

RadNet, Inc.  
Form 10-Q  
May 12, 2014

**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, 2014

OR

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

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

**Commission File Number 001-33307**

**RadNet, Inc.**

**(Exact name of registrant as specified in charter)**

**Delaware  
(State or other jurisdiction of**

**13-3326724  
(I.R.S. Employer**

**Incorporation or organization)                      Identification No.)**

**1510 Cotner Avenue  
Los Angeles, California                      90025  
(Address of principal executive offices) (Zip Code)**

**(310) 478-7808  
  
(Registrant's telephone number, including area code)**

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

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

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

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

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

The number of shares of the registrant's common stock outstanding on May 7, 2014, was 41,749,215 shares.

**RADNET, INC.**

**TABLE OF CONTENTS**

|  | <u>Page</u> |
|--|-------------|
| <b>PART I – FINANCIAL INFORMATION</b>  |             |
| ITEM 1. Condensed Consolidated Financial Statements (unaudited)  |             |
| Condensed Consolidated Balance Sheets at March 31, 2014 and December 31, 2013                                | 3           |
| Condensed Consolidated Statements of Operations for the Three Months Ended March 31, 2014 and 2013           | 4           |
| Condensed Consolidated Statements of Comprehensive Loss for the Three Months Ended March 31, 2014 and 2013   | 5           |
| Condensed Consolidated Statement of Stockholders' Equity (Deficit) for the Three Months Ended March 31, 2014 | 6           |
| Condensed Consolidated Statements of Cash Flows for the Three Months Ended March 31, 2014 and 2013           | 7           |
| Notes to Condensed Consolidated Financial Statements   | 9           |
| ITEM 2. Management's Discussion and Analysis of Financial Condition and Results of Operations                | 26          |
| ITEM 3. Quantitative and Qualitative Disclosures About Market Risk   | 38          |
| ITEM 4. Controls and Procedures  | 38          |
| <b>PART II – OTHER INFORMATION</b>   |             |
| ITEM 1. Legal Proceedings  | 40          |
| ITEM 1A. Risk Factors  | 40          |
| ITEM 2. Unregistered Sales of Equity Securities and Use of Proceeds  | 41          |
| ITEM 3. Defaults Upon Senior Securities  | 41          |
| ITEM 4. Mine Safety Disclosures  | 41          |
| ITEM 5. Other Information  | 41          |
| ITEM 6. Exhibits   | 41          |

|                   |    |
|-------------------|----|
| SIGNATURES        | 42 |
| INDEX TO EXHIBITS | 43 |

**PART I – FINANCIAL INFORMATION****ITEM 1. Condensed Consolidated Financial Statements (unaudited)****RADNET, INC. AND SUBSIDIARIES****CONDENSED CONSOLIDATED BALANCE SHEETS****(IN THOUSANDS EXCEPT SHARE DATA)**

|   | March 31,<br>2014<br>(unaudited) | December<br>31,<br>2013 |
|---|----------------------------------|-------------------------|
| <b>ASSETS</b>   |                                  |                         |
| <b>CURRENT ASSETS</b>                                 |                                  |                         |
| Cash and cash equivalents                             | \$ 291                           | \$8,412                 |
| Accounts receivable, net                              | 140,629                          | 133,599                 |
| Current portion of deferred tax assets                | 16,691                           | 13,321                  |
| Prepaid expenses and other current assets             | 25,255                           | 21,012                  |
| Total current assets                                  | 182,866                          | 176,344                 |
| <b>PROPERTY AND EQUIPMENT, NET</b>                    | <b>226,209</b>                   | <b>218,547</b>          |
| <b>OTHER ASSETS</b>                                   |                                  |                         |
| Goodwill  | 196,705                          | 196,395                 |
| Other intangible assets                               | 49,334                           | 50,042                  |
| Deferred financing costs, net of current portion      | 7,886                            | 8,735                   |
| Investment in joint ventures                          | 28,939                           | 28,949                  |
| Deferred tax assets, net of current portion           | 41,080                           | 39,914                  |
| Deposits and other                                    | 4,225                            | 3,650                   |
| Total assets  | <b>\$ 737,244</b>                | <b>\$ 722,576</b>       |
| <b>LIABILITIES AND STOCKHOLDERS' (DEFICIT) EQUITY</b> |                                  |                         |
| <b>CURRENT LIABILITIES</b>                            |                                  |                         |
| Accounts payable, accrued expenses and other          | \$ 90,459                        | \$ 106,316              |
| Due to affiliates                                     | 1,548                            | 2,655                   |
| Deferred revenue                                      | 1,305                            | 1,344                   |
| Current portion of notes payable                      | 19,617                           | 3,103                   |
| Current portion of deferred rent                      | 1,963                            | 1,896                   |
| Current portion of obligations under capital leases   | 6,586                            | 3,075                   |
| Total current liabilities                             | 121,478                          | 118,389                 |

## LONG-TERM LIABILITIES

|   |         |         |
|---|---------|---------|
| Deferred rent, net of current portion                   | 19,265  | 18,989  |
| Line of credit  | 18,100  | —       |
| Notes payable, net of current portion                   | 570,207 | 572,669 |
| Obligations under capital lease, net of current portion | 10,329  | 2,779   |
| Other non-current liabilities                           | 7,183   | 7,540   |
| Total liabilities                                       | 746,562 | 720,366 |

## STOCKHOLDERS' (DEFICIT) EQUITY

|   |            |            |
|---|------------|------------|
| Common stock - \$.0001 par value, 200,000,000 shares authorized; 41,117,823, and 40,089,196 shares issued and outstanding at March 31, 2014 and December 31, 2013, respectively | 4          | 4          |
| Paid-in-capital   | 174,620    | 173,622    |
| Accumulated other comprehensive loss  | (68 )      | (50 )      |
| Accumulated deficit   | (186,080 ) | (173,656)  |
| Total RadNet, Inc.'s stockholders' deficit  | (11,524 )  | (80 )      |
| Noncontrolling interests  | 2,206      | 2,290      |
| Total stockholders' (deficit) equity  | (9,318 )   | 2,210      |
| Total liabilities and stockholders' (deficit) equity  | \$ 737,244 | \$ 722,576 |

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<br>March 31, |                   |
|--|---------------------------------|-------------------|
|  | 2014                            | 2013              |
| <b>NET REVENUE</b>   |                                 |                   |
| Service fee revenue, net of contractual allowances and discounts     | \$ 158,763                      | \$ 163,741        |
| Provision for bad debts  | (6,893 )                        | (6,822 )          |
| Net service fee revenue  | 151,870                         | 156,919           |
| Revenue under capitation arrangements                                | 17,006                          | 16,021            |
| Total net revenue  | 168,876                         | 172,940           |
| <b>OPERATING EXPENSES</b>  |                                 |                   |
| Cost of operations, excluding depreciation and amortization          | 145,030                         | 149,562           |
| Depreciation and amortization  | 15,571                          | 14,760            |
| Loss on sale and disposal of equipment                               | 246                             | 170               |
| Severance costs  | 481                             | 123               |
| Total operating expenses   | 161,328                         | 164,615           |
| <b>INCOME FROM OPERATIONS</b>  | <b>7,548</b>                    | <b>8,325</b>      |
| <b>OTHER INCOME AND EXPENSES</b>                                     |                                 |                   |
| Interest expense   | 11,772                          | 12,147            |
| Meaningful use incentive   | (1,762 )                        | -                 |
| Equity in earnings of joint ventures                                 | (1,067 )                        | (1,206 )          |
| Loss on early extinguishment of Senior Notes                         | 15,456                          | -                 |
| Other expenses (income)  | 2                               | (2 )              |
| Total other income and expenses                                      | 24,401                          | 10,939            |
| <b>LOSS BEFORE INCOME TAXES</b>                                      | <b>(16,853 )</b>                | <b>(2,614 )</b>   |
| Benefit from income taxes  | 4,478                           | 1,248             |
| <b>NET LOSS</b>  | <b>(12,375 )</b>                | <b>(1,366 )</b>   |
| Net income (loss) attributable to noncontrolling interests           | 49                              | (24 )             |
| <b>NET LOSS ATTRIBUTABLE TO RADNET, INC.<br/>COMMON STOCKHOLDERS</b> | <b>\$(12,424 )</b>              | <b>\$(1,342 )</b> |

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|  |          |   |          |   |
|--|----------|---|----------|---|
| BASIC AND DILUTED NET LOSS PER SHARE<br>ATTRIBUTABLE TO RADNET, INC. COMMON STOCKHOLDERS | \$ (0.31 | ) | \$ (0.03 | ) |
|--|----------|---|----------|---|

|                                     |            |  |            |  |
|-------------------------------------|------------|--|------------|--|
| WEIGHTED AVERAGE SHARES OUTSTANDING |            |  |            |  |
| Basic and Diluted                   | 40,010,080 |  | 39,314,447 |  |

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



**RADNET, INC. AND SUBSIDIARIES**

**CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS**

**(IN THOUSANDS)**

**(unaudited)**

|  | <b>Three Months<br/>Ended<br/>March 31,</b> |           |
|--|---|-----------|
|  | 2014  | 2013      |
| NET LOSS   | \$(12,375)                                  | \$(1,366) |
| Foreign currency translation adjustments                                   | (18 )                                       | (59 )     |
| COMPREHENSIVE LOSS   | (12,393)                                    | (1,425)   |
| Less comprehensive income (loss) attributable to non-controlling interests | 49  | (24 )     |
| COMPREHENSIVE LOSS ATTRIBUTABLE TO RADNET, INC. COMMON STOCKHOLDERS        | \$(12,442)                                  | \$(1,401) |

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

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

|  | Common Stock<br>Shares | Common Stock<br>Amount | Paid-in<br>Capital | Accumulated<br>Deficit | Accumulated<br>Other<br>Comprehensive<br>Loss | Total<br>Radnet,<br>Inc.'s<br>Equity<br>Deficit | Noncontrolling<br>Interests | Total<br>Equity<br>(Deficit) |
|--|------------------------|------------------------|--------------------|------------------------|---|---|-----------------------------|------------------------------|
| BALANCE -<br>JANUARY 1,<br>2014  | 40,089,196             | \$4                    | \$173,622          | \$(173,656)            | \$(50)  | \$(80)  | \$2,290                     | \$2,290                      |
| Issuance of<br>common stock<br>upon exercise of<br>options/warrants      | 16,842                 | —                      | 29                 | —                      | —   | 29  | —                           | 29                           |
| Stock-based<br>compensation  | —                      | —                      | 969                | —                      | —   | 969   | —                           | 969                          |
| Issuance of<br>restricted stock  | 1,011,785              | —                      | —                  | —                      | —   | —   | —                           | —                            |
| Distributions<br>paid to<br>noncontrolling<br>interests                  | —                      | —                      | —                  | —                      | —   | —   | (133)                       | (133)                        |
| Change in<br>cumulative<br>foreign currency<br>translation<br>adjustment | —                      | —                      | —                  | —                      | (18)  | (18)  | —                           | (18)                         |
| Net (loss)<br>income   | —                      | —                      | —                  | (12,424)               | —   | (12,424)  | 49                          | (12,375)                     |
| BALANCE -<br>MARCH 31,<br>2014   | 41,117,823             | \$4                    | \$174,620          | \$(186,080)            | \$(68)  | \$(11,524)                                      | \$2,206                     | \$(9,932)                    |

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<br>March 31, |            |
|---|---------------------------------|------------|
|   | 2014                            | 2013       |
| <b>CASH FLOWS FROM OPERATING ACTIVITIES</b>   |                                 |            |
| Net loss  | \$(12,375 )                     | \$(1,366 ) |
| Adjustments to reconcile net loss to net cash (used in) provided by operating activities:                             |                                 |            |
| Depreciation and amortization   | 15,571                          | 14,760     |
| Provision for bad debts   | 6,893                           | 6,822      |
| Equity in earnings of joint ventures  | (1,067 )                        | (1,206 )   |
| Distributions from joint ventures   | 1,866                           | 1,921      |
| Deferred rent amortization  | 343                             | 433        |
| Amortization of deferred financing costs  | 552                             | 457        |
| Write off of deferred loan costs due to refinance   | 665                             | -          |
| Amortization of bond and term loan discounts  | 616                             | 400        |
| Loss on sale and disposal of equipment  | 246                             | 170        |
| Loss on early extinguishment of Senior Notes  | 15,456                          | -          |
| Stock-based compensation  | 1,025                           | 952        |
| Changes in operating assets and liabilities, net of assets acquired and liabilities assumed in purchase transactions: |                                 |            |
| Accounts receivable   | (13,923 )                       | (11,782)   |
| Other current assets  | (4,503 )                        | (5,099 )   |
| Other assets  | (575 )                          | (105 )     |
| Deferred taxes  | (4,536 )                        | -          |
| Deferred revenue  | (39 )                           | 3          |
| Accounts payable and accrued expenses   | (11,075 )                       | 8,861      |
| Net cash (used in) provided by operating activities   | (4,860 )                        | 15,221     |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES</b>   |                                 |            |
| Purchase of imaging facilities  | (360 )                          | (3,625 )   |
| Purchase of property and equipment  | (17,047 )                       | (12,926)   |
| Proceeds from sale of equipment   | 4                               | 270        |
| Proceeds from sale of joint venture interests   | -                               | 2,640      |
| Equity contributions in existing joint ventures   | (789 )                          | (724 )     |
| Net cash used in investing activities   | (18,192 )                       | (14,365)   |

## CASH FLOWS FROM FINANCING ACTIVITIES

|  |           |          |
|--|-----------|----------|
| Principal payments on notes and leases payable                           | (1,929 )  | (2,697 ) |
| Proceeds from borrowings   | 210,000   | –        |
| Payments on Senior Notes   | (204,468) | –        |
| Deferred financing costs   | (6,650 )  | –        |
| Proceeds from, net of payments on, line of credit                        | 18,100    | 1,500    |
| Distributions to noncontrolling interests                                | (133 )    | –        |
| Proceeds from issuance of common stock upon exercise of options/warrants | 29        | 469      |
| Net cash provided by (used in) financing activities                      | 14,949    | (728 )   |
| <br>   |           |          |
| EFFECT OF EXCHANGE RATE CHANGES ON CASH                                  | (18 )     | (59 )    |
| <br>   |           |          |
| NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS                     | (8,121 )  | 69       |
| <br>   |           |          |
| CASH AND CASH EQUIVALENTS, beginning of period                           | 8,412     | 362      |
| <br>   |           |          |
| CASH AND CASH EQUIVALENTS, end of period                                 | \$291     | \$431    |
| <br>   |           |          |
| SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION                         |           |          |
| Cash paid during the period for interest                                 | \$14,508  | \$5,531  |

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 \$5.0 million and \$7.7 million during the three months ended March 31, 2014 and 2013, respectively, which were not paid for as of March 31, 2014 and 2013, respectively. The offsetting amounts due were recorded in our consolidated balance sheet under accounts payable and accrued expenses.

