a) the Adjusted Eurodollar Rate (as defined in the Credit Agreement) plus 3.25% or (b) the Base Rate (as defined in the Credit Agreement) plus 2.25%. With respect to all of the term loans under the Credit Agreement, the Adjusted Eurodollar Rate has a minimum floor of 1.0%. The Adjusted Eurodollar Rate at March 31, 2016 was 0.90%.

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

The Second Lien Credit Agreement provides for the following:

*Interest.* The interest rates payable on the Second Lien Term Loans are (a) the Adjusted Eurodollar Rate (as defined in the Second Lien Credit Agreement) plus 7.0% or (b) the Base Rate (as defined in the Second Lien Credit Agreement) plus 6.0%. The Adjusted Eurodollar Rate has a minimum floor of 1.0% on the Second Lien Term Loans. The

Adjusted Eurodollar Rate at March 31, 2016 was 0.90%. The rate paid on the Second Lien Credit Agreement at March 31, 2016 was 8%.

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

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

*Restrictive Covenants.* In addition to certain customary covenants, the Second Lien Credit Agreement places limits on our ability 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.

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

The following describes our key financing activities prior to 2014:

#### 2013 Amendment to the Credit Agreement

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

#### 2012 Refinancing and Original Credit Agreement

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

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

#### **Subsequent Events**

On April 18, 2016, RadNet formed Glendale Advanced Imaging LLC, and on May 9, 2016, utilized the LLC to enter into a joint venture with Dignity Health, a California nonprofit public benefit corporation. Total agreed combined contribution to the venture is expected to be \$3.9 million of cash and assets, with RadNet contributing \$2.2 million (a 55% stake) and Dignity Health contributing \$1.7 million (a 45% stake). The transaction is scheduled to close June 1, 2016. Initial operations at two imaging centers in Glendale, CA are expected to begin by the end of the second quarter of 2016. The venture will explore opportunities to expand both geographically and in its medical service offerings.

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

**Foreign Currency Exchange Risk.** We 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. At March 31, 2016, 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 \$32,000 in operating expenses.

**Interest Rate Sensitivity** We pay interest on various types of debt instruments to our suppliers 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. As described in the Liquidity and Capital Resources section above, we can elect Eurodollar or Base Rate interest rate options on the 2014 First Lien Term Loans, 2015 Incremental First Lien Term Loans and the Second Lien Credit Agreement.

At March 31, 2016, we had \$444.8 million outstanding subject to an Adjusted Eurodollar election on all first lien tranche B term loans under the Credit Agreement and \$180.0 million on the Second Lien Term Loans. As the Adjusted Eurodollar Rate floor exceeds the current spot rate of the 6 month Adjusted Eurodollar, the spot rate would have to increase more than 10 basis points before an additional interest expense would be accrued. An increase of 110 basis points would be necessary to realize a hypothetical 1% increase in the borrowing rate and an annual increase of \$6.2 million of interest expense under our first and second lien term loans. At March 31, 2016, an additional \$22.5 million in debt instruments is tied to the prime rate. A hypothetical 1% increase in the prime rate for 2015-2016 would have resulted in an annual increase in interest expense of approximately \$225,000.

## ITEM 4. CONTROLS AND PROCEDURES

### *Evaluation of Disclosure Controls and Procedures*

We maintain disclosure controls and procedures that are designed to provide reasonable assurance that material information is (1) gathered and communicated to our management, including our principal executive and financial officers, on a timely basis; and (2) recorded, processed, summarized, reported and filed with the SEC as required under the Securities Exchange Act of 1934, as amended. Under the supervision of our management, including our Chief Executive Officer and Chief Financial Officer, we conducted an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures under Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934, as amended, as of March 31, 2016. Based on this evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were not effective for their intended purpose as of March 31, 2016 because of deficiencies in the design and operating effectiveness of certain information technology general controls (“ITGC’s”) and information technology dependent manual controls related to the revenue and accounts receivable process caused a material weakness in our internal control over financial reporting as described in more detail below.

### *Management's Report on Internal Control over Financial Reporting*

Our management is responsible for establishing and maintaining adequate internal control over financial reporting. Internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with GAAP. Internal control over financial reporting includes policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the Company, (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the Company are transacted in accordance with authorizations of management and directors of the Company, and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the Company’s assets that could have a material effect on the financial statements.

Our management, under the supervision of our Chief Executive Officer and Chief Financial Officer, conducted an assessment of the effectiveness of its internal control over financial reporting as of March 31, 2016 based on the criteria established in Internal Control - Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Based on this assessment, management concluded that our internal control over financial reporting was not effective at that reasonable assurance level as of March 31, 2016 because of the material weakness described below.

A material weakness is defined as “a deficiency, or a combination of deficiencies in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the Company’s annual or interim financial statements will not be prevented or detected on a timely basis.”

Our management initially identified certain control deficiencies in connection with the review of our controls at December 31, 2015 and concluded that, as of March 31, 2016, the following control deficiencies related to the Company’s revenue and accounts receivable process continue to aggregate to a material weakness in the Company’s internal control over financial reporting:



ITGCs were ineffective for multiple systems which capture and bill revenue transactions as a result of deficiencies pertaining to user access and program change controls and

Certain information technology dependent manual controls which are designed to ensure the completeness of revenue transaction processing and appropriate valuation of the account receivable were not performed timely or reviewed with sufficient precision.

The ineffective design and operation of these ITGCs and the related information technology dependent manual controls impacts a material portion of our revenue transactions and consequently created a reasonable possibility that a material misstatement could occur. Our management is not aware of any material misstatement or inaccuracy in the financial statements included in this report.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with existing policies or procedures may deteriorate.

#### ***Remediation Plan for Material Weakness***

Our management, with oversight of our Audit Committee, has been actively engaged in developing a remediation plan to address the material weakness reported. During the quarter ended March 31, 2016, the Company began to implement remediation efforts as follows:

- Streamline the number and improve the quality of systems utilized by the Company for the capture and billing of revenue transactions.

- Implement effective user access controls across all revenue related systems to ensure proper authentication for established users and timely removal of terminated users, and improve documentation surrounding program change controls.

- Ensure that all revenue-related IT dependent manual controls are performed on a timely basis with a sufficient level of precision.

If the remedial measures described above are insufficient to address the material weakness described above, or are not implemented timely, or additional deficiencies arise in the future, material misstatements in our interim or annual financial statements may occur in the future and could have the effects described in “Item 1A. Risk Factors” in Part II of this Form 10-Q.

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

Except for the remediation efforts described above, management did not identify any change in internal control over financial reporting occurring during the quarter ended March 31, 2016 that materially affected, or was reasonably likely to materially affect, the Company’s internal control 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**

For information about the risks and uncertainties related to our business, please see the risk factors described in our annual report on Form 10-K for the year ended December 31, 2015, as amended. The risks described 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.

### **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.

**SIGNATURES**

Pursuant to the requirements of Section 13 or 15(d) 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.

RADNET, INC.  
(Registrant)

Date: May 10, 2016      By:    /s/ Howard G. Berger, M.D.  
Howard G. Berger, M.D., President and Chief Executive  
Officer  
(Principal Executive Officer)

Date: May 10, 2016      By:    /s/ Mark D. Stolper  
Mark D. Stolper, Chief Financial Officer  
(Principal Financial and Accounting Officer)

**INDEX TO EXHIBITS**

<b>Exhibit Number</b>	Description
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.

