

RadNet, Inc.
Form 10-Q
November 13, 2013

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 September 30, 2013

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

13-3326724

(State or other jurisdiction of
Incorporation or organization) (I.R.S. Employer
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 November 5, 2013, was 40,089,196 shares.

RADNET, INC.

INDEX

	<u>Page</u>
PART I – FINANCIAL INFORMATION	
ITEM 1. Condensed Consolidated Financial Statements (unaudited)	
Condensed Consolidated Balance Sheets at September 30, 2013 and December 31, 2012	3
Condensed Consolidated Statements of Operations for the Three and Nine Months ended September 30, 2013 and 2012	4
Condensed Consolidated Statements of Comprehensive (Loss) Income for the Three and Nine Months ended September 30, 2013 and 2012	5
Condensed Consolidated Statement of Equity (Deficit) for the Nine Months ended September 30, 2013	6
Condensed Consolidated Statements of Cash Flows for the Nine Months Ended September 30, 2013 and 2012	7
Notes to Condensed Consolidated Financial Statements	9
ITEM 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations	31
ITEM 3. Quantitative and Qualitative Disclosures About Market Risk	46
ITEM 4. Controls and Procedures	47
PART II – OTHER INFORMATION	
ITEM 1. Legal Proceedings	48
ITEM 1A. Risk Factors	48
ITEM 2. Unregistered Sales of Equity Securities and Use of Proceeds	49
ITEM 3. Defaults Upon Senior Securities	49
ITEM 4. Mine Safety Disclosures	49
ITEM 5. Other Information	49

ITEM 6. Exhibits	49
SIGNATURES	50
INDEX TO EXHIBITS	51

PART I - FINANCIAL INFORMATION

RADNET, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

(IN THOUSANDS EXCEPT SHARE DATA)

	September 30, 2013 (unaudited)	December 31, 2012 (Restated)
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	\$ 268	\$ 362
Accounts receivable, net	134,265	129,194
Current portion of deferred tax assets	5,888	7,607
Prepaid expenses and other current assets	17,803	18,737
Total current assets	158,224	155,900
PROPERTY AND EQUIPMENT, NET	217,383	216,560
OTHER ASSETS		
Goodwill	196,090	193,871
Other intangible assets	50,808	51,674
Deferred financing costs	10,600	11,977
Investment in joint ventures	28,610	28,598
Deferred tax assets, net of current portion	49,679	48,535
Deposits and other	3,738	3,749
Total assets	\$ 715,132	\$ 710,864
LIABILITIES AND STOCKHOLDERS' EQUITY (DEFICIT)		
CURRENT LIABILITIES		
Accounts payable, accrued expenses and other	\$ 99,765	\$ 106,357
Due to affiliates	1,273	1,602
Deferred revenue	1,448	1,273
Current portion of deferred rent	1,448	1,164
Current portion of notes payable	5,431	4,703
Current portion of obligations under capital leases	2,071	3,942
Total current liabilities	111,436	119,041

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

LONG-TERM LIABILITIES

Deferred rent, net of current portion	18,459	15,850
Line of credit	3,400	33,000
Notes payable, net of current portion	571,082	537,009
Obligations under capital lease, net of current portion	2,523	3,753
Other non-current liabilities	7,870	8,895
Total liabilities	714,770	717,548

STOCKHOLDERS' EQUITY (DEFICIT)

Common stock - \$.0001 par value, 200,000,000 shares authorized; 40,089,196, and 38,540,482 shares issued and outstanding at September 30, 2013 and December 31, 2012, respectively	4	4
Paid-in-capital	173,130	168,415
Accumulated other comprehensive (loss) income	(65)	39
Accumulated deficit	(174,899)	(175,776)
Total RadNet, Inc.'s stockholders' equity (deficit)	(1,830)	(7,318)
Noncontrolling interests	2,192	634
Total stockholders' equity (deficit)	362	(6,684)
Total liabilities and stockholders' equity (deficit)	\$ 715,132	\$ 710,864

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

RADNET, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF OPERATION

(IN THOUSANDS EXCEPT SHARE DATA)

(unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
NET REVENUE				
Service fee revenue, net of contractual allowances and discounts	\$ 165,373	\$ 152,381	\$ 496,424	\$ 463,733
Provision for bad debts	(7,033	) (6,574	) (20,810	) (19,453
Net service fee revenue	158,340	145,807	475,614	444,280
Revenue under capitation arrangements	16,848	14,646	49,034	43,540
Total net revenue	175,188	160,453	524,648	487,820
OPERATING EXPENSES				
Cost of operations, excluding depreciation and amortization	151,770	133,223	450,030	405,177
Depreciation and amortization	14,762	13,369	44,050	43,154
(Gain) loss on sale and disposal of equipment	(5	) (45	) 357	255
Severance costs	72	66	312	678
Total operating expenses	166,599	146,613	494,749	449,264
INCOME FROM OPERATIONS	8,589	13,840	29,899	38,556
OTHER EXPENSES				
Interest expense	11,052	13,875	34,542	40,917
Equity in earnings of joint ventures	(1,617	) (909	) (4,481	) (4,157
Gain on sale of imaging centers	–	–	(2,108) –
Gain on de-consolidation of joint venture	–	(2,777	) –	(2,777
Other expense (income)	4	(1,360	) 152	(3,851
Total other expenses	9,439	8,829	28,105	30,132
(LOSS) INCOME BEFORE INCOME TAXES	(850	) 5,011	1,794	8,424
Provision for income taxes	483	(30	) (766	) (696
NET (LOSS) INCOME	(367	) 4,981	1,028	7,728
Net income (loss) attributable to noncontrolling interests	100	(72	) 151	(160
NET (LOSS) INCOME ATTRIBUTABLE TO RADNET, INC. COMMON STOCKHOLDERS	\$(467	) \$5,053	\$877	\$7,888

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

BASIC NET (LOSS) INCOME PER SHARE				
ATTRIBUTABLE TO RADNET, INC. COMMON STOCKHOLDERS	\$ (0.01	) \$ 0.13	\$ 0.02	\$ 0.21
DILUTED NET (LOSS) INCOME PER SHARE				
ATTRIBUTABLE TO RADNET, INC. COMMON STOCKHOLDERS	\$ (0.01	) \$ 0.13	\$ 0.02	\$ 0.20
WEIGHTED AVERAGE SHARES OUTSTANDING				
Basic	39,235,863	38,340,482	39,105,522	37,737,467
Diluted	39,235,863	39,860,685	39,886,140	39,244,299

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

RADNET, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE (LOSS) INCOME

(in thousands)

(unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
NET (LOSS) INCOME	\$(367)	\$4,981	\$1,028	\$7,728
Foreign currency translation adjustments	13	36	(104)	62
Reclassification of net cash flow hedge losses included in net income during the period	-	276	-	827
COMPREHENSIVE (LOSS) INCOME	(354)	5,293	924	8,617
Less comprehensive income (loss) attributable to non-controlling interests	100	(72)	151	(160)
COMPREHENSIVE (LOSS) INCOME ATTRIBUTIBLE TO RADNET, INC. COMMON STOCKHOLDERS	\$(454)	\$5,365	\$773	\$8,777

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

RADNET, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENT OF EQUITY (DEFICIT)

(IN THOUSANDS EXCEPT SHARE DATA)

(unaudited)

	Common Stock	Paid-in	Accumulated	Accumulated	Total	Noncontrolling	Total	
	Shares	Amount	Capital	Deficit	Other Comprehensive Income (loss)	Interests	Equity (Deficit)	
BALANCE - JANUARY 1, 2013 (Restated)	38,540,482	\$ 4	\$ 168,415	\$(175,776)	\$ 39	\$(7,318)	\$ 634	\$(6,684)
Issuance of common stock upon exercise of options/warrants	898,714	—	469	—	—	469	—	469
Stock-based compensation	—	—	2,045	—	—	2,045	—	2,045
Issuance of restricted stock	650,000	—	—	—	—	—	—	—
Sale of a noncontrolling interest in one of our consolidated joint ventures	—	—	2,201	—	—	2,201	439	2,640
Purchase of a controlling interest in a joint venture	—	—	—	—	—	—	979	979
Dividends paid to noncontrolling interests	—	—	—	—	—	—	(11)	(11)
Change in cumulative foreign currency translation adjustment	—	—	—	—	(104)	(104)	—	(104)
Net income	—	—	—	877	—	877	151	1,028
BALANCE - September 30, 2013	40,089,196	\$ 4	\$ 173,130	\$(174,899)	\$ (65)	\$(1,830)	\$ 2,192	\$ 362

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

RADNET, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (IN THOUSANDS)

(unaudited)