During the three months ended March 31, 2014, we added capital lease debt of approximately \$12.6 million relating to radiology equipment.



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

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

**(unaudited)**

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

We provide diagnostic imaging services including magnetic resonance imaging (MRI), computed tomography (CT), positron emission tomography (PET), nuclear medicine, mammography, ultrasound, diagnostic radiology, or X-ray, fluoroscopy and other related procedures. At March 31, 2014, we operated directly or indirectly through joint ventures, 250 imaging centers located in California, Maryland, Florida, Delaware, New Jersey, Rhode Island and New York. Our operations comprise a single segment for financial reporting purposes.

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

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

Howard G. Berger, M.D. is our President and Chief Executive Officer, a member of our Board of Directors and is deemed to be the beneficial owner, directly and indirectly, of approximately 13.12% of our outstanding common stock. Dr. Berger also owns, indirectly, 99% of the equity interests in BRMG. BRMG provides all of the professional



medical services at the majority of our facilities located in California under a management agreement with us, and employs physicians or contracts with various other independent physicians and physician groups to provide the professional medical services at most of our other California facilities. We generally obtain professional medical services from BRMG in California, rather than provide such services directly or through subsidiaries, in order to comply with California's prohibition against the corporate practice of medicine. However, as a result of our close relationship with Dr. Berger and BRMG, we believe that we are able to better ensure that medical service is provided at our California facilities in a manner consistent with our needs and expectations and those of our referring physicians, patients and payors than if we obtained these services from unaffiliated physician groups. BRMG is a partnership of ProNet Imaging Medical Group, Inc., Breastlink Medical Group, Inc. and Beverly Radiology Medical Group, Inc., each of which are 99% or 100% owned by Dr. Berger.

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

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

We have determined that BRMG and the B&C Entities are VIEs, and that we are the primary beneficiary, and consequently, we consolidate the revenue, expenses, assets and liabilities of each. BRMG and the B&C Entities on a combined basis recognized \$20.6 million and \$17.4 million of revenue, net of management service fees to RadNet, Inc., for the three months ended March 31, 2014 and 2013, respectively, and \$20.6 million and \$17.4 million of operating expenses for the three months ended March 31, 2014 and 2013, respectively. RadNet, Inc. recognized in its condensed consolidated statement of operations \$89.0 million and \$80.6 million of total billed net service fee revenue relating to these VIE's for the three months ended March 31, 2014 and 2013, respectively, of which \$68.5 million and \$63.2 million was for management services provided to BRMG and the B&C Entities relating primarily to the technical portion of total billed net service fee revenue for the three months ended March 31, 2014 and 2013, respectively.

The cash flows of BRMG and the B&C Entities are included in the accompanying consolidated statements of cash flows. All intercompany balances and transactions have been eliminated in consolidation. In our consolidated balance sheets at March 31, 2014 and December 31, 2013, we have included approximately \$62.6 million and \$65.2 million, respectively, of accounts receivable and approximately \$11.2 million and \$11.9 million, respectively, of accounts payable and accrued liabilities, related to BRMG and the B&C Entities combined.

The creditors of both BRMG and the B&C Entities do not have recourse to our general credit and there are no other arrangements that could expose us to losses on behalf of BRMG and the B&C Entities. However, both BRMG and the B&C Entities 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 certain centers in California and all of our centers in New York City where we contract with BRMG and the B&C Entities, respectively, for the provision of professional medical services, at all of our other centers, we have entered into long-term contracts with independent radiology groups in the area to provide physician services at those facilities. These third party radiology practices provide professional services, including supervision and interpretation of diagnostic imaging procedures, in our diagnostic imaging centers. The radiology practices maintain full control over the provision of professional services. The contracted radiology practices generally have outstanding physician and practice credentials and reputations; strong competitive market positions; a broad sub-specialty mix of physicians; a history of growth and potential for continued growth. In these facilities we enter into long-term agreements with radiology practice groups (typically 40 years). Under these arrangements, in addition to obtaining technical fees for the use of our diagnostic imaging equipment and the provision of technical services, we provide management services and receive a fee based on the practice group's professional revenue, including revenue derived outside of our diagnostic imaging centers. We own the diagnostic imaging equipment and, therefore, receive 100% of the technical reimbursements associated with imaging procedures. The radiology practice groups retain the professional reimbursements associated with imaging procedures after deducting management service fees paid to us. We have no financial controlling interest in the independent (non-BRMG or non-B&C Entities) radiology practices; accordingly, we do not consolidate the financial statements of those practices in our consolidated financial statements.

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X and, therefore, do not include all information and footnotes necessary for a fair presentation of financial position, results of operations and cash flows in 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, 2014 and 2013 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, 2013 filed on March 17, 2014, as amended.

*Significant Accounting Policies*

During the period covered in this report, there have been no material changes to the significant accounting policies we use, and have explained, in our annual report on Form 10-K for the fiscal year ended December 31, 2013. 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, 2013, as amended.

*Revenues*

Service fee revenue, net of contractual allowances and discounts, consists of net patient fees received from various payers and patients themselves based mainly upon established contractual billing rates, less allowances for contractual adjustments. As it relates to centers affiliated with both BRMG and the B&C Entities, this service fee revenue includes payments for both the professional medical interpretation revenue recognized by BRMG and the B&C Entities as well as the payment for all other aspects related to our providing the imaging services, for which we earn management fees from BRMG and the B&C Entities. As it relates to non-BRMG and B&C Entity centers, this service fee revenue is earned through providing the administration of the non-medical functions relating to the professional medical practice at our non-BRMG and B&C Entity centers, including among other functions, provision of clerical and administrative personnel, bookkeeping and accounting services, billing and collection, provision of medical and office supplies, secretarial, reception and transcription services, maintenance of medical records, and advertising, marketing and promotional activities.

Service fee revenues are recorded during the period the patient services are provided based upon the estimated amounts due from the patients and third-party payers. Third-party payers include federal and state agencies (under the Medicare and Medicaid programs), managed care health plans, commercial insurance companies and employers. Estimates of contractual allowances under managed care health plans are based upon the payment terms specified in the related contractual agreements. Contractual payment terms in managed care agreements are generally based upon predetermined rates per discounted fee-for-service rates. We also record a provision for doubtful accounts (based primarily on historical collection experience) related to patients and copayment and deductible amounts for patients who have health care coverage under one of our third-party payers.

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

Our revenue, net of contractual allowances, discounts and provision for bad debts for the three months ended March 31, 2014 and 2013 is summarized in the following table (in thousands):

|                                       | 2014      | 2013      |
|---------------------------------------|-----------|-----------|
| Commercial insurance                  | \$104,614 | \$106,558 |
| Medicare                              | 33,666    | 35,713    |
| Medicaid                              | 5,163     | 5,777     |
| Workers' compensation/personal injury | 7,453     | 7,316     |
| Other                                 | 7,867     | 8,377     |

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|  |            |            |
|--|------------|------------|
| Service fee revenue, net of contractual allowances and discounts | 158,763    | 163,741    |
| Provision for bad debts  | (6,893 )   | (6,822 )   |
| Net service fee revenue  | 151,870    | 156,919    |
| Revenue under capitation arrangements                            | 17,006     | 16,021     |
| Total net revenue  | \$ 168,876 | \$ 172,940 |

*Provision for Bad Debts*

We provide for an allowance against accounts receivable that could become uncollectible to reduce the carrying value of such receivables to their estimated net realizable value. We estimate this allowance based on the aging of our accounts receivable by each type of payer over an 18-month look-back period, and other relevant factors. A significant portion of our provision for bad debt relates to co-payments and deductibles owed to us from patients with insurance. Although we attempt to collect deductibles and co-payments due from patients with insurance at the time of service, this attempt to collect at the time of service is not an assessment of the patient's ability to pay nor are revenues recognized based on an assessment of the patient's ability to pay. There are various factors that can impact collection trends, such as changes in the economy, which in turn have an impact on the increased burden of co-payments and deductibles to be made by patients with insurance. These factors continuously change and can have an impact on collection trends and our estimation process.

*Deferred Tax Assets*

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

### *Deferred Financing Costs*

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

### *Meaningful Use Incentive*

Under the American Recovery and Reinvestment Act of 2009, a program was enacted that provides financial incentives for providers that successfully implement and utilize electronic health record technology to improve patient care. Our software development team in Canada established an objective to build a Radiology Information System (RIS) software platform that has been awarded Meaningful Use certification. As this certified RIS system is implemented throughout our imaging centers, the radiologists that utilize this software will be eligible for the available financial incentive money. In order to receive such incentive payments providers must attest that they have demonstrated meaningful use of the certified RIS in each stage of the program. Once an attestation is accepted by Medicare, payments will be made in four to eight weeks to the same taxpayer identification number and through the same channels as their claims payments are made. We account for this meaningful use incentive under the Gain Contingency Model outlined in ASC 450-30. Under this model, we record within non-operating income, meaningful use incentive only after Medicare accepts an attestation from the qualified eligible professional demonstrating meaningful use. We recorded approximately \$1.8 million during the three months ended March 31, 2014 relating to this incentive.

### *Liquidity and Capital Resources*

We had cash and cash equivalents of \$291,000 and accounts receivable of \$140.6 million at March 31, 2014, compared to cash and cash equivalents of \$8.4 million and accounts receivable of \$133.6 million at December 31, 2013. We had a working capital balance of \$61.4 million and \$58.0 million at March 31, 2014 and December 31, 2013, respectively. We had net loss attributable to RadNet, Inc. common stockholders for the three months ended March 31, 2014 and 2013 of \$12.4 million and \$1.3 million, respectively. We also had stockholders' (deficit) equity of (\$9.3 million) and \$2.2 million at March 31, 2014 and December 31, 2013, 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 short-term and long-term 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, 2014 are \$6.5 million of senior notes, \$581.2 million of senior secured term loan debt (net of unamortized discounts of \$14.1 million) and \$18.1 million aggregate principal amount outstanding under the revolving credit facility.

The following describes our most recent financing activities:

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

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

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

*Second Lien Credit and Guaranty Agreement.* Radnet Management entered into a Second Lien Credit and Guaranty Agreement (the “Second Lien Credit Agreement”) to provide for, among other things, the borrowing by Radnet Management of \$180.0 million of second lien term loans (the “Second Lien Term Loans”). The proceeds from the Second Lien Term Loans and the 2014 First Lien Term Loans were used to redeem the senior notes, as more fully described below under the heading “Senior Notes”, to pay the expenses related to the transaction and for general corporate purposes.

*Line of Credit.* The \$101.25 million revolving credit line established in the Credit and Guaranty Agreement dated October 10, 2012 was unaltered by the agreements above and remains in place.

The 2014 Amendment provides for the following:

*Interest.* The interest rates payable on the 2014 First Lien Term Loans are the same as the rates currently payable under the Refinance Agreement, as amended by the 2013 Amendment,, which are (a) the Adjusted Eurodollar Rate plus 3.25% or (b) the base rate plus 2.25%. The Adjusted Eurodollar Rate has a minimum floor of 1.0% on all of the term loans under the Refinance Agreement. The Adjusted Eurodollar Rate at March 31, 2014 was 0.33%.

*Payments.* The scheduled amortization of the term loans under the Refinance Agreement has been increased from quarterly payments of \$975,000 to quarterly payments of \$5,191,563 starting in June 2014, with the remaining



balance to be paid at maturity.

The other material terms of the Refinance Agreement remain unchanged as described in our annual report on Form 10-K for the fiscal year ended December 31, 2013, as amended.

The Second Lien Credit Agreement provides for the following:

*Interest.* The interest rates payable on the Second Lien Term Loans are (a) the Adjusted Eurodollar Rate plus 7.0% or (b) the base rate plus 6.0%. The Adjusted Eurodollar Rate has a minimum floor of 1.0% on the Second Lien Term Loans. The Eurodollar Rate at March 31, 2014 was 0.33%.

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

*Termination.* The termination date for the Second Lien Term Loans is the earlier to occur of (i) March 25, 2021, and (ii) the date on which the Second Lien Term Loans shall otherwise become due and payable in full under the Second Lien Credit Agreement, whether by acceleration or otherwise.

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

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

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

These limitations are subject to a number of important qualifications and exceptions, as described in the Second Lien Credit Agreement. As of March 31, 2014, we were in compliance with all covenants.

## Senior Notes

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

*Optional Redemption.* Under the Indenture, Radnet Management could redeem the senior notes, in whole or in part, at any time on or after April 1, 2014, at the redemption prices specified under the Indenture. Prior to April 1, 2014, Radnet Management was also permitted to redeem the senior notes, in whole or in part, at a redemption price equal to 100% of the principal amount redeemed, plus a make-whole premium established by the Indenture and accrued and unpaid interest, if any.