	Nine Months Ended September 30,	
	2013	2012
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	\$1,028	\$7,728
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	44,050	43,154
Provision for bad debt	20,810	19,453
Equity in earnings of joint ventures	(4,481)	(4,157)
Distributions from joint ventures	5,624	5,526
Deferred rent amortization	2,893	2,990
Amortization of deferred financing cost	1,676	1,803
Amortization of bond and term loan discount	1,651	706
Loss on sale and disposal of equipment	357	255
Gain on sale of imaging centers	(2,108)	-
Gain on de-consolidation of joint venture	-	(2,777)
Amortization of cash flow hedge	-	827
Stock-based compensation	2,045	2,139
Changes in operating assets and liabilities, net of assets acquired and liabilities assumed in purchase transactions:		
Accounts receivable	(25,096)	(18,362)
Other current assets	(1,504)	(433)
Other assets	172	(51)
Deferred taxes	575	-
Deferred revenue	175	72
Accounts payable, accrued expenses and other	(5,357)	(3,255)
Net cash provided by operating activities	42,510	55,618
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchase of imaging facilities	(5,918)	(10,617)
Purchase of property and equipment	(39,921)	(35,279)
Proceeds from sale of equipment	510	841
Proceeds from sale of imaging facilities	3,920	2,300
Proceeds from sale of joint venture interests	2,640	1,800
Purchase of equity interest in joint ventures	(1,803)	(2,756)
Net cash used in investing activities	(40,572)	(43,711)

CASH FLOWS FROM FINANCING ACTIVITIES

Principal payments on notes and leases payable	(7,476)	(11,180)
Deferred financing costs	(432)	–
Proceeds from borrowings upon refinancing	35,122	–
Net (payments on) proceeds from line of credit	(29,600)	1,800
Payments to counterparties of interest rate swaps, net of amounts received	–	(4,587)
Distributions to noncontrolling interests	(11)	(67)
Proceeds from issuance of common stock upon exercise of options/warrants	469	–
Net cash used in financing activities	(1,928)	(14,034)

EFFECT OF EXCHANGE RATE CHANGES ON CASH

(104) 60

NET DECREASE IN CASH AND CASH EQUIVALENTS

(94) (2,067)

CASH AND CASH EQUIVALENTS, beginning of period

362 2,455

CASH AND CASH EQUIVALENTS, end of period

\$268 \$388

SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION

Cash paid during the period for interest \$26,614 \$32,074

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 \$11.3 million and \$13.2 million during the nine months ended September 30, 2013 and 2012, respectively, that we had not paid for as of September 30, 2013 and 2012, respectively. The offsetting amount due was recorded in our consolidated balance sheet under accounts payable and accrued expenses.

Detail of investing activity related to acquisitions can be found in Note 2.

RADNET, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

NOTE 1 – NATURE OF BUSINESS AND BASIS OF PRESENTATION

At September 30, 2013, we operated directly or indirectly through joint ventures, 251 centers located in California, Maryland, Florida, Delaware, New Jersey, Rhode Island and New York. 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. 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 13.5% 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 also owns a controlling interest in three medical groups ("Crues Entities") which provide professional medical services at our imaging facilities located in New York, New York, two of which we acquired as part of our December 31, 2012 acquisition of Lenox Hill and one in connection with our August 1, 2013 acquisition of Manhattan Diagnostic Radiology.

RadNet provides non-medical, technical and administrative services to BRMG and the Crues 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 Crues Entities. Through our management agreements with BRMG and the Crues Entities, we determine the annual budget of BRMG and the Crues Entities and make all physician employment decisions. BRMG and the Crues Entities both have insignificant operating assets and liabilities, and de minimis equity. Through the management agreements with us, all cash flows of both BRMG and the Crues Entities are transferred to us.

We have determined that BRMG and the Crues Entities are variable interest entities, and that we are the primary beneficiary, and consequently, we consolidate the revenue, expenses, assets and liabilities of each. BRMG and the Crues Entities on a combined basis recognized \$24.7 million and \$15.0 million of revenue, net of management service fees to RadNet, Inc., for the three months ended September 30, 2013 and 2012, respectively, and \$24.7 million and \$15.0 million of operating expenses for the three months ended September 30, 2013 and 2012, respectively. RadNet, Inc. recognized in its condensed consolidated statement of operations \$98.3 million and \$68.0 million of total billed net service fee revenue relating to these VIE's for the three months ended September 30, 2013 and 2012, respectively, of which \$73.6 million and \$53.0 million was for management services provided to BRMG and the Crues Entities relating primarily to the technical portion of total billed net service fee revenue for the three months ended September 30, 2013 and 2012, respectively.

BRMG and the Crues Entities combined recognized \$58.2 million and \$41.4 million of revenue, net of management service fees to RadNet, Inc., for the nine months ended September 30, 2013 and 2012, respectively, and \$58.2 million and \$41.4 million of operating expenses for the nine months ended September 30, 2013 and 2012, respectively. RadNet, Inc. recognized in its condensed consolidated statement of operations \$256.6 million and \$198.0 million of total billed net service fee revenue relating to these VIE's for the nine months ended September 30, 2013 and 2012, respectively, of which \$198.4 million and \$156.6 million was for management services provided to BRMG and the Crues Entities relating primarily to the technical portion of total billed net service fee revenue for the nine months ended September 30, 2013 and 2012, respectively.

The cash flows of BRMG and the Crues 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 September 30, 2013 and December 31, 2012, we have included approximately \$62.7 million and \$51.8 million, respectively, of accounts receivable and approximately \$11.4 million and \$6.3 million, respectively, of accounts payable and accrued liabilities, related to BRMG and the Crues Entities combined.

The creditors of both BRMG and the Crues 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 Crues Entities. However, both BRMG and the Crues 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 centers in California and New York City where we contract with BRMG and the Crues Entities, respectively, for the provision of professional medical services, at the remaining centers in California and at all of the centers which are located outside of California except for New York City, we have entered into long-term contracts with independent radiology groups in the area to provide physician services at those facilities. These third party radiology practices provide professional services, including supervision and interpretation of diagnostic imaging procedures, in our diagnostic imaging centers. The radiology practices maintain full control over the provision of professional services. 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-Cruces 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 September 30, 2013 and 2012 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/A for the year ended December 31, 2012 filed on November 13, 2013, as amended.

Significant Accounting Policies

As of 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, 2012 as amended. . The information below is intended only to supplement the disclosure in our annual report on Form 10-K for the fiscal year ended December 31, 2012 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 Crues Entities, this service fee revenue includes payments for both the professional medical interpretation revenue recognized by BRMG and the Crues 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 Crues Entities. As it relates to non-BRMG and Crues 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 Crues 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 which we are obligated to provide services to plan enrollees under contracts with various health plans.

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

Our revenue, net of contractual allowances, discounts and provision for bad debts for the three and nine months ended September 30, 2013 and 2012 are summarized in the following table (in thousands):

	Three Months Ended		Nine Months Ended	
	September 30, 2013	2012	September 30, 2013	2012
Commercial Insurance	\$ 102,672	\$ 93,967	\$ 305,194	\$ 286,615
Medicare	37,811	35,523	111,952	106,259
Medicaid	5,798	5,495	18,503	17,431
Workers Compensation/Personal Injury	8,462	7,242	28,234	22,860
Other	3,597	3,579	11,732	11,116
Service fee revenue, net of contractual allowances/discounts/bad debt	158,340	145,807	475,613	444,281
Revenue under capitation arrangements	16,848	14,646	49,034	43,540
Total net revenue	\$ 175,188	\$ 160,453	\$ 524,647	\$ 487,821

The break-out of our service fee revenue, net of contractual allowances and discounts, is calculated based upon the aggregate payments received from all consolidated imaging centers from dates of service during each respective period illustrated.

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.

Liquidity and Capital Resources

We had cash and cash equivalents of \$268,000 and accounts receivable of \$134.3 million at September 30, 2013, compared to cash and cash equivalents of \$362,000 and accounts receivable of \$129.2 million at December 31, 2012. We had a working capital balance of \$46.8 million and \$36.9 million at September 30, 2013 and December 31, 2012,

respectively. We had net income attributable to RadNet, Inc. common stockholders for the nine months ended September 30, 2013 and 2012 of \$877,000 and \$7.9 million, respectively. We also had stockholders' equity (deficit) of \$362,000 and (\$6.7 million) at September 30, 2013 and December 31, 2012, 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. However, we have no formal plan of doing so at this time.

Included in our condensed consolidated balance sheet at September 30, 2013 are \$198.3 million of senior notes (net of unamortized discounts of \$1.7 million), \$375.3 million of senior secured term loan debt (net of unamortized discounts of \$11.0 million) and \$3.4 million aggregate principal amount outstanding under the revolving credit facility.