*Tender Offer and Exercise of Optional Redemption.* On March 7, 2014, Radnet Management commenced a tender offer to purchase for cash any and all outstanding senior notes. In connection with the tender offer, Radnet Management also commenced a consent solicitation to amend the Indenture to eliminate or modify certain restrictive covenants. On March 25, 2014 (the “Initial Payment Date”), Radnet Management made a payment in cash for all senior notes tendered prior to 5:00 P.M., New York City time, on March 20, 2014 (the “Consent Payment Deadline”). As of the Consent Payment Deadline, Radnet Management had received tenders and consents in respect of \$193,464,000 aggregate principal amount of the senior notes, representing 96.73% of the outstanding senior notes, all of which were accepted for purchase. The total consideration for each \$1,000 principal amount of senior notes validly tendered and not withdrawn at or prior to the Consent Payment Deadline and accepted for purchase was \$1,056.88 (the “Total Consideration”), which amount included a consent payment (the “Consent Payment”) of \$30.00 per \$1,000 principal amount of senior notes. In addition, all senior notes accepted for payment received accrued and unpaid interest in respect of such notes from the last interest payment date prior to the applicable settlement date to, but not including, the applicable settlement date. The tender offer expired on April 3, 2014 and between the Consent Payment Deadline and the expiration of the tender offer, no additional senior notes were tendered. Radnet Management also called for redemption all of its remaining outstanding senior notes, which redemption is described more fully under Note 8, “Subsequent Events”. For the three month ended March 31, 2014, RadNet recorded a loss on early extinguishment of Senior Notes of \$15.5 million related to this offer.

## Capital Lease Investments

During the three months ended March 31, 2014, we added capital lease debt of approximately \$12.6 million relating to radiology equipment.

**NOTE 2 – RECENT ACCOUNTING STANDARDS**

In July 2013, the FASB issued Accounting Standards Update (“ASU”) No. 2013-11 (“ASU 2013-11”), *Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists*. ASU 2013-11 requires an unrecognized tax benefit, or a portion of an unrecognized tax benefit, to be presented in the financial statements as a reduction to a deferred tax asset for a net operating loss carryforward, a similar tax loss, or a tax credit carryforward, except as follows. To the extent a net operating loss carryforward, a similar tax loss, or a tax credit carryforward is not available at the reporting date, the unrecognized tax benefit should be presented in the financial statements as a liability and not combined with deferred tax assets. ASU 2013-11 became effective for annual and interim periods beginning after December 15, 2013. The adoption of ASU 2013-11 did not have a material impact on our financial statements.

**NOTE 3 – EARNINGS PER SHARE**

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

|  | Three Months Ended<br>March 31, |            |
|--|---------------------------------|------------|
|  | 2014                            | 2013       |
| Net loss attributable to RadNet, Inc.'s common stockholders  | \$(12,424 )                     | \$(1,342 ) |
| <b>BASIC AND DILUTED NET LOSS PER SHARE ATTRIBUTABLE TO RADNET,<br/>INC.'S COMMON STOCKHOLDERS</b> |                                 |            |
| Weighted average number of common shares outstanding during the period                             | 40,010,080                      | 39,314,447 |
| Basic and diluted net loss per share attributable to RadNet, Inc.'s common stockholders            | \$(0.31 )                       | \$(0.03 )  |

For the three months ended March 31, 2014, and 2013 we excluded all outstanding options, warrants and restricted stock awards in the calculation of diluted earnings per share because their effect would be antidilutive.

**NOTE 4 – INVESTMENT IN JOINT VENTURES**

We have nine 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, 2014 (in thousands):

|   |    |        |
|---|----|--------|
| Balance as of<br>December 31, 2013        | \$ | 28,949 |
| Equity contributions<br>in existing joint |    | 789    |

|   |    |          |
|---|----|----------|
| ventures                                |    |          |
| Equity earnings in these joint ventures |    | 1,067    |
| Distribution of earnings                |    | (1,866 ) |
| Balance as of March 31, 2014            | \$ | 28,939   |

We received management service fees from the centers underlying these joint ventures of approximately \$2.4 million and \$2.0 million for the three months ended March 31, 2014 and 2013, respectively. We eliminate from total fees recorded the uncollected portion at period end 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, 2014 (in thousands) and for the three months ended March 31, 2014 and 2013 (in thousands):

| Balance Sheet Data:   | March<br>31,<br>2014 |
|---|----------------------|
| Current assets  | \$15,912             |
| Noncurrent assets   | 48,119               |
| Current liabilities   | (5,127 )             |
| Noncurrent liabilities  | (6,302 )             |
| Total net assets  | \$52,602             |
| Book value of Radnet joint venture interests  | \$23,792             |
| Cost in excess of book value of acquired joint venture interests                    | 4,772                |
| Elimination of intercompany profit remaining on Radnet's consolidated balance sheet | 375                  |
| Total value of Radnet joint venture interests                                       | \$28,939             |
| Total book value of other joint venture partner interests                           | \$28,810             |

| Income Statement Data for the three months ended March 31, | 2014     | 2013     |
|--|----------|----------|
| Net revenue  | \$22,806 | \$22,281 |
| Net income   | \$2,149  | \$2,733  |

## NOTE 5 – STOCK-BASED COMPENSATION

### Stock Incentive Plans

#### *Options and Warrants*

We have two long-term incentive plans which we refer to as the 2000 Plan and the 2006 Plan. The 2000 Plan was terminated as to future grants when the 2006 Plan was approved by the stockholders in 2006. As of March 31, 2014, we have reserved for issuance under the 2006 Plan 11,000,000 shares of common stock. Certain options granted under the 2006 Plan to employees are intended to qualify as incentive stock options under existing tax regulations. In addition, we may issue non-qualified stock options and warrants under the 2006 Plan from time to time to non-employees, in connection with acquisitions and for other purposes and we may also issue restricted stock under the 2006 Plan. Stock options and warrants generally vest over two to five years and expire five to ten years from date of grant.

As of March 31, 2014, 4,248,000, or approximately 95.3%, of the 4,458,000 outstanding stock options and warrants granted under our option plans are fully vested. During the three months ended March 31, 2014, we did not grant options or warrants under our 2006 Plan.

We have issued warrants outside the 2006 Plan under various types of arrangements to employees, and in exchange for outside services. All warrants issued to employees or consultants after our February 2007 listing on the NASDAQ Global Market have been characterized as awards under the 2006 Plan. All warrants outside the 2006 Plan have been issued with an exercise price equal to the fair value of the underlying common stock on the date of grant. The warrants expire from five to seven years from the date of grant. Vesting terms are determined by the board of directors or the compensation committee of the board of directors at the date of grant.

As of March 31, 2014, all 200,000 the outstanding warrants outside the 2006 Plan are fully vested. During the three months ended March 31, 2014, we did not grant warrants outside of our 2006 Plan.



The following summarizes all of our option and warrant transactions during the three months ended March 31, 2014:

| Outstanding Options and Warrants  |            | Weighted<br>Average<br>Exercise<br>price<br>Per<br>Common<br>Share | Weighted<br>Average<br>Remaining<br>Contractual<br>Life<br>(in years) | Aggregate<br>Intrinsic<br>Value |
|-----------------------------------|------------|--|---|---------------------------------|
| Under the 2006 Plan and 2000 Plan | Shares     |  |   |                                 |
| Balance, December 31, 2013        | 4,701,250  | \$ 3.15  |   |                                 |
| Granted                           | —          | —  |   |                                 |
| Exercised                         | (43,250 )  | 2.41   |   |                                 |
| Canceled or expired               | (200,000 ) | 5.66   |   |                                 |
| Balance, March 31, 2014           | 4,458,000  | 3.04   | 1.21  | \$ 1,392,910                    |
| Exercisable at March 31, 2014     | 4,248,000  | 3.06   | 1.11  | 1,382,327                       |

| Non-Plan                      |         | Weighted<br>Average<br>Exercise<br>price<br>Per<br>Common<br>Share | Weighted<br>Average<br>Remaining<br>Contractual<br>Life<br>(in years) | Aggregate<br>Intrinsic<br>Value |
|-------------------------------|---------|--|---|---------------------------------|
| Outstanding Warrants          | Shares  |  |   |                                 |
| Balance, December 31, 2013    | 200,000 | \$ 2.62  |   |                                 |
| Granted                       | —       | —  |   |                                 |
| Exercised                     | —       | —  |   |                                 |
| Canceled or expired           | —       | —  |   |                                 |
| Balance, March 31, 2014       | 200,000 | 2.62   | 1.67  | \$ 44,000                       |
| Exercisable at March 31, 2014 | 200,000 | 2.62   | 1.67  | 44,000                          |

Aggregate intrinsic value in the table above represents the total pretax intrinsic value (the difference between our closing stock price on March 31, 2014 and the exercise price, multiplied by the number of in-the-money options or warrants, as applicable) that would have been received by the holder had all holders exercised their options or warrants, as applicable, on March 31, 2014. Total intrinsic value of options and warrants exercised during the three months ended March 31, 2014 and 2013 was approximately \$16,000 and \$2.3 million, respectively. As of March 31, 2014, total unrecognized stock-based compensation expense related to non-vested employee awards was approximately \$150,000, which is expected to be recognized over a weighted average period of approximately 1.3 years.

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

The 2006 Plan permits the award of restricted stock. On January 2, 2014, we granted awards for 1,011,785 shares of our common stock to certain employees and outside directors. Of these awards granted, 337,262 shares vested on the award date, with the remaining 674,524 shares vesting at the completion of each year’s service by 337,262 shares per year over the next two years. We valued this award based on the closing market price of our stock on January 2, 2014 which was \$1.62 per share.

At March 31, 2014, the total unrecognized fair value of all restricted stock awards was approximately \$1,698,891, which will be recognized over the remaining vesting period of 3.00 years.

In sum, of the 11,000,000 shares of common stock reserved for issuance under the 2006 Plan, at March 31, 2014, we had 7,152,285 options, warrants and shares of restricted stock outstanding, 63,250 options exercised and 3,784,465 available for grant.

**NOTE 6 – FAIR VALUE MEASUREMENTS**

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

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

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

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



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

|                              | As of March 31, 2014 |           |            |                        |                            |
|------------------------------|----------------------|-----------|------------|------------------------|----------------------------|
|                              | Level<br>1           | Level 2   | Level<br>3 | Total<br>Fair<br>Value | Total<br>Carrying<br>Value |
| Senior First Lien Term Loan  | \$-                  | \$413,768 | \$-        | \$413,768              | \$415,325                  |
| Senior Second Lien Term Loan | -                    | \$179,100 | \$-        | 179,100                | \$180,000                  |
| Senior Notes                 | -                    | 6,875     | -          | 6,875                  | 6,536                      |

|                  | As of December 31, 2013 |           |            |           |                            |
|------------------|-------------------------|-----------|------------|-----------|----------------------------|
|                  | Level<br>1              | Level 2   | Level<br>3 | Total     | Total<br>Carrying<br>Value |
| Senior Term Loan | \$-                     | \$380,508 | \$-        | \$380,508 | \$349,125                  |
| Senior Notes     | -                       | 199,000   | -          | 199,000   | 200,000                    |

The carrying value of our line of credit at March 31, 2014 and December 31, 2013 of \$18.1 million and \$0, respectively, approximated its fair value.

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

## NOTE 7 – SUPPLEMENTAL GUARANTOR INFORMATION

In accordance with SEC Regulation S-X, Rule 3-10, Paragraph (d), the following tables present unaudited interim condensed consolidating financial information for: (a) RadNet, Inc. (the “Parent”) on a stand-alone basis as a guarantor of the registered senior notes due 2018 ; (b) Radnet Management, Inc., the subsidiary borrower and issuer (the “Subsidiary Issuer”) of the registered senior notes due 2018; (c) on a combined basis, the guarantor subsidiaries (the “Guarantor Subsidiaries”) of the registered senior notes due 2018, which include all other 100% owned subsidiaries of the Subsidiary Issuer; (d) on a combined basis, the non-guarantor subsidiaries, which include joint venture partnerships of which the Subsidiary Issuer holds investments of 50% or greater, as well as BRMG and the Crues Entities, which we consolidate as VIEs. Separate financial statements of the Subsidiary Issuer or the Guarantor Subsidiaries are not presented because the guarantee by the Parent and each Guarantor Subsidiary is full and unconditional, joint and several.



**RADNET, INC. AND SUBSIDIARIES****CONDENSED CONSOLIDATED BALANCE SHEET****March 31, 2014****(in thousands)****(unaudited)**

|  | Parent     | Subsidiary<br>Issuer | Guarantor<br>Subsidiaries | Non-Guarantor<br>Subsidiaries | Eliminations | Consolidated |
|--|------------|----------------------|---------------------------|-------------------------------|--------------|--------------|
| <b>ASSETS</b>  |            |                      |                           |                               |              |              |
| <b>CURRENT ASSETS</b>  |            |                      |                           |                               |              |              |
| Cash and cash equivalents  | \$—        | \$—                  | \$ 291                    | \$ —                          | \$—          | \$ 291       |
| Accounts receivable, net   | —          | —                    | 75,567                    | 65,062                        | —            | 140,629      |
| Current portion of deferred taxes  | —          | —                    | 16,691                    | —                             | —            | 16,691       |
| Prepaid expenses, current portion of<br>deferred financing costs and other<br>current assets | —          | 9,579                | 15,133                    | 543                           | —            | 25,255       |
| Total current assets   | —          | 9,579                | 107,682                   | 65,605                        | —            | 182,866      |
| <b>PROPERTY AND EQUIPMENT,<br/>NET</b>   | —          | 56,455               | 163,428                   | 6,326                         | —            | 226,209      |
| <b>OTHER ASSETS</b>  |            |                      |                           |                               |              |              |
| Goodwill   | —          | 49,444               | 142,521                   | 4,740                         | —            | 196,705      |
| Other intangible assets  | —          | 120                  | 49,140                    | 74                            | —            | 49,334       |
| Deferred financing costs, net of<br>current portion  | —          | 7,886                | —                         | —                             | —            | 7,886        |
| Investment in subsidiaries   | (11,524)   | 427,624              | 25,720                    | —                             | (441,820 )   | —            |
| Investment in joint ventures   | —          | 1,009                | 27,930                    | —                             | —            | 28,939       |
| Deferred tax assets, net of current<br>portion   | —          | —                    | 41,080                    | —                             | —            | 41,080       |
| Deposits and other   | —          | 1,550                | 2,596                     | 79                            | —            | 4,225        |
| Total assets   | \$(11,524) | \$553,667            | \$ 560,097                | \$ 76,824                     | \$(441,820 ) | \$ 737,244   |
| <b>LIABILITIES AND EQUITY<br/>(DEFICIT)</b>  |            |                      |                           |                               |              |              |
| <b>CURRENT LIABILITIES</b>   |            |                      |                           |                               |              |              |
| Intercompany   | \$—        | \$(102,714)          | \$ 68,411                 | \$ 34,303                     | \$—          | \$—          |
| Accounts payable, accrued expenses<br>and other  | —          | 45,811               | 32,002                    | 12,646                        | —            | 90,459       |
| Due to affiliates  | —          | —                    | 1,548                     | —                             | —            | 1,548        |
| Deferred revenue   | —          | —                    | 1,305                     | —                             | —            | 1,305        |
| Current portion of notes payable   | —          | 18,406               | 1,179                     | 32                            | —            | 19,617       |
| Current portion of deferred rent   | —          | 1,112                | 809                       | 42                            | —            | 1,963        |
|  | —          | 1,517                | 4,533                     | 536                           | —            | 6,586        |

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|  |            |           |            |           |              |            |
|--|------------|-----------|------------|-----------|--------------|------------|
| Current portion of obligations under capital leases      |            |           |            |           |              |            |
| Total current liabilities                                | –          | (35,868 ) | 109,787    | 47,559    | –            | 121,478    |
| <b>LONG-TERM LIABILITIES</b>                             |            |           |            |           |              |            |
| Deferred rent, net of current portion                    | –          | 11,097    | 7,745      | 423       | –            | 19,265     |
| Line of Credit   | –          | 18,100    | –          | –         | –            | 18,100     |
| Notes payable, net of current portion                    | –          | 569,258   | 33         | 916       | –            | 570,207    |
| Obligations under capital leases, net of current portion | –          | 2,604     | 7,725      | –         | –            | 10,329     |
| Other non-current liabilities                            | –          | –         | 7,183      | –         | –            | 7,183      |
| Total liabilities  | –          | 565,191   | 132,473    | 48,898    | –            | 746,562    |
| <b>STOCKHOLDERS' (DEFICIT)</b>                           |            |           |            |           |              |            |
| <b>EQUITY</b>  |            |           |            |           |              |            |
| Total RadNet, Inc.'s stockholders' (deficit) equity      | (11,524)   | (11,524 ) | 427,624    | 25,720    | (441,820 )   | (11,524 )  |
| Noncontrolling interests                                 | –          | –         | –          | 2,206     | –            | 2,206      |
| Total stockholders' (deficit) equity                     | (11,524)   | (11,524 ) | 427,624    | 27,926    | (441,820 )   | (9,318 )   |
| Total liabilities and stockholders' (deficit) equity     | \$(11,524) | \$553,667 | \$ 560,097 | \$ 76,824 | \$(441,820 ) | \$ 737,244 |

**RADNET, INC. AND SUBSIDIARIES****CONDENSED CONSOLIDATED BALANCE SHEET****December 31, 2013****(in thousands)****(unaudited)**

|  | Parent   | Subsidiary<br>Issuer | Guarantor<br>Subsidiaries | Non-Guarantor<br>Subsidiaries | Eliminations  | Consolidated |
|--|----------|----------------------|---------------------------|-------------------------------|---------------|--------------|
| <b>ASSETS</b>  |          |                      |                           |                               |               |              |
| <b>CURRENT ASSETS</b>  |          |                      |                           |                               |               |              |
| Cash and cash equivalents  | \$ –     | \$ –                 | \$ 8,412                  | \$ –                          | \$ –          | \$ 8,412     |
| Accounts receivable, net   | –        | –                    | 56,696                    | 76,903                        | –             | 133,599      |
| Current portion of deferred taxes  | –        | –                    | 13,321                    | –                             | –             | 13,321       |
| Prepaid expenses, current portion of<br>deferred financing costs and other current<br>assets | –        | 13,982               | 6,336                     | 694                           | –             | 21,012       |
| Total current assets   | –        | 13,982               | 84,765                    | 77,597                        | –             | 176,344      |
| <b>PROPERTY AND EQUIPMENT, NET</b>   | –        | 54,271               | 157,981                   | 6,295                         | –             | 218,547      |
| <b>OTHER ASSETS</b>  |          |                      |                           |                               |               |              |
| Goodwill   | –        | 49,444               | 142,211                   | 4,740                         | –             | 196,395      |
| Other intangible assets  | –        | 130                  | 49,831                    | 81                            | –             | 50,042       |
| Deferred financing costs, net of current<br>portion  | –        | 8,735                | –                         | –                             | –             | 8,735        |
| Investment in subsidiaries   | (80 )    | 368,682              | 26,037                    | –                             | (394,639 )    | –            |
| Investment in joint ventures   | –        | 1,053                | 27,896                    | –                             | –             | 28,949       |
| Deferred tax assets, net of current portion  | –        | –                    | 39,914                    | –                             | –             | 39,914       |
| Deposits and other   | –        | 1,486                | 2,085                     | 79                            | –             | 3,650        |
| Total assets   | \$ (80 ) | \$ 497,783           | \$ 530,720                | \$ 88,792                     | \$ (394,639 ) | \$ 722,576   |
| <b>LIABILITIES AND EQUITY</b>  |          |                      |                           |                               |               |              |
| <b>(DEFICIT)</b>   |          |                      |                           |                               |               |              |
| <b>CURRENT LIABILITIES</b>   |          |                      |                           |                               |               |              |
| Intercompany   | \$ –     | \$(132,501 )         | \$ 87,529                 | \$ 44,972                     | \$ –          | \$ –         |
| Accounts payable, accrued expenses and<br>other  | –        | 44,241               | 48,906                    | 13,169                        | –             | 106,316      |
| Due to affiliates  | –        | –                    | 2,655                     | –                             | –             | 2,655        |
| Deferred revenue   | –        | –                    | 1,344                     | –                             | –             | 1,344        |
| Current portion of notes payable   | –        | 1,700                | 1,325                     | 78                            | –             | 3,103        |
| Current portion of deferred rent   | –        | 1,097                | 759                       | 40                            | –             | 1,896        |
| Current portion of obligations under<br>capital leases                                       | –        | 435                  | 1,876                     | 764                           | –             | 3,075        |
| Total current liabilities  | –        | (85,028 )            | 144,394                   | 59,023                        | –             | 118,389      |



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LONG-TERM LIABILITIES

|  |   |         |         |        |   |         |
|--|---|---------|---------|--------|---|---------|
| Deferred rent, net of current portion                    | – | 11,129  | 7,480   | 380    | – | 18,989  |
| Line of Credit   | – | –       | –       | –      | – | –       |
| Notes payable, net of current portion                    | – | 571,516 | 91      | 1,062  | – | 572,669 |
| Obligations under capital leases, net of current portion | – | 246     | 2,533   | –      | – | 2,779   |
| Other non-current liabilities                            | – | –       | 7,540   | –      | – | 7,540   |
| Total liabilities  | – | 497,863 | 162,038 | 60,465 | – | 720,366 |

STOCKHOLDERS' (DEFICIT)

EQUITY

|  |          |            |            |           |               |            |
|--|----------|------------|------------|-----------|---------------|------------|
| Total RadNet, Inc.'s stockholders' (deficit) equity  | (80 )    | (80 )      | 368,682    | 26,037    | (394,639 )    | (80 )      |
| Noncontrolling interests                             | –        | –          | –          | 2,290     | –             | 2,290      |
| Total stockholders' (deficit) equity                 | (80 )    | (80 )      | 368,682    | 28,327    | (394,639 )    | 2,210      |
| Total liabilities and stockholders' (deficit) equity | \$ (80 ) | \$ 497,783 | \$ 530,720 | \$ 88,792 | \$ (394,639 ) | \$ 722,576 |

**RADNET, INC. AND SUBSIDIARIES****CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS****For The Three Months Ended March 31, 2014****(in thousands)****(unaudited)**

|   | Parent   | Subsidiary<br>Issuer | Guarantor<br>Subsidiaries | Non-Guarantor<br>Subsidiaries | Eliminations | Consolidated |
|---|----------|----------------------|---------------------------|-------------------------------|--------------|--------------|
| <b>NET SERVICE FEE REVENUE</b>  |          |                      |                           |                               |              |              |
| Service fee revenue, net of contractual allowances and discounts                  | \$-      | \$ 29,618            | \$ 104,246                | \$ 24,899                     | \$ -         | \$ 158,763   |
| Provision for bad debts   | -        | (1,428 )             | (4,061 )                  | (1,404 )                      | -            | (6,893 )     |
| Net service fee revenue   | -        | 28,190               | 100,185                   | 23,495                        | -            | 151,870      |
| Revenue under capitation arrangements   | -        | 9,546                | 4,417                     | 3,043                         | -            | 17,006       |
| Total net revenue   | -        | 37,736               | 104,602                   | 26,538                        | -            | 168,876      |
| <b>OPERATING EXPENSES</b>   |          |                      |                           |                               |              |              |
| Cost of operations  | -        | 33,960               | 85,849                    | 25,221                        | -            | 145,030      |
| Depreciation and amortization   | -        | 3,556                | 11,582                    | 433                           | -            | 15,571       |
| Loss on sale and disposal of equipment  | -        | 15                   | 233                       | (2 )                          | -            | 246          |
| Severance costs   | -        | 104                  | 377                       | -                             | -            | 481          |
| Total operating expenses  | -        | 37,635               | 98,041                    | 25,652                        | -            | 161,328      |
| <b>INCOME FROM OPERATIONS</b>   | -        | 101                  | 6,561                     | 886                           | -            | 7,548        |
| <b>OTHER INCOME AND EXPENSES</b>  |          |                      |                           |                               |              |              |
| Interest expense  | -        | 2,609                | 9,139                     | 24                            | -            | 11,772       |
| Meaningful use incentive  | -        | -                    | (1,762 )                  | -                             | -            | (1,762 )     |
| Equity in earnings of joint ventures  | -        | -                    | (1,067 )                  | -                             | -            | (1,067 )     |
| Loss on early extinguishment of Senior Notes                                      | -        | 15,456               | -                         | -                             | -            | 15,456       |
| Other income  | -        | -                    | 2                         | -                             | -            | 2            |
| Total other income and expenses   | -        | 18,065               | 6,312                     | 24                            | -            | 24,401       |
| <b>(LOSS) INCOME BEFORE INCOME TAXES AND EQUITY IN EARNINGS OF JOINT VENTURES</b> | -        | (17,964 )            | 249                       | 862                           | -            | (16,853 )    |
| Benefit from income taxes   | -        | -                    | 4,478                     | -                             | -            | 4,478        |
| (Losses) equity in earnings of consolidated subsidiaries                          | (12,424) | 5,540                | 813                       | -                             | 6,071        | -            |
| <b>NET (LOSS) INCOME</b>  | (12,424) | (12,424 )            | 5,540                     | 862                           | 6,071        | (12,375 )    |

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|  |            |             |          |        |          |             |
|--|------------|-------------|----------|--------|----------|-------------|
| Net income attributable to noncontrolling interests                | -          | -           | -        | 49     | -        | 49          |
| NET (LOSS) INCOME ATTRIBUTABLE TO RADNET, INC. COMMON STOCKHOLDERS | \$(12,424) | \$(12,424 ) | \$ 5,540 | \$ 813 | \$ 6,071 | \$(12,424 ) |

**RADNET, INC. AND SUBSIDIARIES****CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS****For The Three Months Ended March 31, 2013****(in thousands)****(unaudited)**

|  | Parent | Subsidiary<br>Issuer | Guarantor<br>Subsidiaries | Non-Guarantor<br>Subsidiaries | Eliminations | Consolidated |
|--|--------|----------------------|---------------------------|-------------------------------|--------------|--------------|
| <b>NET SERVICE FEE REVENUE</b>                                     |        |                      |                           |                               |              |              |
| Service fee revenue, net of contractual allowances and discounts   | \$ –   | \$ 28,384            | \$ 115,307                | \$ 20,050                     | \$ –         | \$ 163,741   |
| Provision for bad debts  | –      | (1,385 )             | (4,217 )                  | (1,220 )                      | –            | (6,822 )     |
| Net service fee revenue  | –      | 26,999               | 111,090                   | 18,830                        | –            | 156,919      |
| Revenue under capitation arrangements                              | –      | 9,124                | 4,043                     | 2,854                         | –            | 16,021       |
| Total net revenue  | –      | 36,123               | 115,133                   | 21,684                        | –            | 172,940      |
| <b>OPERATING EXPENSES</b>  |        |                      |                           |                               |              |              |
| Cost of operations   | –      | 33,236               | 95,518                    | 20,808                        | –            | 149,562      |
| Depreciation and amortization                                      | –      | 3,128                | 11,323                    | 309                           | –            | 14,760       |
| Loss on sale and disposal of equipment                             | –      | 85                   | 85                        | –                             | –            | 170          |
| Severance costs  | –      | 11                   | 110                       | 2                             | –            | 123          |
| Total operating expenses   | –      | 36,460               | 107,036                   | 21,119                        | –            | 164,615      |
| <b>(LOSS) INCOME FROM OPERATIONS</b>                               | –      | (337 )               | 8,097                     | 565                           | –            | 8,325        |
| <b>OTHER INCOME AND EXPENSES</b>                                   |        |                      |                           |                               |              |              |
| Interest expense   | –      | 6,673                | 5,391                     | 83                            | –            | 12,147       |
| Equity in earnings of joint ventures                               | –      | –                    | (1,206 )                  | –                             | –            | (1,206 )     |
| Other income   | –      | –                    | (2 )                      | –                             | –            | (2 )         |
| Total other income and expenses                                    | –      | 6,673                | 4,183                     | 83                            | –            | 10,939       |
| <b>(LOSS) INCOME BEFORE INCOME TAXES AND EQUITY IN EARNINGS OF</b> | –      | (7,010 )             | 3,914                     | 482                           | –            | (2,614 )     |