The following describes our most recent financing activities:

2010 Credit Agreement

On April 6, 2010, we completed a series of transactions which we refer to as our “debt refinancing plan” for an aggregate of \$585.0 million. As part of the debt refinancing plan, our wholly owned subsidiary, Radnet Management, Inc., issued and sold \$200.0 million in 10 3/8% senior unsecured notes due 2018 (the “senior notes”). All payments of the senior notes, including principal and interest, are 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 agreement dated April 6, 2010 (the “Indenture”), by and among Radnet Management, as issuer, RadNet, Inc., as parent guarantor, the subsidiary guarantors thereof and U.S. Bank National Association, as trustee, in a private placement that was not subject to the registration requirements of the Securities Act of 1933, as amended (the “Securities Act”). The senior notes initially issued on April 6, 2010 in a private placement were subsequently publicly offered for exchange enabling holders of the outstanding senior notes to exchange the outstanding notes for publicly registered exchange notes with nearly identical terms. The exchange offer was completed on February 14, 2011.

In addition to the issuance of senior notes, Radnet Management entered into a Credit and Guaranty Agreement with a syndicate of lenders (the “Credit Agreement”), whereby Radnet Management obtained \$385.0 million in senior secured first-lien bank financing, consisting of (i) a \$285.0 million, six-year term loan facility and (ii) a \$100.0 million, five-year revolving credit facility, including a swing line subfacility and a letter of credit subfacility (collectively, the “Credit Facilities”).

Radnet Management’s obligations under the Credit Agreement were unconditionally guaranteed by RadNet, Inc., all of Radnet Management’s current and future domestic subsidiaries as well as certain affiliates, including Beverly Radiology Medical Group III and its equity holders (Beverly Radiology Medical Group, Inc., BreastLink Medical Group, Inc. and ProNet Imaging Medical Group, Inc.). The Credit Facilities created by the Credit Agreement were secured by a perfected first-priority security interest in all of Radnet Management’s and the guarantors’ tangible and intangible assets, including, but not limited to, pledges of equity interests of Radnet Management and all of our current and future domestic subsidiaries.

2012 Refinancing

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

The termination date for the \$350 million term loan is the earliest to occur of (i) the sixth anniversary of the closing date (October 10, 2012), (ii) the date on which all of the term loans shall become due and payable in full under the Refinance Agreement whether by acceleration or otherwise and (iii) October 1, 2017 if our senior notes due 2018 have not been refinanced by such date. The termination date for the \$101.25 million revolving credit facility is the earliest to occur of (i) the fifth anniversary of the closing date, (ii) the date the revolving credit facility is permanently reduced to zero pursuant to section 2.13(b) of the Refinance Agreement, (iii) the date of the termination of the revolving credit facility pursuant to section 8.01 of the Refinance Agreement and (iv) October 1, 2017 if our senior notes due 2018 have not been refinanced by such date.

In connection with the refinancing of the Credit Facilities in 2012, Radnet Management used the net proceeds to repay in full its existing six year term loan facility for \$277.9 million in principal amount outstanding, which would have matured on April 6, 2016, and its revolving credit facility for \$59.8 million in principal amount outstanding, which would have matured on April 6, 2015.

Refinance Agreement

Interest. The Refinance Agreement bears interest through maturity at a rate determined by adding the applicable margin to either (a) the Base Rate, which is defined in the Refinance Agreement as the highest of (i) the prime rate quoted in the Wall Street Journal, (ii) the rate which is 0.5% in excess of the federal funds rate, (iii) (with respect to term loans only) 2.25% and (iv) 1.00% in excess of the one-month Adjusted Eurodollar Rate at such time, or (b) the Adjusted Eurodollar Rate, which is defined in the Refinance Agreement as the higher of (i) the London interbank offered rate, adjusted for statutory reserve requirements, for the respective interest period, as determined by the administrative agent and (ii) (with respect to term loans only) 1.25%. As used in the Refinance Agreement, applicable margin means (i) (a) with respect to term loans that are Eurodollar Rate Loans, 4.25% per annum and (b) with respect to term loans that are Base Rate Loans, 3.25% per annum; and (ii) (a) with respect to revolving loans that are Eurodollar Rate Loans, 4.25% per annum and (b) with respect to revolving loans and swing line loans that are Base Rate Loans, 3.25% per annum.

Payments. Commencing on December 31, 2012 we began making quarterly amortization payments on the term loan facility under the Refinance Agreement, each in the amount of \$875,000, with the remaining principal balance to be paid at maturity. Under the Refinance Agreement, we are also required to make mandatory prepayments, subject to specified exceptions, from consolidated excess cash flow, and upon certain events, including, but not limited to, (i) the receipt of net cash proceeds from the sale or other disposition of any property or assets by us or any of our subsidiaries, (ii) the receipt of net cash proceeds from insurance or condemnation proceeds paid on account of any loss of any property or assets of us or any of our subsidiaries, and (iii) the receipt of net cash proceeds from the incurrence of indebtedness by us or any of our subsidiaries (other than certain indebtedness otherwise permitted under the Refinance Agreement).

Guarantees and Collateral. The obligations under the Refinance Agreement are guaranteed by us, all of our current and future domestic subsidiaries and certain of our affiliates. The obligations under the Refinance Agreement and the guarantees are secured by a perfected first priority security interest in all of Radnet Management's and the guarantors' tangible and intangible assets, including, but not limited to, pledges of equity interests of Radnet Management and all of our current and future domestic subsidiaries.

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

Financial Covenants. The Refinance 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 Refinance Agreement include failure to pay principal or interest when due, a material breach of any representation or warranty contained in the loan documents, covenant defaults, events of bankruptcy and a change of control. The occurrence of an event of default could permit the lenders under the Refinance Agreement to declare all amounts borrowed, together with accrued interest and fees, to be immediately due and payable and to exercise other default remedies.

2013 Amendment to the Refinance Agreement

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

The amendment provides for the following:

Interest. The interest rate spread over LIBOR for the senior secured term loans was reduced from 4.25% to 3.25% and the interest rate spread over the alternative base rate for the senior secured term loans was reduced from 3.25% to 2.25%. The minimum LIBOR rate underlying the senior secured term loans was reduced from 1.25% to 1.0%. The minimum alternative base rate was reduced from 2.25% to 2.0%. On a same principal basis of \$348.3 million, the rate changes listed above will result in a reduction of interest expense by approximately \$19.9 million over the same financing period of the 2012 Refinance Agreement.

Payments. Commencing on June 28, 2013, we began making quarterly amortization payments on the term loan facility under the amendment in the amount of \$975,000, with the remaining principal balance to be paid at maturity.

The other material terms of the amendment remain unchanged compared to the Refinance Agreement, as described above under the heading “2012 Refinancing.”

Senior Notes

On April 6, 2010, we issued \$200 million in aggregate amount of unsecured senior notes which have a coupon of 10.375% and were issued at a price of 98.680%. The senior notes were issued by Radnet Management, Inc. and guaranteed jointly and severally on a senior unsecured basis by us and all of our current and future wholly-owned domestic restricted subsidiaries. The senior notes were offered and sold in a private placement exempt from registration under the Securities Act to qualified institutional buyers pursuant to Rule 144A and Regulation S under the Securities Act. We pay interest on the senior notes on April 1 and October 1, commencing October 1, 2010, and they will expire on April 1, 2018. The senior notes are governed under the Indenture. Under the terms of the Indenture, we agreed to file a registration statement with the SEC relating to an offer to exchange the senior notes for registered publicly tradable notes that have substantially identical terms as the senior notes. On August 30, 2010, we filed a registration statement on Form S-4 with the SEC relating to the offer to exchange the senior notes. On January 13, 2011, our registration statement was declared effective by the SEC. On February 14, 2011, we completed an exchange offer whereby all senior notes were exchanged for registered publicly tradable notes.

Ranking. The senior notes and the guarantees:

- rank equally in right of payment with any existing and future unsecured senior indebtedness of the guarantors;
- rank senior in right of payment to all existing and future subordinated indebtedness of the guarantors;
- are effectively subordinated in right of payment to any secured indebtedness of the guarantors (including indebtedness under the Refinance Agreement) to the extent of the value of the assets securing such indebtedness; and
- are structurally subordinated in right of payment to all existing and future indebtedness and other liabilities of any of the Company’s subsidiaries that is not a guarantor of the senior notes.

Optional Redemption. Radnet Management may 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, 2013, Radnet Management may redeem up to 35% of aggregate principal amount of the senior notes issued under the Indenture from the net proceeds of one or more equity offerings at a redemption price equal to 110.375% of the senior notes redeemed, plus accrued and unpaid interest, if any. Radnet Management is also permitted to redeem the senior notes prior to April 1, 2014, in whole or in part, at a redemption price equal to 100% of the principal amount redeemed, plus a make-whole premium and accrued and unpaid interest, if any.