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JOINT VENTURES

|  |            |             |          |        |   |             |             |
|--|------------|-------------|----------|--------|---|-------------|-------------|
| Benefit from (provision for) income taxes                          | –          | –           | 1,254    | (6     | ) | –           | 1,248       |
| (Losses) equity in earnings of consolidated subsidiaries           | (1,342)    | 5,668       | 500      | –      |   | (4,826 )    | –           |
| NET (LOSS) INCOME  | (1,342)    | (1,342 )    | 5,668    | 476    |   | (4,826 )    | (1,366 )    |
| Net loss attributable to noncontrolling interests                  | –          | –           | –        | (24    | ) | –           | (24 )       |
| NET (LOSS) INCOME ATTRIBUTABLE TO RADNET, INC. COMMON STOCKHOLDERS | \$ (1,342) | \$ (1,342 ) | \$ 5,668 | \$ 500 |   | \$ (4,826 ) | \$ (1,342 ) |

**RADNET, INC. AND SUBSIDIARIES****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS****For The Three Months Ended March 31, 2014****(in thousands)****(unaudited)**

|   | <b>Parent</b> | <b>Subsidiary<br/>Issuer</b> | <b>Guarantor<br/>Subsidiaries</b> | <b>Non-Guarantor<br/>Subsidiaries</b> | <b>Eliminations</b> | <b>Consolidated</b> |
|---|---------------|------------------------------|-----------------------------------|---------------------------------------|---------------------|---------------------|
| <b>CASH FLOWS FROM OPERATING ACTIVITIES</b>   |               |                              |                                   |                                       |                     |                     |
| Net (loss) income   | \$ (12,424)   | \$ (12,424 )                 | \$ 5,540                          | \$ 862                                | \$ 6,071            | \$ (12,375 )        |
| Adjustments to reconcile net (loss) income to net cash (used in) provided by operating activities:                    |               |                              |                                   |                                       |                     |                     |
| Depreciation and amortization   | –             | 3,556                        | 11,582                            | 433                                   | –                   | 15,571              |
| Provision for bad debt  | –             | 1,428                        | 4,061                             | 1,404                                 | –                   | 6,893               |
| Equity in earnings of consolidated subsidiaries   | 12,424        | (5,540 )                     | (813 )                            | –                                     | (6,071 )            | –                   |
| Distributions from consolidated subsidiaries  | –             | –                            | 1,128                             | –                                     | (1,128 )            | –                   |
| Equity in earnings of joint ventures  | –             | (53 )                        | (1,014 )                          | –                                     | –                   | (1,067 )            |
| Distributions from joint ventures   | –             | –                            | 1,866                             | –                                     | –                   | 1,866               |
| Deferred rent amortization  | –             | (18 )                        | 316                               | 45                                    | –                   | 343                 |
| Amortization of deferred financing cost   | –             | 552                          | –                                 | –                                     | –                   | 552                 |
| Write off of deferred loan costs due to refinance   | –             | 665                          | –                                 | –                                     | –                   | 665                 |
| Amortization of term loan and bond discount   | –             | 616                          | –                                 | –                                     | –                   | 616                 |
| Loss on sale and disposal of equipment  | –             | 15                           | 231                               | –                                     | –                   | 246                 |
| Loss on extinguishment of debt  | –             | 15,456                       | –                                 | –                                     | –                   | 15,456              |
| Stock-based compensation  | –             | 256                          | 769                               | –                                     | –                   | 1,025               |
| Changes in operating assets and liabilities, net of assets acquired and liabilities assumed in purchase transactions: |               |                              |                                   |                                       |                     |                     |
| Accounts receivable   | –             | –                            | (29,822 )                         | 15,899                                | –                   | (13,923 )           |
| Other current assets  | –             | 4,401                        | (9,056 )                          | 152                                   | –                   | (4,503 )            |
| Other assets  | –             | (64 )                        | (511 )                            | –                                     | –                   | (575 )              |
| Deferred taxes  | –             | –                            | (4,536 )                          | –                                     | –                   | (4,536 )            |
| Deferred revenue  | –             | –                            | (39 )                             | –                                     | –                   | (39 )               |

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|   |     |            |           |           |          |            |
|---|-----|------------|-----------|-----------|----------|------------|
| Accounts payable, accrued expenses and other        | –   | (38,301 )  | 43,882    | (16,656 ) | –        | (11,075 )  |
| Net cash (used in) provided by operating activities | –   | (29,455 )  | 23,584    | 2,139     | (1,128 ) | (4,860 )   |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES</b>         |     |            |           |           |          |            |
| Purchase of imaging facilities                      | –   | –          | (360 )    | –         | –        | (360 )     |
| Purchase of property and equipment                  | –   | (435 )     | (16,154 ) | (458 )    | –        | (17,047 )  |
| Proceeds from sale of equipment                     | –   | –          | 4         | –         | –        | 4          |
| Proceeds from sale of joint venture interests       | –   | –          | –         | –         | –        | –          |
| Equity contributions in existing joint ventures     | –   | –          | (789 )    | –         | –        | (789 )     |
| Net cash used in investing activities               | –   | (435 )     | (17,299 ) | (458 )    | –        | (18,192 )  |
| <b>CASH FLOWS FROM FINANCING ACTIVITIES</b>         |     |            |           |           |          |            |
| Principal payments on notes and leases payable      | –   | 11,740     | (13,249 ) | (420 )    | –        | (1,929 )   |
| Proceeds from borrowings upon refinancing           | –   | 210,000    | –         | –         | –        | 210,000    |
| Principal payments on Senior Note Tender            | –   | (204,468 ) | –         | –         | –        | (204,468 ) |
| Deferred financing costs                            | –   | (6,650 )   | –         | –         | –        | (6,650 )   |
| Proceeds from, net of payments, on line of credit   | –   | 18,100     | –         | –         | –        | 18,100     |
| Distributions paid to non-controlling interests     | –   | –          | –         | (1,261 )  | 1,128    | (133 )     |
| Proceeds from issuance of common stock              | –   | 29         | –         | –         | –        | 29         |
| Net provided by (cash used) in financing activities | –   | 28,751     | (13,249 ) | (1,681 )  | 1,128    | 14,949     |
| EFFECT OF EXCHANGE RATE CHANGES ON CASH             | –   | –          | (18 )     | –         | –        | (18 )      |
| NET DECREASE IN CASH AND CASH EQUIVALENTS           | –   | (1,139 )   | (6,982 )  | –         | –        | (8,121 )   |
| CASH AND CASH EQUIVALENTS, beginning of period      | –   | 1,139      | 7,273     | –         | –        | 8,412      |
| CASH AND CASH EQUIVALENTS, end of period            | \$– | \$–        | \$ 291    | \$ –      | \$ –     | \$ 291     |

**RADNET, INC. AND SUBSIDIARIES****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS****For The Three Months Ended March 31, 2013****(in thousands)****(unaudited)**

|  | <b>Parent</b> | <b>Subsidiary<br/>Issuer</b> | <b>Guarantor<br/>Subsidiaries</b> | <b>Non-Guarantor<br/>Subsidiaries</b> | <b>Eliminations</b> | <b>Consolidated</b> |
|--|---------------|------------------------------|-----------------------------------|---------------------------------------|---------------------|---------------------|
| <b>CASH FLOWS FROM OPERATING<br/>ACTIVITIES</b>  |               |                              |                                   |                                       |                     |                     |
| Net (loss) income  | \$ (1,342)    | \$ (1,342 )                  | \$ 5,668                          | \$ 476                                | \$ (4,826 )         | \$ (1,366 )         |
| Adjustments to reconcile net (loss)<br>income to net cash provided by<br>operating activities:                                 |               |                              |                                   |                                       |                     |                     |
| Depreciation and amortization  | —             | 3,128                        | 11,323                            | 309                                   | —                   | 14,760              |
| Provision for bad debt   | —             | 1,385                        | 4,217                             | 1,220                                 | —                   | 6,822               |
| Equity in earnings of consolidated<br>subsidiaries   | 1,342         | (5,668 )                     | (500 )                            | —                                     | 4,826               | —                   |
| Distributions from consolidated<br>subsidiaries  | —             | —                            | —                                 | —                                     | —                   | —                   |
| Equity in earnings of joint ventures   | —             | —                            | (1,206 )                          | —                                     | —                   | (1,206 )            |
| Distributions from joint ventures  | —             | —                            | 1,921                             | —                                     | —                   | 1,921               |
| Deferred rent amortization   | —             | 156                          | 254                               | 23                                    | —                   | 433                 |
| Amortization of deferred financing cost  | —             | 457                          | —                                 | —                                     | —                   | 457                 |
| Amortization of term loan and bond<br>discount   | —             | 400                          | —                                 | —                                     | —                   | 400                 |
| Loss on sale and disposal of equipment   | —             | 85                           | 85                                | —                                     | —                   | 170                 |
| Stock-based compensation   | —             | 238                          | 714                               | —                                     | —                   | 952                 |
| Changes in operating assets and<br>liabilities, net of assets acquired and<br>liabilities assumed in purchase<br>transactions: |               |                              |                                   |                                       |                     |                     |
| Accounts receivable  | —             | —                            | 1,214                             | (12,996 )                             | —                   | (11,782 )           |
| Other current assets   | —             | (3,611 )                     | (1,606 )                          | 118                                   | —                   | (5,099 )            |
| Other assets   | —             | 225                          | (330 )                            | —                                     | —                   | (105 )              |
| Deferred revenue   | —             | —                            | 3                                 | —                                     | —                   | 3                   |
| Accounts payable, accrued expenses<br>and other  | —             | 7,957                        | (10,285 )                         | 11,189                                | —                   | 8,861               |
| Net cash provided by operating<br>activities   | —             | 3,410                        | 11,472                            | 339                                   | —                   | 15,221              |
| <b>CASH FLOWS FROM INVESTING<br/>ACTIVITIES</b>  |               |                              |                                   |                                       |                     |                     |



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|  |     |          |           |        |      |           |
|--|-----|----------|-----------|--------|------|-----------|
| Purchase of imaging facilities   | –   | (350 )   | (3,275 )  | –      | –    | (3,625 )  |
| Purchase of property and equipment   | –   | (4,053 ) | (8,847 )  | (26 )  | –    | (12,926 ) |
| Proceeds from sale of equipment  | –   | 145      | 125       | –      | –    | 270       |
| Proceeds from sale of joint venture interests                              | –   | –        | 2,640     | –      | –    | 2,640     |
| Purchase of equity interest in joint ventures                              | –   | –        | (724 )    | –      | –    | (724 )    |
| Net cash used in investing activities                                      | –   | (4,258 ) | (10,081 ) | (26 )  | –    | (14,365 ) |
| <b>CASH FLOWS FROM FINANCING ACTIVITIES</b>                                |     |          |           |        |      |           |
| Principal payments on notes and leases payable                             | –   | (1,424 ) | (960 )    | (313 ) | –    | (2,697 )  |
| Deferred financing costs   | –   | –        | –         | –      | –    | –         |
| Proceeds from, net of payments, on line of credit                          | –   | 1,500    | –         | –      | –    | 1,500     |
| Payments to counterparties of interest rate swaps, net of amounts received | –   | –        | –         | –      | –    | –         |
| Purchase of non-controlling interests                                      | –   | –        | –         | –      | –    | –         |
| Proceeds from issuance of common stock                                     | –   | 469      | –         | –      | –    | 469       |
| Net provided by (cash used) in financing activities                        | –   | 545      | (960 )    | (313 ) | –    | (728 )    |
| <b>EFFECT OF EXCHANGE RATE CHANGES ON CASH</b>                             |     |          |           |        |      |           |
| NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS                       | –   | (59 )    | –         | –      | –    | (59 )     |
| CASH AND CASH EQUIVALENTS, beginning of period                             | –   | (362 )   | 431       | –      | –    | 69        |
| CASH AND CASH EQUIVALENTS, end of period                                   | \$– | \$–      | \$ 431    | \$ –   | \$ – | \$ 431    |

## **NOTE 8 – SUBSEQUENT EVENTS**

### ***Redemption of Remaining Senior Notes***

On March 25, 2014, Radnet Management called for redemption all of its remaining outstanding senior notes not purchased prior to the expiration of the tender offer described in Note 1, with a redemption date of April 24, 2014 (the “Redemption Date”). Upon redemption on April 24, 2014, the holders of the senior notes being redeemed received a redemption price equal to 105.188% of the outstanding principal amount of the senior notes being redeemed (or \$1,051.88 per \$1,000 in principal amount of the senior notes) in accordance with the terms of the Indenture, or approximately \$6.9 million in total, including approximately \$43,000 of accrued and unpaid interest up to, but excluding the Redemption Date. As of that date, Radnet Management completed the satisfaction and discharge of the Indenture in accordance with its terms and no senior notes remained outstanding. With a net carrying amount including unamortized issue costs of \$6.4 million, a loss on early extinguishment of debt of \$470,800 will be recorded in the second quarter of 2014.





We are the leading national provider of freestanding, fixed-site outpatient diagnostic imaging services in the United States based on number of locations and annual imaging revenue. At March 31, 2014, we operated directly or indirectly through joint ventures, 250 centers located in California, Maryland, Florida, Delaware, New Jersey, Rhode Island and New York. Our centers provide physicians with imaging capabilities to facilitate the diagnosis and treatment of diseases and disorders and may reduce unnecessary invasive procedures, often reducing the cost and amount of care for patients. Our services include magnetic resonance imaging (MRI), computed tomography (CT), positron emission tomography (PET), nuclear medicine, mammography, ultrasound, diagnostic radiology (X-ray), fluoroscopy and other related procedures.