Change of Control and Asset Sales. If a change in control of Radnet Management occurs, Radnet Management must give holders of the senior notes the opportunity to sell their senior notes at 101% of their face amount, plus accrued interest. If we or one of our restricted subsidiaries sells assets under certain circumstances, Radnet Management will be required to make an offer to purchase the senior notes at their face amount, plus accrued and unpaid interest to the purchase date.

Restrictive Covenants. The Indenture contains covenants that limit, among other things, the ability of us and our restricted subsidiaries, to:

- pay dividends or make certain other restricted payments or investments;
- incur additional indebtedness and issue preferred stock;
 - create liens (other than permitted liens) securing indebtedness or trade payables unless the notes are secured on an equal and ratable basis with the obligations so secured, and, if such liens secure subordinated indebtedness, the notes are secured by a lien senior to such liens;
- sell certain assets or merge with or into other companies or otherwise dispose of all or substantially all of our assets;
- enter into certain transactions with affiliates;
- create restrictions on dividends or other payments by our restricted subsidiaries; and
- create guarantees of indebtedness by restricted subsidiaries.

However, these limitations are subject to a number of important qualifications and exceptions, as described in the Indenture. As of September 30, 2013, we were in compliance with all covenants.

NOTE 1A – RESTATEMENT

On November 13, 2013, the Company amended its Annual Report on Form 10-K as of and for the year ended December 31, 2012. The Company is also restating herein its previously issued consolidated balance sheet as of December 31, 2012 to correct an error in its accounting for income taxes.

In the fourth quarter of 2012, the Company recorded a benefit from income taxes of approximately \$60.4 million primarily resulting from the release of a valuation allowance against its deferred tax assets. In November 2013, during a review of the Company's work papers supporting its deferred tax assets, management discovered an error in the historical tax treatment of certain mark-to-market adjustments recorded in relation to its interest rate swaps, dating back as far as 2009. This error caused the Company's deferred tax assets to be overstated by approximately \$4.3 million and unrecognized tax benefit liability (included in accounts payable, accrued expenses and other) to be understated by approximately \$0.4 million at December 31, 2012. Periods prior to the fourth quarter of 2012 were not significantly impacted by the overstatement as the Company had a valuation allowance established against the overstated deferred tax assets.

To correct the income tax benefit overstatement described above, the Company restated the following line items in its financial statements:

	As Previously Reported	Restatement Adjustments	As Restated
As of and for the year ended December 31, 2012			
Current portion of deferred tax assets	\$ 7,607	\$ –	\$ 7,607
Deferred tax assets, net of current portion	52,790	(4,255)	48,535
Total deferred tax assets	60,397	(4,255)	56,142
Total Assets	715,119	(4,255)	710,864
Accounts payable, accrued expenses and other	105,929	428	106,357
Total current liabilities	118,613	428	119,041
Total liabilities	717,120	428	717,548
Accumulated deficit	(171,093)	(4,683)	(175,776)
Total stockholders' deficit	(2,001)	(4,683)	(6,684)

NOTE 2 – FACILITY ACQUISITIONS & DISPOSITIONS

On August 1, 2013, we completed our acquisition of Manhattan Diagnostic Radiology consisting of two multi-modality imaging centers located in New York, New York, for cash consideration of \$507,000 and the settlement of approximately \$1.8 million of equipment leases. The facilities provide MRI, CT, mammography, ultrasound and X-ray services. We have made a fair value determination of the acquired assets and assumed liabilities and approximately \$2.0 million of fixed assets, \$150,000 of other intangible assets and \$161,000 of other assets were recorded with respect to this transaction.

On May 1, 2013, we acquired a 40% equity interest in Orange County Radiation Oncology, LLC, a Radiation Oncology Center located in Orange County, California for cash consideration of \$1.0 million. As of May 1, 2013 we have accounted for this investment under the equity method.

On April 1, 2013, we sold one of our wholly-owned multi-modality imaging centers located in Northfield, New Jersey for \$3.9 million in cash. The net book value associated with the imaging center was \$1.8 million on the date of sale and accordingly a gain of \$2.1 million was recorded with respect to this transaction.

On February 28, 2013, we completed our acquisition of a multi-modality imaging center located in Brooklyn, New York by exercising a \$1.00 purchase option to acquire an initial 50% interest (we acquired this option through our December 31, 2012 acquisition of Lenox Hill Radiology which we valued at approximately \$2.5 million) and then by purchasing the remaining 50% interest from the existing partner for approximately \$2.4 million in cash. We have made a fair value determination of the acquired assets and assumed liabilities and approximately \$813,000 of fixed assets, \$4.2 million of goodwill and \$124,000 of notes payable was recorded with respect to this transaction.

On February 8, 2013, we completed the acquisition of a multi-modality imaging center located in New York, New York for \$1.0 million. The facility provides MRI, CT, mammography, ultrasound and X-ray services. We have made a fair value determination of the acquired assets and assumed liabilities and approximately \$1.0 million of fixed assets was recorded with respect to this transaction.

On February 5, 2013, we sold a 10% interest in a wholly owned limited liability company consisting of two multi-modality imaging centers located in Bel Air, Maryland for approximately \$2.6 million. On the date of sale, we recorded approximately \$439,000 of non-controlling interests and \$2.2 million of additional paid in capital with respect to this transaction.

On January 30, 2013, we purchased for \$430,000 an additional 20.9% interest in a joint venture multi-modality imaging center located in New York, New York of which we initially held a 31.5% interest from our December 31, 2012 acquisition of Lenox Hill Radiology which we valued at approximately \$648,000. This additional 20.9% interest gave us a 52.4% controlling interest and so accordingly, we began consolidating this imaging center, recording all of its assets and liabilities at their fair value at January 30, 2013. We have made a fair value determination of the acquired assets and assumed liabilities and approximately \$358,000 of working capital, \$2.1 million of fixed assets, \$2.0 million of goodwill, \$2.4 million of notes payable and \$979,000 of non-controlling interests was recorded with respect to this transaction.

On January 1, 2013, we completed our acquisition of a breast surgery practice located in Mission Viejo, California for \$350,000. We have made a fair value determination of the acquired assets and assumed liabilities and approximately \$135,000 of working capital, \$30,000 of fixed assets and \$185,000 of goodwill was recorded with respect to this transaction.

On December 31, 2012, we completed our acquisition of Lenox Hill Radiology, consisting of three multi-modality imaging centers as well as three additional x-ray facilities all located in New York, New York. We also acquired in this transaction a 31.5% interest in a joint venture multi-modality imaging center in New York, New York and an option to purchase a 50% interest in a multi-modality imaging center located in Brooklyn, New York for \$1.00. The purchase price consisted of approximately \$28.4 million in cash. In the first quarter of 2013, with the services of an external valuation expert, we made a final fair value determination of the acquired assets and assumed liabilities and \$4.5 million of working capital, \$8.7 million of fixed assets, which is approximately \$1.5 million higher than our initial estimate, \$648,000 of joint venture interests, \$2.5 million in a \$1.00 joint venture purchase option, \$100,000 of intangible assets, \$14.0 million of goodwill and indefinite life intangibles which is approximately \$1.3 million lower than our initial estimate, the assumption of approximately \$650,000 of other liabilities, which is approximately \$150,000 higher than our initial estimate, and \$1.3 million of capital lease debt was recorded with respect to this transaction.

NOTE 3 – RECENT ACCOUNTING STANDARDS

Presentation of Unrecognized Tax Benefits. 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 is effective for annual and interim periods beginning after December 15, 2013. The Company does not expect the adoption of the standard to have a material effect on its statements of financial position, results of operations or cash flow.

Reclassifications Out of Accumulated Other Comprehensive Income. In February 2013, the Financial Accounting Standards Board (FASB) issued guidance for the reporting of amounts reclassified out of accumulated other comprehensive income. The new guidance requires entities to report the effect of significant reclassifications out of accumulated other comprehensive income on the respective line items in net income if the amount being reclassified is required under U.S. generally accepted accounting principles (GAAP) to be reclassified in its entirety to net income. The new guidance does not change the current requirements for reporting net income or other comprehensive income in financial statements and is effective prospectively for reporting periods beginning after December 15, 2012. The adoption of this new guidance in 2013 did not impact our financial position, results of operations or cash flows.

Balance Sheet Offsetting. In December 2012, the FASB issued guidance for new disclosure requirements related to the nature of an entity’s rights of set-off and related arrangements associated with its financial instruments and derivative instruments. The new guidance is effective for annual reporting periods, and interim periods within those years, beginning on or after January 1, 2013. The adoption of this new guidance in 2013 did not impact our financial position, results of operations or cash flows.

NOTE 4 – EARNINGS PER SHARE

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
Net (loss) income attributable to RadNet, Inc.'s common stockholders	\$(467	) \$5,053	\$877	\$7,888
BASIC NET (LOSS) INCOME PER SHARE ATTRIBUTABLE TO RADNET, INC.'S COMMON STOCKHOLDERS				
Weighted average number of common shares outstanding during the period	39,235,863	38,340,482	39,105,522	37,737,467
Basic net (loss) income per share attributable to RadNet, Inc.'s common stockholders	\$(0.01	) \$0.13	\$0.02	\$0.21
DILUTED NET (LOSS) INCOME PER SHARE ATTRIBUTABLE TO RADNET, INC.'S COMMON STOCKHOLDERS				
Weighted average number of common shares outstanding during the period	39,235,863	38,340,482	39,105,522	37,737,467
Add nonvested restricted stock subject only to service vesting	–	560,000	311,419	516,655
Add additional shares issuable upon exercise of stock options and warrants	–	960,203	469,199	990,177
Weighted average number of common shares used in calculating diluted net income per share	39,235,863	39,860,685	39,886,140	39,244,299
Diluted net (loss) income per share attributable to RadNet, Inc.'s common stockholders	\$(0.01	) \$0.13	\$0.02	\$0.20

For the three months ended September 30, 2013 we excluded all options, warrants and RSA's in the calculation of diluted earnings per share because their effect would be antidilutive.

NOTE 5 – 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 nine months ended September 30, 2013 (in thousands):

Balance as of December 31, 2012	\$28,598
Acquisition of a controlling interest in a joint venture (see Note 2)	(648)
Purchase of a 40% interest in a new joint venture (see Note 2)	1,000
Equity contributions in existing joint ventures	803
Equity earnings in these joint ventures	4,481
Distribution of earnings	(5,624)
Balance as of September 30, 2013	\$28,610

We received management service fees from the centers underlying these joint ventures of approximately \$2.3 million and \$2.2 million for the three months ended September 30, 2013 and 2012, respectively, and \$7.0 million and \$5.6 million for the nine months ended September 30, 2013 and 2012, respectively, and eliminated the uncollected portion of the fees earned associated with our ownership from our net revenue with an offsetting increase to our equity earnings.

The following table is a summary of key financial data for these joint ventures as of September 30, 2013 and for the nine months ended September 30, 2013 and 2012 (in thousands):

Balance Sheet Data:	September 30, 2013
Current assets	\$ 15,521
Noncurrent assets	49,361
Current liabilities	(6,995)
Noncurrent liabilities	(6,487)
Total net assets	\$ 51,400
Book value of Radnet joint venture interests	\$ 23,222
Cost in excess of book value of acquired joint venture interests	5,059
Elimination of intercompany profit remaining on Radnet's consolidated balance sheet	329
Total value of Radnet joint venture interests	\$ 28,610
Total book value of other joint venture partner interests	\$ 28,178

Income Statement Data for the nine months ended September 30,	2013	2012
Net revenue	\$68,912	\$60,954
Net income	\$9,819	\$9,011

NOTE 6 – STOCK-BASED COMPENSATION

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 September 30, 2013, 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 September 30, 2013, 5,156,250, or approximately 93.6%, of the 5,506,250 outstanding stock options and warrants granted under our option plans are fully vested. During the nine months ended September 30, 2013, we did not grant options or warrants under the 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 September 30, 2013, 330,000, or 100%, of all the outstanding warrants outside the 2006 Plan are fully vested. During the nine months ended September 30, 2013, we did not grant warrants outside of our 2006 Plan.

The following summarizes all of our option and warrant transactions for the nine months ended September 30, 2013:

Outstanding Options and Warrants Under the 2006 Plan and 2000 Plan	Shares	Weighted Average Exercise price Per Common Share	Weighted Average Remaining Contractual Life (in years)	Aggregate Intrinsic Value
Balance, December 31, 2012	6,231,250	\$ 3.58		
Granted	—	—		
Exercised	—	—		
Canceled or expired	(725,000)	6.82		
Balance, September 30, 2013	5,506,250	3.16	1.36	\$ 391,013
Exercisable at September 30, 2013	5,156,250	3.17	1.28	391,013
Non-Plan				
Outstanding Warrants	Shares	Weighted Average Exercise price Per Common Share	Weighted Average Remaining Contractual Life (in years)	Aggregate Intrinsic Value
Balance, December 31, 2012	1,502,898	\$ 1.50		
Granted	—	—		
Exercised	(1,172,898)	1.12		
Canceled or expired	—	—		
Balance, September 30, 2013	330,000	2.87	1.35	\$—
Exercisable at September 30, 2013	330,000	2.87	1.35	—

The aggregate intrinsic value in the tables above represents the total pretax intrinsic value (the difference between our closing stock price on September 30, 2013 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 September 30, 2013. The total intrinsic value of options and warrants exercised during the nine months ended September 30, 2013 and 2012 was approximately \$2.3 million and \$265,000, respectively. As of September 30, 2013, total unrecognized stock-based compensation expense related to non-vested employee awards was approximately \$316,000, which is expected to be recognized over a weighted average period of approximately 0.7 years.

Restricted Stock Awards

The 2006 Plan permits the award of restricted stock. On January 2, 2013, we granted awards for 450,000 shares of our common stock to certain employees. Of the awards granted, 170,000 were vested on the award date, 140,000 cliff vest after one year provided that the employees remain continuously employed through the vesting date and 140,000 cliff vest after two years provided that the employees remain continuously employed through the vesting date. We valued the awards based on the closing market price of our stock on January 2, 2013 which was \$2.51 per share. On April 1, 2013, we granted an award for 200,000 shares of our common stock to an affiliated physician who provides services to the Company. Of this award granted, 40,000 was vested on the award date, 40,000 cliff vests after one year provided that the affiliated physician continues providing services to the Company through the vesting date, 40,000 cliff vests after two years provided that the affiliated physician continues providing services to the Company through the vesting date, 40,000 cliff vests after three years provided that the affiliated physician continues providing services to the Company through the vesting date and 40,000 cliff vests after four years provided that the affiliated physician continues providing services to the Company through the vesting date. We valued this award based on the closing market price of our stock on April 1, 2013 which was \$2.82 per share.

At September 30, 2013, the total unrecognized fair value of all restricted stock awards was approximately \$1.3 million, which will be recognized over the remaining vesting period of 3.50 years.

In sum, of the 11,000,000 shares of common stock reserved for issuance under the 2006 Plan, at September 30, 2013, we had 7,138,750 options, warrants and shares of restricted stock outstanding, 20,000 options exercised and 3,841,250 available for grant.

NOTE 7 – 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 September 30, 2013			Total Fair Value
	Level 1	Level 2	Level 3	
Senior Secured Term Loan	–	387,266	–	387,266
Senior Notes	–	210,500	–	210,500
	As of December 31, 2012			
	Level 1	Level 2	Level 3	Total Fair Value
Senior Secured Term Loan	\$–	\$352,180	\$–	\$352,180
Senior Notes	–	204,500	–	204,500

The carrying value of our line of credit at September 30, 2013 and December 31, 2012 of \$3.4 million and \$33.0 million, respectively, approximated its fair value.