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

We derive substantially all of our revenue, directly or indirectly, from fees charged for the diagnostic imaging services performed at our facilities. For the three months ended March 31, 2014 and 2013, we performed 1,115,847 and 1,112,967 diagnostic imaging procedures, respectively, and generated total net revenue of \$168.9 million and \$172.9 million, respectively.

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

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

Howard G. Berger, M.D. is our President and Chief Executive Officer, a member of our Board of Directors and is deemed to be the beneficial owner, directly and indirectly, of approximately 13.12% of our outstanding common stock. Dr. Berger also owns, indirectly, 99% of the equity interests in BRMG. BRMG provides all of the professional medical services at the majority of our facilities located in California under a management agreement with us, and employs physicians or contracts with various other independent physicians and physician groups to provide the professional medical services at most of our other California facilities. We generally obtain professional medical services from BRMG in California, rather than provide such services directly or through subsidiaries, in order to comply with California’s prohibition against the corporate practice of medicine. However, as a result of our close relationship with Dr. Berger and BRMG, we believe that we are able to better ensure that medical service is provided at our California facilities in a manner consistent with our needs and expectations and those of our referring physicians, patients and payors than if we obtained these services from unaffiliated physician groups. BRMG is a partnership of ProNet Imaging Medical Group, Inc., Breastlink Medical Group, Inc. and Beverly Radiology Medical Group, Inc., each of which are 99% or 100% owned by Dr. Berger.

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

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

We have determined that BRMG and the B&C Entities are VIEs, and that we are the primary beneficiary, and consequently, we consolidate the revenue, expenses, assets and liabilities of each. BRMG and the B&C Entities on a combined basis recognized \$20.6 million and \$17.4 million of revenue, net of management service fees to RadNet, Inc., for the three months ended March 31, 2014 and 2013, respectively, and \$20.6 million and \$17.4 million of operating expenses for the three months ended March 31, 2014 and 2013, respectively. RadNet, Inc. recognized in its condensed consolidated statement of operations \$89.0 million and \$80.6 million of total billed net service fee revenue relating to these VIE's for the three months ended March 31, 2014 and 2013, respectively, of which \$68.5 million and \$63.2 million was for management services provided to BRMG and the B&C Entities relating primarily to the technical portion of total billed net service fee revenue for the three months ended March 31, 2014 and 2013, respectively.

The cash flows of BRMG and the B&C Entities are included in the accompanying consolidated statements of cash flows. All intercompany balances and transactions have been eliminated in consolidation. In our consolidated balance sheets at March 31, 2014 and December 31, 2013, we have included approximately \$62.6 million and \$65.2 million, respectively, of accounts receivable and approximately \$11.2 million and \$11.9 million, respectively, of accounts payable and accrued liabilities, related to BRMG and the B&C Entities combined.

The creditors of both BRMG and the B&C Entities do not have recourse to our general credit and there are no other arrangements that could expose us to losses on behalf of BRMG and the B&C Entities. However, both BRMG and the B&C Entities 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 certain centers in California and all of our centers in New York City where we contract with BRMG and the B&C Entities, respectively, for the provision of professional medical services, at all of our other centers, we have entered into long-term contracts with independent radiology groups in the area to provide physician services at those facilities. These third party radiology practices provide professional services, including supervision and interpretation of diagnostic imaging procedures, in our diagnostic imaging centers. The radiology practices maintain full control over the provision of professional services. The contracted radiology practices generally have outstanding physician and practice credentials and reputations; strong competitive market positions; a broad sub-specialty mix of physicians; a history of growth and potential for continued growth. In these facilities we enter into long-term agreements with radiology practice groups (typically 40 years). Under these arrangements, in addition to obtaining technical fees for the use of our diagnostic imaging equipment and the provision of technical services, we provide management services and receive a fee based on the practice group's professional revenue, including revenue derived outside of our diagnostic imaging centers. We own the diagnostic imaging equipment and, therefore, receive 100% of the technical reimbursements associated with imaging procedures. The radiology practice groups retain the professional reimbursements associated with imaging procedures after deducting management service fees paid to us. We have no financial controlling interest in the independent (non-BRMG or non-B&C Entities) radiology practices; accordingly, we do not consolidate the financial statements of those practices in our consolidated financial statements.

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

## **Critical Accounting Policies**

### *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.

The Securities and Exchange Commission, or SEC, 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, 2013, 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.

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, 2013, as amended.

**Revenues**

Service fee revenue, net of contractual allowances and discounts, consists of net patient fees received from various payers and patients themselves based mainly upon established contractual billing rates, less allowances for contractual adjustments. As it relates to centers affiliated with both BRMG and the B&C Entities, this service fee revenue includes payments for both the professional medical interpretation revenue recognized by BRMG and the B&C Entities as well as the payment for all other aspects related to our providing the imaging services, for which we earn management fees from BRMG and the B&C Entities. As it relates to non-BRMG and B&C Entity centers, this service fee revenue is earned through providing the administration of the non-medical functions relating to the professional medical practice at our non-BRMG and B&C Entity centers, including among other functions, provision of clerical and administrative personnel, bookkeeping and accounting services, billing and collection, provision of medical and office supplies, secretarial, reception and transcription services, maintenance of medical records, and advertising, marketing and promotional activities.

Service fee revenues are recorded during the period the patient services are provided based upon the estimated amounts due from the patients and third-party payers. Third-party payers include federal and state agencies (under the Medicare and Medicaid programs), managed care health plans, commercial insurance companies and employers. Estimates of contractual allowances under managed care health plans are based upon the payment terms specified in the related contractual agreements. Contractual payment terms in managed care agreements are generally based upon predetermined rates per discounted fee-for-service rates. We also record a provision for doubtful accounts (based primarily on historical collection experience) related to patients and copayment and deductible amounts for patients who have health care coverage under one of our third-party payers.

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

Our revenue, net of contractual allowances, discounts and provision for bad debts for the three months ended March 31, 2014 and 2013 are summarized in the following table (in thousands):

|                                       | 2014      | 2013      |
|---------------------------------------|-----------|-----------|
| Commercial insurance                  | \$104,614 | \$106,558 |
| Medicare                              | 33,666    | 35,713    |
| Medicaid                              | 5,163     | 5,777     |
| Workers' compensation/personal injury | 7,453     | 7,316     |
| Other                                 | 7,867     | 8,377     |

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|  |           |           |
|--|-----------|-----------|
| Service fee revenue, net of contractual allowances and discounts | 158,763   | 163,741   |
| Provision for bad debts  | (6,893 )  | (6,822 )  |
| Net service fee revenue  | 151,870   | 156,919   |
| Revenue under capitation arrangements                            | 17,006    | 16,021    |
| Total net revenue  | \$168,876 | \$172,940 |

***Provision for Bad Debts***

We provide for an allowance against accounts receivable that could become uncollectible to reduce the carrying value of such receivables to their estimated net realizable value. We estimate this allowance based on the aging of our accounts receivable by each type of payer over an 18-month look-back period, and other relevant factors. A significant portion of our provision for bad debt relates to co-payments and deductibles owed to us from patients with insurance. Although we attempt to collect deductibles and co-payments due from patients with insurance at the time of service, this attempt to collect at the time of service is not an assessment of the patient's ability to pay nor are revenues recognized based on an assessment of the patient's ability to pay. There are various factors that can impact collection trends, such as changes in the economy, which in turn have an impact on the increased burden of co-payments and deductibles to be made by patients with insurance. These factors continuously change and can have an impact on collection trends and our estimation process.

### ***Accounts Receivable***

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

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

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

### ***Deferred Tax Assets***

Income tax expense is computed using an asset and liability method and using expected annual effective tax rates. Under this method, deferred income tax assets and liabilities result from temporary differences in the financial reporting bases and the income tax reporting bases of assets and liabilities. The measurement of deferred tax assets is reduced, if necessary, by the amount of any tax benefit that, based on available evidence, is not expected to be realized. When it appears more likely than not that deferred taxes will not be realized, a valuation allowance is recorded to reduce the deferred tax asset to its estimated realizable value. For net deferred tax assets we consider estimates of future taxable income, including tax planning strategies, in determining whether our net deferred tax assets are more likely than not to be realized. At March 31, 2014, we determined that approximately \$57.8 million of our net deferred tax assets are more likely than not to be realized.

### ***Valuation of Goodwill and Long-Lived Assets***

Goodwill at March 31, 2014 totaled \$196.7 million. Goodwill is recorded as a result of business combinations. Management evaluates goodwill, at a minimum, on an annual basis and whenever events and changes in circumstances suggest that the carrying amount may not be recoverable in accordance with ASC 350, *Intangibles – Goodwill and Other*. 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. We tested goodwill for impairment on October 1, 2013. Based on our test, we noted no impairment related to goodwill as of October 1, 2013. However, if estimates or the related assumptions change in the future, we may be required to record impairment charges to reduce the carrying amount of goodwill.

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, 2014.

### **Recent Accounting Standards**

In July 2013, the FASB issued Accounting Standards Update ("ASU") No. 2013-11 ("ASU 2013-11"), *Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists*. ASU 2013-11 requires an unrecognized tax benefit, or a portion of an unrecognized tax benefit, to be presented in the financial statements as a reduction to a deferred tax asset for a net operating loss carryforward, a similar tax loss, or a tax credit carryforward, except as follows. To the extent a net operating loss carryforward, a similar tax loss, or a tax credit carryforward is not available at the reporting date, the unrecognized tax benefit should be presented in the financial statements as a liability and not combined with deferred tax assets. ASU 2013-11 became effective for annual and interim periods beginning after December 15, 2013. The adoption of ASU 2013-11 did not have a material impact on our financial statements.

## Industry Updates

Sequestration spending cuts took effect on April 1, 2013, which reduced our Medicare payments by 2%. Recently these spending cuts were extended through 2014 and 2015 by a two-year funding bill signed into law on December 26, 2013, which will continue to negatively impact our condensed consolidated financial results.

On March 31, 2014, Congress passed its seventeenth delay to the implementation of the Sustainable Growth Rate (SGR) formula, which would have led to a 24% reduction in Medicare payments to physicians. This delay extends implementation for an additional twelve months, during which time Congress hopes to be able to pass a more permanent solution to the SGR formula.

## 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)

|  | <b>Three Months<br/>Ended<br/>March 31,</b> |       |
|--|---|-------|
|  | 2014  | 2013  |
| NET REVENUE  |   |       |
| Service fee revenue, net of contractual allowances and discounts | 90.3%                                       | 91.1% |
| Provision for bad debts  | -3.9%                                       | -3.8% |
| Net service fee revenue  | 86.4%                                       | 87.3% |
| Revenue under capitation arrangements                            | 9.7%  | 8.9%  |
| Total net revenue  | 96.1%                                       | 96.2% |

|  |       |       |
|--|-------|-------|
| <b>OPERATING EXPENSES</b>  |       |       |
| Cost of operations, excluding depreciation and amortization      | 82.5% | 83.2% |
| Depreciation and amortization                                    | 8.9%  | 8.2%  |
| Loss on sale and disposal of equipment                           | 0.1%  | 0.1%  |
| Severance costs  | 0.3%  | 0.1%  |
| Total operating expenses   | 91.8% | 91.6% |
| <b>INCOME FROM OPERATIONS</b>                                    | 4.3%  | 4.6%  |
| <b>OTHER INCOME AND EXPENSES</b>                                 |       |       |
| Interest expense   | 6.7%  | 6.8%  |
| Meaningful use incentive   | -1.0% | 0.0%  |
| Equity in earnings of joint ventures                             | -0.6% | -0.7% |
| Loss on early extinguishment of Senior Notes                     | 8.8%  | 0.0%  |
| Other (income) expenses  | 0.0%  | 0.0%  |
| Total other income and expenses                                  | 13.9% | 6.1%  |
| <b>LOSS BEFORE INCOME TAXES</b>                                  | -9.6% | -1.5% |
| Benefit from income taxes  | 2.5%  | 0.7%  |
| <b>NET LOSS</b>  | -7.0% | -0.8% |
| Net income (loss) attributable to noncontrolling interests       | 0.0%  | 0.0%  |
| <b>NET LOSS ATTRIBUTABLE TO RADNET, INC. COMMON STOCKHOLDERS</b> | -7.1% | -0.7% |

***Three Months Ended March 31, 2014 Compared to the Three Months Ended March 31, 2013***

***Service Fee Revenue***

Service fee revenue for the three months ended March 31, 2014 was \$158.8 million compared to \$163.7 million for the three months ended March 31, 2013, a decrease of \$4.9 million, or 3.0%.

Service fee revenue, including only those centers which were in operation throughout the first quarters of both 2014 and 2013 decreased \$5.5 million, or 3.4%. This 3.4% decrease was mainly due to decreases in the number of imaging procedures as a result of inclement weather affecting our east coast operations. This comparison excludes revenue contributions from centers that were acquired or divested subsequent to January 1, 2013. For the three months ended March 31, 2014, service fee revenue from centers that were acquired or divested subsequent to January 1, 2013 and excluded from the above comparison was \$2.5 million. For the three months ended March 31, 2013, service fee revenue from centers that were acquired or divested subsequent to January 1, 2013 and excluded from the above comparison was \$1.9 million.

***Provision for Bad Debts***

Provision for bad debts increased \$71,000, or 1.0%, to approximately \$6.9 million, or 4.5% of net service fee revenue, for the three months ended March 31, 2014 compared to \$6.8 million, or 4.4% of net service fee revenue, for the three months ended March 31, 2013.

***Revenue Under Capitation Arrangements***

Revenue under capitation arrangements for the three months ended March 31, 2014 was \$17.0 million compared to \$16.0 million for the three months ended March 31, 2013, an increase of \$985,000 or 6.1%.