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

NOTE 8 - 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

CONSOLIDATED BALANCE SHEET

September 30, 2013

(in thousands)

(unaudited)

	Parent	Subsidiary Issuer	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
ASSETS						
CURRENT ASSETS						
Cash and cash equivalents	\$—	\$—	\$ 268	\$ —	\$—	\$ 268
Accounts receivable, net	—	—	59,980	74,285	—	134,265
Current portion of deferred tax assets	—	—	5,888	—	—	5,888
Prepaid expenses and other current assets	—	12,757	4,190	856	—	17,803
Total current assets	—	12,757	70,326	75,141	—	158,224
PROPERTY AND EQUIPMENT, NET	—	52,395	159,423	5,565	—	217,383
OTHER ASSETS						
Goodwill	—	49,139	142,211	4,740	—	196,090
Other intangible assets	—	140	50,580	88	—	50,808
Deferred financing costs	—	10,600	—	—	—	10,600
Investment in subsidiaries	(1,830)	361,281	26,931	—	(386,382)	—
Investment in joint ventures	—	1,020	27,590	—	—	28,610
Deferred tax assets, net of current portion	—	—	49,679	—	—	49,679
Deposits and other	—	1,495	2,164	79	—	3,738
Total assets	\$(1,830)	\$488,827	\$ 528,904	\$ 85,613	\$(386,382)	\$ 715,132
LIABILITIES AND EQUITY (DEFICIT)						
CURRENT LIABILITIES						
Intercompany	\$—	\$(155,450)	\$ 115,090	\$ 40,360	\$—	\$—
Accounts payable, accrued expenses and other	—	56,619	29,647	13,499	—	99,765
Due to affiliates	—	—	1,273	—	—	1,273
Deferred revenue	—	—	1,448	—	—	1,448
Current portion of deferred rent	—	768	629	51	—	1,448
Current portion of notes payable	—	3,900	1,408	123	—	5,431
Current portion of obligations under capital leases	—	593	561	917	—	2,071

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

Total current liabilities	–	(93,570)	150,056	54,950	–	111,436
LONG-TERM LIABILITIES						
Deferred rent, net of current portion	–	10,872	7,332	255	–	18,459
Line of Credit	–	3,400	–	–	–	3,400
Notes payable, net of current portion	–	569,662	214	1,206	–	571,082
Obligations under capital leases, net of current portion	–	293	2,151	79	–	2,523
Other non-current liabilities	–	–	7,870	–	–	7,870
Total liabilities	–	490,657	167,623	56,490	–	714,770
EQUITY (DEFICIT)						
Total Radnet, Inc.'s equity (deficit)	(1,830)	(1,830)	361,281	26,931	(386,382)	(1,830)
Noncontrolling interests	–	–	–	2,192	–	2,192
Total equity (deficit)	(1,830)	(1,830)	361,281	29,123	(386,382)	362
Total liabilities and equity (deficit)	\$(1,830)	\$488,827	\$ 528,904	\$ 85,613	\$(386,382)	\$ 715,132

RADNET, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEET

December 31, 2012

(in thousands)

(Restated)

	Parent	Subsidiary Issuer	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
ASSETS						
CURRENT ASSETS						
Cash and cash equivalents	\$—	\$362	\$—	\$—	\$—	\$362
Accounts receivable, net	—	—	76,838	52,356	—	129,194
Current portion of deferred tax assets	—	—	7,607	—	—	7,607
Prepaid expenses and other current assets	—	9,735	8,308	694	—	18,737
Total current assets	—	10,097	92,753	53,050	—	155,900
PROPERTY AND EQUIPMENT, NET	—	48,025	168,401	134	—	216,560
OTHER ASSETS						
Goodwill	—	48,954	144,072	845	—	193,871
Other intangible assets	—	170	51,394	110	—	51,674
Deferred financing costs	—	11,977	—	—	—	11,977
Investment in subsidiaries	(7,318)	338,113	9,217	—	(340,012)	—
Investment in joint ventures	—	—	28,598	—	—	28,598
Deferred tax assets, net of current portion	—	—	48,535	—	—	48,535
Deposits and other	—	1,821	1,928	—	—	3,749
Total assets	\$(7,318)	\$459,157	\$544,898	\$54,139	\$(340,012)	\$710,864
LIABILITIES AND EQUITY (DEFICIT)						
CURRENT LIABILITIES						
Intercompany	\$—	\$(176,217)	\$138,223	\$37,994	\$—	\$—
Accounts payable, accrued expenses and other	—	57,939	42,124	6,294	—	106,357
Due to affiliates	—	—	1,602	—	—	1,602
Deferred revenue	—	—	1,273	—	—	1,273
Current portion of notes payable	—	3,500	1,203	—	—	4,703
Current portion of deferred rent	—	574	590	—	—	1,164
Current portion of obligations under capital leases	—	1,186	2,756	—	—	3,942
Total current liabilities	—	(113,018)	187,771	44,288	—	119,041

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

LONG-TERM LIABILITIES

Deferred rent, net of current portion	–	9,579	6,271	–	–	15,850
Line of Credit	–	33,000	–	–	–	33,000
Notes payable, net of current portion	–	536,248	761	–	–	537,009
Obligations under capital leases, net of current portion	–	666	3,087	–	–	3,753
Other non-current liabilities	–	–	8,895	–	–	8,895
Total liabilities	–	466,475	206,785	44,288	–	717,548

EQUITY (DEFICIT)

Total Radnet, Inc.'s equity (deficit)	(7,318)	(7,318)	338,113	9,217	(340,012)	(7,318)
Noncontrolling interests	–	–	–	634	–	634
Total equity (deficit)	(7,318)	(7,318)	338,113	9,851	(340,012)	(6,684)
Total liabilities and equity (deficit)	\$(7,318)	\$459,157	\$ 544,898	\$ 54,139	\$(340,012)	\$ 710,864

RADNET, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

For The Three Months Ended September 30, 2013

(in thousands)

(unaudited)

	Parent	Subsidiary Issuer	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
NET REVENUE						
Service fee revenue, net of contractual allowances and discounts	\$ –	\$ 28,938	\$ 106,414	\$ 30,021	\$ –	\$ 165,373
Provision for bad debts	–	(1,390)	(4,155)	(1,488)	–	(7,033)
Net service fee revenue	–	27,548	102,259	28,533	–	158,340
Net Revenue under capitation arrangements	–	9,604	4,429	2,815	–	16,848
Total net revenue	–	37,152	106,688	31,348	–	175,188
OPERATING EXPENSES						
Cost of operations	–	39,288	82,835	29,647	–	151,770
Depreciation and amortization	–	3,261	11,108	393	–	14,762
(Gain) loss on sale and disposal of equipment	–	–	(5)	–	–	(5)
Severance costs	–	28	44	–	–	72
Total operating expenses	–	42,577	93,982	30,040	–	166,599
(LOSS) INCOME FROM OPERATIONS	–	(5,425)	12,706	1,308	–	8,589
OTHER EXPENSES						
Interest expense	–	2,734	8,350	(32)	–	11,052
Equity in earnings of joint ventures	–	–	(1,617)	–	–	(1,617)
Other expenses	–	–	4	–	–	4
Total other expenses	–	2,734	6,737	(32)	–	9,439
(LOSS) INCOME BEFORE INCOME TAXES	–	(8,159)	5,969	1,340	–	(850)
(Provision for) benefit from income taxes	–	(710)	1,193	–	–	483
Equity in earnings of consolidated subsidiaries	(467)	8,402	1,240	–	(9,175)	–
NET (LOSS) INCOME	(467)	(467)	8,402	1,340	(9,175)	(367)
Net income attributable to noncontrolling interests	–	–	–	100	–	100

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

NET (LOSS) INCOME

ATTRIBUTABLE TO RADNET, INC. \$(467) \$(467) \$ 8,402 \$ 1,240 \$ (9,175) \$ (467)
COMMON STOCKHOLDERS

RADNET, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

For The Three Months Ended September 30, 2012

(in thousands)

(unaudited)

	Parent	Subsidiary Issuer	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
NET REVENUE						
Service fee revenue, net of contractual allowances and discounts	\$-	\$ 30,380	\$ 110,272	\$ 11,729	\$-	\$ 152,381
Provision for bad debts	-	(1,483)	(4,411)	(680)	-	(6,574)
Net service fee revenue	-	28,897	105,861	11,049	-	145,807
Net Revenue under capitation arrangements		6,942	5,271	2,433		14,646
Total net revenue	-	35,839	111,132	13,482	-	160,453
OPERATING EXPENSES						
Cost of operations	-	31,479	88,129	13,615	-	133,223
Depreciation and amortization	-	3,231	10,110	28	-	13,369
Loss on sale and disposal of equipment	-	6	(51)	-	-	(45)
Severance costs	-	8	58	-	-	66
Total operating expenses	-	34,724	98,246	13,643	-	146,613
INCOME (LOSS) FROM OPERATIONS	-	1,115	12,886	(161)	-	13,840
OTHER EXPENSES						
Interest expense	-	6,306	7,569	-	-	13,875
Equity in earnings of joint ventures	-	-	(3,686)	-	-	(3,686)
Other expenses (income)	-	(1,382)	22	-	-	(1,360)
Total other expenses	-	4,924	3,905	-	-	8,829
(LOSS) INCOME BEFORE INCOME TAXES	-	(3,809)	8,981	(161)	-	5,011
Provision for income taxes	-	-	(30)	-	-	(30)
Equity in earnings of consolidated subsidiaries	5,053	8,862	(89)	-	(13,826)	-
NET INCOME (LOSS) ATTRIBUTABLE TO	5,053	5,053	8,862	(161)	(13,826)	4,981
Net loss attributable to noncontrolling interests	-	-	-	(72)	-	(72)

NET INCOME (LOSS)

ATTRIBUTABLE TO RADNET, INC.	\$5,053	\$5,053	\$8,862	\$ (89	) \$ (13,826	) \$ 5,053
COMMON STOCKHOLDERS						

RADNET, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

For The Nine Months Ended September 30, 2013

(in thousands)

(unaudited)

	Parent	Subsidiary Issuer	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
NET REVENUE						
Service fee revenue, net of contractual allowances and discounts	\$—	\$ 85,129	\$ 339,836	\$ 71,459	\$—	\$ 496,424
Provision for bad debts	—	(4,137)	(12,654)	(4,019)	—	(20,810)
Net service fee revenue	—	80,992	327,182	67,440	—	475,614
Net Revenue under capitation arrangements		27,861	12,660	8,513		49,034
Total net revenue	—	108,853	339,842	75,953	—	524,648
OPERATING EXPENSES						
Cost of operations	—	101,255	276,745	72,030	—	450,030
Depreciation and amortization	—	9,541	33,415	1,094	—	44,050
(Gain) loss on sale and disposal of equipment	—	(114)	471	—	—	357
Severance costs	—	59	251	2	—	312
Total operating expenses	—	110,741	310,882	73,126	—	494,749
(LOSS) INCOME FROM OPERATIONS	—	(1,888)	28,960	2,827	—	29,899
OTHER EXPENSES						
Interest expense	—	8,074	26,316	152	—	34,542
Equity in earnings of joint ventures	—	—	(4,481)	—	—	(4,481)
Gain on Sale of Imaging Centers	—	—	(2,108)	—	—	(2,108)
Other expenses	—	120	32	—	—	152
Total other expenses	—	8,194	19,759	152	—	28,105
(LOSS) INCOME BEFORE INCOME TAXES	—	(10,082)	9,201	2,675	—	1,794
Benefit from (provision for) income taxes	—	(16)	(744)	(6)	—	(766)
Equity in earnings of consolidated subsidiaries	877	10,975	2,518	—	(14,370)	—
NET INCOME	877	877	10,975	2,669	(14,370)	1,028
	—	—	—	151	—	151

Net income attributable to noncontrolling
interests

NET INCOME ATTRIBUTABLE TO RADNET, INC. COMMON STOCKHOLDERS	\$ 877	\$ 877	\$ 10,975	\$ 2,518	\$ (14,370)	\$ 877
---	--------	--------	-----------	----------	--------------	--------

RADNET, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

For The Nine Months Ended September 30, 2012

(in thousands)

(unaudited)

	Parent	Subsidiary Issuer	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
NET REVENUE						
Service fee revenue, net of contractual allowances and discounts	\$—	\$ 87,842	\$ 339,616	\$ 36,275	\$ —	\$ 463,733
Provision for bad debts	—	(4,074)	(13,467)	(1,912)	—	(19,453)
Net service fee revenue	—	83,768	326,149	34,363	—	444,280
Net Revenue under capitation arrangements	—	22,192	14,070	7,278	—	43,540
Total net revenue	—	105,960	340,219	41,641	—	487,820
OPERATING EXPENSES						
Cost of operations	—	94,498	269,308	41,371	—	405,177
Depreciation and amortization	—	9,592	33,410	152	—	43,154
Loss on sale and disposal of equipment	—	245	10	—	—	255
Severance costs	—	50	602	26	—	678
Total operating expenses	—	104,385	303,330	41,549	—	449,264
INCOME FROM OPERATIONS	—	1,575	36,889	92	—	38,556
OTHER EXPENSES						
Interest expense	—	22,218	18,699	—	—	40,917
Equity in earnings of joint ventures	—	—	(4,157)	—	—	(4,157)
Gain on de-consolidation of joint venture	—	—	(2,777)	—	—	(2,777)
Other (income) expense	—	(4,032)	181	—	—	(3,851)
Total other expenses	—	18,186	11,946	—	—	30,132
(LOSS) INCOME BEFORE INCOME TAXES	—	(16,611)	24,943	92	—	8,424
Provision for income taxes	—	(21)	(670)	(5)	—	(696)
Equity in earnings of consolidated subsidiaries	7,888	24,520	247	—	(32,655)	—
NET INCOME	7,888	7,888	24,520	87	(32,655)	7,728
Net loss attributable to noncontrolling interests	—	—	—	(160)	—	(160)
	\$7,888	\$ 7,888	\$ 24,520	\$ 247	\$ (32,655)	\$ 7,888

NET INCOME ATTRIBUTABLE TO
RADNET, INC. COMMON
STOCKHOLDERS

27

RADNET, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

For The Nine Months Ended September 30, 2013

(in thousands)

(unaudited)

CASH FLOWS FROM OPERATING ACTIVITIES	Parent	Subsidiary Issuer	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
Net income	\$ 877	\$ 877	\$ 10,975	\$ 2,669	\$ (14,370)	\$ 1,028
Adjustments to reconcile net income to net cash provided by (used in) operating activities:						
Depreciation and amortization	–	9,541	33,415	1,094	–	44,050
Provision for bad debt	–	4,137	12,654	4,019	–	20,810
Equity in earnings of consolidated subsidiaries	(877)	(10,975)	(2,518)	–	14,370	–
Distributions from consolidated subsidiaries	–	–	(9,277)	–	9,277	–
Equity in earnings of joint ventures	–	(20)	(4,461)	–	–	(4,481)
Distributions from joint ventures	–	–	5,624	–	–	5,624
Deferred rent amortization	–	1,485	1,315	93	–	2,893
Amortization of deferred financing cost	–	1,676	–	–	–	1,676
Amortization of term loan and bond discount	–	1,651	–	–	–	1,651
(Gain) loss on sale and disposal of equipment	–	(114)	471	–	–	357
(Gain) loss on sale of imaging centers	–	–	(2,108)	–	–	(2,108)
Stock-based compensation	–	511	1,534	–	–	2,045
Changes in operating assets and liabilities, net of assets acquired and liabilities assumed in purchase transactions:						
Accounts receivable	–	–	(2,204)	(22,892)	–	(25,096)
Other current assets	–	(2,987)	1,487	(4)	–	(1,504)
Other assets	–	326	(134)	(20)	–	172
Deferred taxes	–	–	575	–	–	575
Deferred revenue	–	–	175	–	–	175
Accounts payable, accrued expenses and other	–	6,645	(19,533)	7,531	–	(5,357)
Net cash provided by (used in) operating activities	–	12,753	27,990	(7,510)	9,277	42,510

CASH FLOWS FROM INVESTING
ACTIVITIES

Purchase of imaging facilities	–	(350)	(5,568)	–	–	(5,918)
Purchase of property and equipment	–	(14,466)	(25,363)	(92)	–	(39,921)
Proceeds from sale of equipment	–	198	312	–	–	510
Proceeds from sale of imaging centers	–	–	3,920	–	–	3,920
Proceeds from sale of joint venture interests	–	–	2,640	–	–	2,640
Purchase of equity interest in joint ventures	–	–	(1,803)	–	–	(1,803)
Net cash used in investing activities	–	(14,618)	(25,862)	(92)	–	(40,572)

CASH FLOWS FROM FINANCING
ACTIVITIES

Principal payments on notes and leases payable	–	(4,056)	(1,756)	(1,664)	–	(7,476)
Deferred financing costs	–	(432)	–	–	–	(432)
Proceeds from, net of payments, on Term Loan	–	35,122	–	–	–	35,122
Proceeds from, net of payments, on line of credit	–	(29,600)	–	–	–	(29,600)
Distributions paid to noncontrolling interests	–	–	–	9,266	(9,277)	(11)
Proceeds from issuance of common stock	–	469	–	–	–	469
Net cash provided by (used in) financing activities	–	1,503	(1,756)	7,602	(9,277)	(1,928)
EFFECT OF EXCHANGE RATE CHANGES ON CASH	–	–	(104)	–	–	(104)
NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS	–	(362)	268	–	–	(94)
CASH AND CASH EQUIVALENTS, beginning of period	–	362	–	–	–	362
CASH AND CASH EQUIVALENTS, end of period	\$–	\$–	\$ 268	\$ –	\$ –	\$ 268

RADNET, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

For The Nine Months Ended September 30, 2012

(in thousands)

(unaudited)