Revenue under capitation arrangements, including only those centers which were in operation throughout the first quarters of both 2014 and 2013 increased \$874,000, or 5.5%. This 5.5% increase was mainly due to new contractual relationships with private insurers. For the three months ended March 31, 2014, revenue under capitation arrangements from centers that were acquired or divested subsequent to January 1, 2013 and excluded from the above comparison was approximately \$111,000.



***Operating Expenses***

Cost of operations for the three months ended March 31, 2014 decreased approximately \$3.3 million, or 2.0%, from \$164.6 million for the three months ended March 31, 2013 to \$161.3 million for the three months ended March 31, 2014. The following table sets forth our cost of operations and total operating expenses for the three months ended March 31, 2014 and 2013 (in thousands):

|  | 2014      | 2013      |
|--|-----------|-----------|
| Salaries and professional reading fees, excluding stock-based compensation | \$80,713  | \$81,691  |
| Stock-based compensation   | 1,025     | 952       |
| Building and equipment rental  | 15,615    | 16,303    |
| Medical supplies   | 8,787     | 9,178     |
| Other operating expenses *   | 38,890    | 41,438    |
| Cost of operations   | 145,030   | 149,562   |
| Depreciation and amortization  | 15,571    | 14,760    |
| Loss on sale and disposal of equipment                                     | 246       | 170       |
| Severance costs  | 481       | 123       |
| Total operating expenses   | \$161,328 | \$164,615 |

\* 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 decreased \$978,000, or 1.2%, to \$80.7 million for the three months ended March 31, 2014 compared to \$81.7 million for the three months ended March 31, 2013.

Salaries and professional reading fees, including only those centers which were in operation throughout the first quarters of both 2014 and 2013, decreased \$2.1 million, or 2.5%. This 2.5% decrease was primarily due reduced volumes and staff reductions. For the three months ended March 31, 2014, salaries and professional reading fees from centers that were acquired or divested subsequent to January 1, 2013 and excluded from the above comparison was approximately \$1.5 million. For the three months ended March 31, 2013, salaries and professional reading fees from centers that were acquired or divested subsequent to January 1, 2013 and excluded from the above comparison was approximately \$442,000.

### **Stock-based compensation**

Stock-based compensation increased \$73,000, or 7.7%, to approximately \$1.0 million for the three months ended March 31, 2014 compared to \$952,000 for the three months ended March 31, 2013.

### **Building and equipment rental**

Building and equipment rental expenses decreased \$688,000, or 4.2%, to \$15.6 million for the three months ended March 31, 2014 compared to \$16.3 million for the three months ended March 31, 2013.

Building and equipment rental expenses, including only those centers which were in operation throughout the first quarters of both 2014 and 2013, decreased \$1.3 million, or 8.0%. This 8.0% decrease mainly related to the re-negotiation of radiology equipment operating leases into capital leases, thus reducing equipment rental expense. This comparison excludes expenses from centers that were acquired or divested subsequent to January 1, 2013. For the three months ended March 31, 2014, building and equipment rental expenses from centers that were acquired or divested subsequent to January 1, 2013 and excluded from the above comparison was approximately \$744,000. For the three months ended March 31, 2013, building and equipment rental expenses from centers that were acquired or divested subsequent to January 1, 2013 and excluded from the above comparison was \$138,000.

## **Medical supplies**

Medical supplies expense decreased \$391,000, or 4.3%, to \$8.8 million for the three months ended March 31, 2014 compared to \$9.2 million for the three months ended March 31, 2013.

Medical supplies expenses, including only those centers which were in operation throughout the first quarter of both 2014 and 2013, increased \$292,000, or 3.5%. This 3.5% increase is primarily due to a decrease in rebates for key medical supplies over the three months ended March 31, 2014 compared to the three months ended March 31, 2013. This comparison excludes expenses from centers that were acquired or divested subsequent to January 1, 2013. For the three months ended March 31, 2014, medical supplies expense from centers that were acquired or divested subsequent to January 1, 2013 and excluded from the above comparison was \$158,000. For the three months ended March 31, 2013, medical supplies expense from centers that were acquired or divested subsequent to January 1, 2013 was \$841,000.

## **Other operating expenses**

Other operating expenses decreased \$2.5 million, or 6.1%, to \$38.9 million for the three months ended March 31, 2014 compared to \$41.4 million for the three months ended March 31, 2013.

Other operating expenses, including only those centers which were in operation throughout the first quarters of both 2014 and 2013, decreased \$3.0 million, or 7.3%. This 7.3 % decrease is primarily due to reduced rates on certain of our maintenance contracts along with decreased license fees. This comparison excludes expenses from centers that were acquired or divested subsequent to January 1, 2013. For the three months ended March 31, 2014, other operating expense from centers that were acquired or divested subsequent January 1, 2013 and excluded from the above comparison was \$718,000. For the three months ended March 31, 2013, other operating expense from centers that were acquired or divested subsequent to January 1, 2013 was \$253,000.

### **Depreciation and amortization**

Depreciation and amortization increased \$811,000, or 5.5%, to \$15.6 million for the three months ended March 31, 2014 compared to \$14.8 million for the three months ended March 31, 2013.

Depreciation and amortization, including only those centers which were in operation throughout the first quarter of both 2014 and 2013, increased \$495,000, or 3.4%. This 3.4% rise is primarily due to operating leases that were re-negotiated into capital leases starting in January 2014 resulting in increased depreciation. This comparison excludes expenses from centers that were acquired or divested subsequent to January 1, 2013. For the three months ended March 31, 2014, depreciation and amortization from centers that were acquired or divested subsequent to January 1, 2013 and excluded from the above comparison was \$397,000. For the three months ended March 31, 2013, medical supplies expense from centers that were acquired or divested subsequent to January 1, 2013 was \$81,000.

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

We recorded a net loss on sale of equipment of approximately \$246,000 and \$170,000 for the three months ended March 31, 2014 and 2013, respectively. This was related to the difference between the net book value of certain equipment sold and proceeds we received from the sale.

### ***Interest expense***

Interest expense for the three months ended March 31, 2014 decreased approximately \$375,000, or 3.1%, to \$11.7 million for the three months ended March 31, 2014 compared to \$12.1 million for the three months ended March 31, 2013. Interest expense for the three months ended March 31, 2014 included \$1.8 million of combined non-cash amortization and write-off of deferred loan costs as well as discount on issuance and refinance of debt. Interest expense for the three months ended March 31, 2013 included \$857,000 of non-cash amortization of deferred loan costs and discount on issuance of debt. Excluding these non-cash amounts for each period, interest expense decreased approximately \$1.3 million for the three months ended March 31, 2014 compared to the three months ended March 31, 2013. This decrease was primarily due to a reduction in interest expense on the senior term loan stemming from the April 2013 amendment to the October 2012 refinancing. See "Liquidity and Capital Resources" below for more details on our debt refinancing.

### ***Equity in earnings of joint ventures***

For the three months ended March 31, 2014, we recognized equity in earnings from unconsolidated joint ventures of \$1.1 million compared to \$1.2 million for the three months ended March 31, 2013.

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

For the three months ended March 31, 2014, we recognized a \$15.5 million loss on early extinguishment of debt through our tender offer for our senior notes. Completion of the tender was conditioned on the closing of the amendment to the First Lien and the Second Lien Credit and Guaranty Agreement. As of March 31, 2014, holders of 96.73% of the outstanding senior notes, amounting to \$193.5 million face value, accepted the 105.688% tender offer consideration, totaling \$204.5 million. The net carrying amount adjusted for unamortized discount, note issue costs and related expenses was \$189.0 million. See “Liquidity and Capital Resources” below and Notes 1 and 8 to the condensed consolidated financial statements contained herein for more details on our debt refinancing.

***Meaningful use incentive***

For the three months ended March 31, 2014, we recognized other income from meaningful use incentive in the amount of \$1.8 million. This amount was earned under a Medicare program to promote the use of electronic health record technology. See Note 1 to the condensed consolidated financial statements contain herein for more detail regarding this meaningful use incentive.

***Adjusted EBITDA***

We use both GAAP and non-GAAP metrics to measure our financial results. 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.

One non-GAAP measure we believe assists us is Adjusted EBITDA. 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 reconciled to its nearest comparable GAAP financial measure, net income (loss) attributable to RadNet, Inc. common stockholders. 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.

The following is a reconciliation of GAAP net loss to Adjusted EBITDA for the three months ended March 31, 2014 and 2013, respectively:

|   | Three Months<br>Ended |           |
|---|-----------------------|-----------|
|   | March 31,<br>2014     | 2013      |
| Net loss attributable to RadNet, Inc. common stockholders | \$(12,424)            | \$(1,342) |
| Plus benefit from income taxes                            | (4,478 )              | (1,248 )  |
| Plus other expenses (income)                              | 2                     | (2 )      |

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|  |          |          |
|--|----------|----------|
| Plus loss on early extinguishment of Senior Notes  | 15,456   | –        |
| Plus interest expense                              | 11,772   | 12,147   |
| Plus severance costs                               | 481      | 123      |
| Plus loss (gain) on sale and disposal of equipment | 246      | 170      |
| Plus depreciation and amortization                 | 15,571   | 14,760   |
| Plus non-cash employee stock-based compensation    | 1,025    | 952      |
| Adjusted EBITDA                                    | \$27,651 | \$25,560 |

**Liquidity and Capital Resources**

We had cash and cash equivalents of \$291,000 and accounts receivable of \$140.6 million at March 31, 2014, compared to cash and cash equivalents of \$8.4 million and accounts receivable of \$133.6 million at December 31, 2013. We had a working capital balance of \$61.4 million and \$58.0 million at March 31, 2014 and December 31, 2013, respectively. We had net loss attributable to RadNet, Inc. common stockholders for the three months ended March 31, 2014 and 2013 of \$12.4 million and \$1.3 million, respectively. We also had stockholders' (deficit) equity of (\$9.3 million) and \$2.2 million at March 31, 2014 and December 31, 2013, respectively.

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

Under the 2014 Amendment to the Refinance Agreement explained in further detail below, the scheduled annual amortization payments on the First Lien Term Loan increased from 1% per annum to 5% per annum. As a result, scheduled amortization increased by \$16.8 million from pre-amendment terms. This \$16.8 million additional cash obligation will be partially offset by annual interest savings of approximately \$5.0 million under the terms of the Second Lien Term Loan as compared to that under the retired Senior Notes. We expect to fund this approximately \$11.8 million net increase in amortization payments from cash provided by operating activities.

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 short-term and long-term 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. However, we have no formal plan of doing so at this time.

Included in our condensed consolidated balance sheet at March 31, 2014 were \$6.5 million of senior notes, \$581.2 million of senior secured term loan debt (net of unamortized discounts of \$14.1 million) and \$18.1 million aggregate principal amount outstanding under the revolving credit facility.

#### Sources and Uses of Cash

Cash used by operating activities was \$4.9 million for the three months ended March 31, 2014 compared to cash provided by operating activities of \$15.2 million for the three months ended March 31, 2013.



Cash used in investing activities was \$18.2 million and \$14.4 million for the three months ended March 31, 2014 and 2013, respectively. For the three months ended March 31, 2014, we purchased property and equipment for approximately \$17.0 million, acquired the assets and businesses of an additional imaging facility for \$360,000 (see Note 2 to the condensed consolidated financial statements contained herein), and purchased additional equity interests in non-consolidated joint ventures for \$789,000.

Cash provided by financing activities was \$15.0 million for the three months ended March 31, 2014 compared to cash used in financing activities of \$728,000 for the three months ending March 31, 2013. The cash provided by financing activities for the three months ended March 31, 2014, was primarily due to amounts received through the First and Second Lien Credit and Guaranty Agreements and borrowings under our line of credit offset by the retirement of \$193.5 million face value of the senior notes and principal payments on our notes and capital leases. (See Note 1 to the condensed consolidated financial statements herein).

The following describes our most recent financing activities:

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

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

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

*Second Lien Credit and Guaranty Agreement.* Radnet Management entered into a Second Lien Credit and Guaranty Agreement (the “Second Lien Credit Agreement”) to provide for, among other things, the borrowing by Radnet Management of \$180.0 million of second lien term loans (the “Second Lien Term Loans”). The proceeds from the Second Lien Term Loans and the 2014 First Lien Term Loans were used to redeem the senior notes, as more fully described below under the heading “Senior Notes”, to pay the expenses related to the transaction and for general corporate purposes.

*Line of Credit.* The \$101.25 million revolving credit line established in the Credit and Guaranty Agreement dated October 10, 2012 was unaltered by the agreements above and remains in place.

The 2014 Amendment provides for the following:

*Interest.* The interest rates payable on the 2014 First Lien Term Loans are the same as the rates currently payable under the Refinance Agreement, as amended by the 2013 Amendment,, which are (a) the Adjusted Eurodollar Rate plus 3.25% or (b) the base rate plus 2.25%. The Adjusted Eurodollar Rate has a minimum floor of 1.0% on all of the term loans under the Refinance Agreement. The Eurodollar Rate at March 31, 2014 was 0.33%.

*Payments.* The scheduled amortization of the term loans under the Refinance Agreement has been increased from quarterly payments of \$975,000 to quarterly payments of \$5,191,563 starting in June 2014, with the remaining balance to be paid at maturity.

The other material terms of the Refinance Agreement remain unchanged as described in our annual report on Form 10-K for the fiscal year ended December 31, 2013, as amended.

The Second Lien Credit Agreement provides for the following:

*Interest.* The interest rates payable on the Second Lien Term Loans are (a) the Adjusted Eurodollar Rate plus 7.0% or (b) the base rate plus 6.0%. The Adjusted Eurodollar Rate has a minimum floor of 1.0% on the Second Lien Term Loans. The Eurodollar Rate at March 31, 2014 was 0.33%.

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

*Termination.* The termination date for the Second Lien Term Loans is the earlier to occur of (i) March 25, 2021, and (ii) the date on which the Second Lien Term Loans shall otherwise become due and payable in full under the Second Lien Credit Agreement, whether by acceleration or otherwise.

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

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

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

These limitations are subject to a number of important qualifications and exceptions, as described in the Second Lien Credit Agreement. As of March 31, 2014, we were in compliance with all covenants.

### Senior Notes

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

*Optional Redemption.* Under the Indenture, Radnet Management could redeem the senior notes, in whole or in part, at any time on or after April 1, 2014, at the redemption prices specified under the Indenture. Prior to April 1, 2014,

Radnet Management was also permitted to redeem the senior notes, in whole or in part, at a redemption price equal to 100% of the principal amount redeemed, plus a make-whole premium established by the Indenture and accrued and unpaid interest, if any.

*Tender Offer and Exercise of Optional Redemption.* On March 7, 2014, Radnet Management commenced a tender offer to purchase for cash any and all outstanding senior notes. In connection with the tender offer, Radnet Management also commenced a consent solicitation to amend the Indenture to eliminate or modify certain restrictive covenants. On March 25, 2014 (the “Initial Payment Date”), Radnet Management made a payment in cash for all senior notes tendered prior to 5:00 P.M., New York City time, on March 20, 2014 (the “Consent Payment Deadline”). As of the Consent Payment Deadline, Radnet Management had received tenders and consents in respect of \$193,464,000 aggregate principal amount of the senior notes, representing 96.73% of the outstanding senior notes, all of which were accepted for purchase. The total consideration for each \$1,000 principal amount of senior notes validly tendered and not withdrawn at or prior to the Consent Payment Deadline and accepted for purchase was \$1,056.88 (the “Total Consideration”), which amount included a consent payment (the “Consent Payment”) of \$30.00 per \$1,000 principal amount of senior notes. In addition, all senior notes accepted for payment received accrued and unpaid interest in respect of such notes from the last interest payment date prior to the applicable settlement date to, but not including, the applicable settlement date. The tender offer expired on April 3, 2014 and between the Consent Payment Deadline and the expiration of the tender offer, no additional senior notes were tendered. Radnet Management also called for redemption all of its remaining outstanding senior notes, which redemption is described more fully under Note 8, “Subsequent Events”. For the three month ended March 31, 2014, RadNet recorded a loss on early extinguishment of Senior Notes of \$15.5 million related to this offer.

#### Capital Lease Investments

During the three months ended March 31, 2014, we added capital lease debt of approximately \$12.6 million relating to radiology equipment.

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

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

Since the completion of the acquisition of Image Medical Corporation, the parent of eRAD, Inc. on October 1, 2010, 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 exchange currency contracts to mitigate this risk. Fluctuations in foreign exchange rates could impact future operating results. A hypothetical one percent increase in the exchange rate between the Canadian Dollar and the Euro against the U.S. Dollar would have resulted in an increase in operating expenses of \$15,000.

**Interest Rate Sensitivity.** RadNet Inc. pays interest on various types of debt instruments to its suppliers, investors and lending institutions. The agreements entail either fixed or variable interest rates. Instruments which have fixed rates include leases on equipment and interest due on our \$6.5 million outstanding senior notes. Variable rate interest obligations relate primarily to amounts borrowed under our outstanding credit facilities, which allows elections of either Adjusted Eurodollar or prime rates of interest. Under the 2014 Amendment to the Refinance Agreement and Second Lien Credit Agreement's election facilities', borrowed funds bear a 1.00% floor or 6 month Adjusted Eurodollar Rate plus an applicable margin of 3.25% for the 2014 First Lien Term Loans and 7% for the Second Lien Term Loans. At March 31, 2014, we had \$404.9 million outstanding subject to an Adjusted Eurodollar election on the 2014 First Lien Term Loans and \$180.0 million on the Second Lien Term Loans. As the Adjusted Eurodollar floor exceeds the current spot rate of 6 month Adjusted Eurodollar, the spot rate would have to increase more than 67 basis points before an additional interest expense would be accrued. An increase of 167 basis points would be necessary to realize a hypothetical 1% increase in the borrowing rate and an annual increase of \$5.8 million of interest expense. At March 31, 2014, an additional \$28.5 million was tied to the prime rate. A hypothetical 1% increase in the prime rate for 2013-2014 would have resulted in an annual increase of approximately \$285,000.

#### **ITEM 4. Controls and Procedures**

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

We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in its reports under the Securities Exchange Act of 1934, as amended, is recorded, processed, summarized and reported within the time periods specified in the Commission's rules and forms and that such information is accumulated and communicated to the Company's management, including its Chief Executive Officer and Chief Financial Officer, as appropriate, to allow for timely decisions regarding required disclosure. In designing and evaluating the disclosure controls and procedures, management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives.

In November 2013 the Company identified a deficiency in controls relating to the accounting for income taxes and concluded at that time that such a deficiency represented a material weakness in internal control over financial reporting. As a result of this discovery, the Company's Chief Executive Officer and Chief Financial Officer concluded that its disclosure controls and procedures were not effective as of December 31, 2012. Subsequent to November 2013 effort was put forth towards strengthening controls over the accounting for income taxes including placing a senior accounting professional in a leadership position within the accounting department to ensure the quality of information delivered to, and improve the review of completed work received from, the Company's outside tax consultant, and although some improvements were achieved, the Chief Executive Officer and Chief Financial Officer of RadNet, Inc. concluded that the Company's disclosure controls and procedures remain ineffective as of March 31, 2014.

### ***Report of Management on Internal Control over Financial Reporting***

The management of RadNet, Inc. is responsible for establishing and maintaining adequate internal control over financial reporting for the Company. The internal control system for RadNet, Inc. was designed to provide reasonable assurance regarding the preparation and fair presentation of published financial statements. 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 the policies or procedures may deteriorate.

In November 2013, during the preparation of the Company's third quarter financial statements for the three and nine months ending September 30, 2013, the Company identified a deficiency in controls relating to the accounting for income taxes and concluded at that time that such a deficiency represented a material weakness in internal control over financial reporting.

A material weakness is a deficiency, or 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.

Under the supervision and with the participation of our management, including our Chief Executive Officer, and Chief Financial Officer, we conducted an evaluation of the effectiveness of our internal control over financial reporting as of March 31, 2014 based on the guidelines established in *Internal Control – Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) (1992 framework). Based on this assessment, management has concluded that as of March 31, 2014, internal control over financial reporting remains ineffective.

### ***Planned Remediation Efforts to Address Material Weakness***

In order to remediate the material weakness discussed above and further strengthen the overall controls surrounding the Company's accounting for income taxes, the Company continues to make progress in the following steps to improve the overall processes and controls in its tax function:

- place a senior accounting professional in a leadership position within the accounting department to ensure the quality of information delivered to, and improve the review of completed work received from, Company's outside tax consultant;
- improve controls over our identification and assessment of uncertain tax positions.

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

As previously reported, except for the material weakness described above, management did not identify any change in internal control over financial reporting occurring during the fourth quarter that materially affected, or was reasonably likely to materially affect, the Company's internal control over financial reporting.

### **Limitations on Disclosure Controls and Procedures**

Our management, including our chief executive officer and chief financial officer, do not expect that our disclosure controls or internal controls over financial reporting will prevent all errors or all instances of fraud. A control system, no matter how well designed and operated, can provide only reasonable, not absolute, assurance that the control system's objectives will be met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within our company have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of simple error or mistake. Controls can also be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the controls. The design of any system of controls is based in part upon certain assumptions about the likelihood of future events, and any design may not succeed in achieving its stated goals under all potential future conditions. Over time, controls may become inadequate because of changes in conditions or deterioration in the degree of compliance with policies or procedures. Because of the inherent limitation of a cost-effective control system, misstatements due to error or fraud may occur and not be detected.



## **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 believe that the outcome of our current litigation will not have a material adverse impact on our business, financial condition and results of operations. However, we could be subsequently named as a defendant in other lawsuits that could adversely affect us.

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

The following is an update to risk factors described in our annual report on Form 10-K for the year ended December 31, 2013, as amended, and should be read in conjunction with the other risk factors therein. The risks described below and in our Form 10-K, as amended, are not the only risks facing our Company. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business, financial condition and/or operating results.

#### ***We are vulnerable to earthquakes, harsh weather and other natural disasters.***

Our corporate headquarters and 113 of our facilities are located in California, an area prone to earthquakes and other natural disasters. Several of our facilities are located in areas of Florida and the east coast that have suffered from hurricanes and other harsh weather. Most recently, our operations in Maryland, Delaware, New York and New Jersey were negatively impacted due to the 2013-2014 winter snow storms that caused us to close our facilities, some for up to five business days, and prevented patients from being able to drive to our facilities, even when open. When Hurricane Sandy made landfall on the east coast in late October 2012, we suffered site closures, loss of power and other related business disruptions. An earthquake, harsh weather conditions or other natural disaster could decrease scan volume during affected periods and seriously impair our operations. Damage to our equipment or interruption of our business would adversely affect our financial condition and results of operations.

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

From time to time, changes designed to contain healthcare costs have been implemented, some of which have resulted in decreased reimbursement rates for diagnostic imaging services that impact our business. For services for which we bill Medicare directly, we are paid under the Medicare Physician Fee Schedule, which is updated on an annual basis. Under the Medicare statutory formula, payments under the Physician Fee Schedule would have decreased for the past several years if Congress failed to intervene.

Medicare program reimbursements for physician services as well as other services to Medicare beneficiaries who are not enrolled in Medicare Advantage plans are based upon the fee-for-service rates set forth in the Medicare Physician Fee Schedule, which relies, in part, on a target-setting formula system called the SGR. Each year, on January 1st, the Medicare program updates the Medicare Physician Fee Schedule reimbursement rates. Many private payors use the Medicare Physician Fee Schedule to determine their own reimbursement rates. Based on the SGR, the annual fee schedule update is adjusted to reflect the comparison of actual expenditures to target expenditures. Because one of the factors for calculating the SGR is linked to the growth in the U.S. gross domestic product (“GDP”), the SGR formula may result in a negative payment update if growth in Medicare beneficiaries’ use of services exceeds GDP growth, a situation which has occurred every year since 2002 and the reoccurrence of which we cannot predict.

CMS determined that, effective January 1, 2014, the SGR formula would result in a decrease to the physician Medicare fee schedule reimbursement by 20.1%. President Obama, however, signed into law the Bipartisan Budget Act of 2013, which prevents the scheduled Medicare payment reduction from taking effect on January 1, 2014, and provides for a 0.5% increase for Medicare payments for services performed from January 1, 2014, to March 31, 2014. On March 31, 2014, Congress passed its seventeenth delay to the implementation of the SGR formula, which would have led to a 24% reduction in Medicare payments to physicians. This delay extends implementation for an additional twelve months, during which time Congress hopes to be able to pass a more permanent solution to the SGR formula.

While Congress has repeatedly intervened to mitigate the negative reimbursement impact associated with the SGR formula, there is no guarantee that Congress will continue to do so in the future. Moreover, the existing methodology may result in significant yearly fluctuations in the Medicare Physician Fee Schedule amounts, which may be unrelated to changes in the actual costs of providing physician services. Unless Congress enacts a change to the SGR methodology, the uncertainty regarding reimbursement rates and fluctuation will continue to exist. Moreover, if Congress does change the SGR methodology or substitute a new system for physician fee-for-service payments, it may require reductions in other Medicare programs including Medicare Advantage to offset such additional costs.

On December 10, 2013, CMS's final rule for Medicare Hospital Outpatient Prospective Payment System (HOPPS) for FY 2014 was published in the Federal Register. CMS will use FY 2011 cost data to establish separate cost centers for CT and MRI, distinctly separate from the diagnostic radiology cost center for pricing out payments for CTs and MRIs in the inpatient setting separately from the radiology cost center. Such a change could have a significant adverse impact on the level of reimbursement that we receive from Medicare for such services.

**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 included herein.

41

**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 12, 2014 By: /s/ Howard G. Berger, M.D.  
Howard G. Berger, M.D.  
President and Chief Executive Officer  
(Principal Executive Officer)

Date: May 12, 2014 By: /s/ Mark D. Stolper  
Mark D. Stolper  
Chief Financial Officer  
(Principal Financial and Accounting Officer)

**INDEX TO EXHIBITS**

| <b><u>Exhibit<br/>Number</u></b> | <b><u>Description</u></b>   |
|----------------------------------|---|
| 4.1                              | Supplemental Indenture, dated as of March 21, 2014, among RadNet, Inc., RadNet Management, Inc., the Guarantors (as defined therein) and U.S. Bank National Association, as trustee (incorporated by reference to exhibit filed with Form 8-K on March 25, 2014).   |
| 10.1                             | Second Amendment Agreement dated March 25, 2014 to the Credit and Guaranty Agreement, dated as of October 10, 2012 (as amended, by the First Amendment Agreement, dated as of April 3, 2013), by and among RadNet, Inc., Radnet Management, Inc., certain subsidiaries and affiliates of Radnet Management, Inc., certain lenders identified therein, and Barclays Bank PLC, as administrative agent and collateral agent (incorporated by reference to exhibit filed with Form 8-K on March 31, 2014). |
| 10.2                             | Second Lien Credit and Guaranty Agreement, dated as of March 25, 2014, by and among Radnet Management, Inc., RadNet, Inc., certain subsidiaries and affiliates of Radnet Management, Inc., the lenders party thereto from time to time, certain other financial institutions and Barclays Bank PLC, as administrative agent and collateral agent (incorporated by reference to exhibit filed with Form 8-K on March 31, 2014).  |
| 10.3                             | Second Lien Pledge and Security Agreement, dated as of March 25, 2014, by and among Radnet Management, Inc., the Grantors identified therein, and Barclays Bank PLC, as collateral agent (incorporated by reference to exhibit filed with Form 8-K on March 31, 2014).  |
| 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 Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of The Sarbanes-Oxley Act of 2002 of Howard G. Berger, M.D.  |
| 32.2*                            | Certification Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of The Sarbanes-Oxley Act of 2002 of Mark D. Stolper.  |
| 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 Incentive 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.