CASH FLOWS FROM OPERATING ACTIVITIES	Parent	Subsidiary Issuer	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
Net income	\$7,888	\$7,888	\$24,520	\$87	\$(32,655)	\$7,728
Adjustments to reconcile net income to net cash provided by (used in) operating activities:						
Depreciation and amortization	–	9,592	33,410	152	–	43,154
Provision for bad debt	–	4,074	13,467	1,912	–	19,453
Equity in earnings of consolidated subsidiaries	(7,888)	(24,520)	(247)	–	32,655	–
Distributions from consolidated subsidiaries	–	–	845	–	(845)	–
Equity in earnings of joint ventures	–	–	(4,157)	–	–	(4,157)
Distributions from joint ventures	–	–	5,526	–	–	5,526
Deferred rent amortization	–	1,848	1,142	–	–	2,990
Deferred financing cost interest expense	–	1,803	–	–	–	1,803
Amortization of bond discount	–	706	–	–	–	706
Loss on sale and disposal of equipment	–	245	10	–	–	255
Gain on de-consolidation of joint venture	–	–	(2,777)	–	–	(2,777)
Amortization of cash flow hedge	–	276	551	–	–	827
Stock-based compensation	–	535	1,604	–	–	2,139
Changes in operating assets and liabilities, net of assets acquired and liabilities assumed in purchase transactions:						
Accounts receivable	–	–	(5,336)	(13,026)	–	(18,362)
Other current assets	–	(772)	(32)	371	–	(433)
Other assets	–	(60)	9	–	–	(51)
Deferred revenue	–	–	72	–	–	72
Accounts payable, accrued expenses and other	–	18,667	(32,249)	10,327	–	(3,255)
Net cash provided by (used in) operating activities	–	20,282	36,358	(177)	(845)	55,618
CASH FLOWS FROM INVESTING ACTIVITIES						

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

Purchase of imaging facilities	–	(8,447)	(2,170)	–	–	(10,617)
Purchase of property and equipment	–	(7,558)	(27,721)	–	–	(35,279)
Proceeds from sale of equipment	–	43	798	–	–	841
Proceeds from sale of imaging facilities	–	–	2,300	–	–	2,300
Proceeds from sale of joint venture interests	–	–	1,800	–	–	1,800
Purchase of equity interest in joint ventures	–	–	(2,756)	–	–	(2,756)
Net cash used in investing activities	–	(15,962)	(27,749)	–	–	(43,711)
CASH FLOWS FROM FINANCING ACTIVITIES						
Principal payments on notes and leases payable	–	(4,440)	(6,740)	–	–	(11,180)
Proceeds from, net of payments, on line of credit	–	1,800	–	–	–	1,800
Payments to counterparties of interest rate swaps, net of amounts received	–	(3,046)	(1,541)	–	–	(4,587)
Distributions paid to noncontrolling interests	–	–	–	(912)	845	(67)
Net cash used in financing activities	–	(5,686)	(8,281)	(912)	845	(14,034)
EFFECT OF EXCHANGE RATE CHANGES ON CASH						
NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS	–	(1,366)	388	(1,089)	–	(2,067)
CASH AND CASH EQUIVALENTS, beginning of period	–	1,366	–	1,089	–	2,455
CASH AND CASH EQUIVALENTS, end of period	\$–	\$–	\$ 388	\$ –	\$ –	\$ 388

NOTE 9 – SUBSEQUENT EVENTS

On November 1, 2013, we completed the acquisition of a multi-modality imaging center located in Encino, California for \$1.3 million. The facility provides MRI, CT, mammography, ultrasound and X-ray services.

30

ITEM 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

Forward-Looking Statements

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

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

The factors included in "Risk Factors," in our annual report on Form 10-K for the fiscal year ended December 31, 2012, as amended or supplemented by the information, if any, in Part II – Item 1A in our quarterly report on Form 10-Q for the quarter ended March 31, 2013 and in Part II – Item 1A below, among others, could cause our actual results to differ materially from those expressed in, or implied by, the forward-looking statements. You should consider the inherent limitations on, and risks associated with, forward-looking statements and not unduly rely on the accuracy of predictions contained in such forward-looking statements. These forward-looking statements speak only as of the date when they are made. Except as required under the federal securities laws or by the rules and regulations of the Securities and Exchange Commission ("SEC"), we do not undertake any responsibility to release publicly any revisions to these forward-looking statements to take into account events or circumstances that occur after the date of those statements. Additionally, we do not undertake any responsibility to update you on the occurrence of any unanticipated events which may cause actual results to differ from those expressed or implied by the forward-looking statements contained in this quarterly report. Moreover, in the future, the Company, through senior management, may make forward-looking statements that involve the risk factors and other matters described in this quarterly report as well as other risk factors subsequently identified, including, among others, those identified in the Company's filings with the SEC.

Overview

We are the leading national provider of freestanding, fixed-site outpatient diagnostic imaging services in the United States based on number of locations and annual imaging revenue. At September 30, 2013, we operated directly or indirectly through joint ventures, 251 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 nine months ended September 30, 2013 and 2012, we performed 3,387,665 and 3,127,687 diagnostic imaging procedures, respectively, and generated total net revenue of \$524.6 million and \$487.8 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 13.5% 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 also owns a controlling interest in three medical groups (“Crues Entities”) which provide professional medical services at our imaging facilities located in New York, New York, two of which we acquired as part of our December 31, 2012 acquisition of Lenox Hill and one in connection with our August 1, 2013 acquisition of Manhattan Diagnostic Radiology.

RadNet provides non-medical, technical and administrative services to BRMG and the Crues 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 Crues Entities. Through our management agreements with BRMG and the Crues Entities, we determine the annual budget of BRMG and the Crues Entities and make all physician employment decisions. BRMG and the Crues Entities both have insignificant operating assets and liabilities, and de minimis equity. Through the management agreements with us, all cash flows of both BRMG and the Crues Entities are transferred to us.

We have determined that BRMG and the Crues Entities are variable interest entities, and that we are the primary beneficiary, and consequently, we consolidate the revenue, expenses, assets and liabilities of each. BRMG and the Crues Entities on a combined basis recognized \$24.7 million and \$15.0 million of revenue, net of management service fees to RadNet, Inc., for the three months ended September 30, 2013 and 2012, respectively, and \$24.7 million and \$15.0 million of operating expenses for the three months ended September 30, 2013 and 2012, respectively. RadNet, Inc. recognized in its condensed consolidated statement of operations \$98.3 million and \$68.0 million of total billed net service fee revenue relating to these VIE's for the three months ended September 30, 2013 and 2012, respectively, of which \$73.6 million and \$53.0 million was for management services provided to BRMG and the Crues Entities relating primarily to the technical portion of total billed net service fee revenue for the three months ended September 30, 2013 and 2012, respectively.

BRMG and the Crues Entities combined recognized \$58.2 million and \$41.4 million of revenue, net of management service fees to RadNet, Inc., for the nine months ended September 30, 2013 and 2012, respectively, and \$58.2 million and \$41.4 million of operating expenses for the nine months ended September 30, 2013 and 2012, respectively. RadNet, Inc. recognized in its condensed consolidated statement of operations \$256.6 million and \$198.0 million of total billed net service fee revenue relating to these VIE's for the nine months ended September 30, 2013 and 2012, respectively, of which \$198.4 million and \$156.6 million was for management services provided to BRMG and the Crues Entities relating primarily to the technical portion of total billed net service fee revenue for the nine months ended September 30, 2013 and 2012, respectively.

The cash flows of BRMG and the Crues 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 September 30, 2013 and December 31, 2012, we have included approximately \$62.7 million and \$51.8 million, respectively, of accounts receivable and approximately \$11.4 million and \$6.3 million, respectively, of accounts payable and accrued liabilities, related to BRMG and the Crues Entities combined.

The creditors of both BRMG and the Crues 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 Crues Entities. However, both BRMG and the Crues 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 centers in California and New York City where we contract with BRMG and the Crues Entities, respectively, for the provision of professional medical services, at the remaining centers in California and at all of the centers which are located outside of California except for New York City, we have entered into long-term contracts with independent radiology groups in the area to provide physician services at those facilities. These third party radiology practices provide professional services, including supervision and interpretation of diagnostic imaging procedures, in our diagnostic imaging centers. The radiology practices maintain full control over the provision of professional services. 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-Crues 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.

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 September 30, 2013 and 2012 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, 2012, as amended.

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, 2012, 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, 2012 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 Crues Entities, this service fee revenue includes payments for both the professional medical interpretation revenue recognized by BRMG and the Crues 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 Crues Entities. As it relates to non-BRMG and Crues 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 Crues 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 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 and nine months ended September 30, 2013 and 2012 are summarized in the following table (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
Commercial Insurance	\$102,672	\$93,967	\$305,194	\$286,615
Medicare	37,811	35,523	111,952	106,259
Medicaid	5,798	5,495	18,503	17,431
Workers Compensation/Personal Injury	8,462	7,242	28,234	22,860
Other	3,597	3,579	11,732	11,116
Service fee revenue, net of contractual allowances/discounts/bad debt	158,340	145,807	475,613	444,281
Revenue under capitation arrangements	16,848	14,646	49,034	43,540
Total net revenue	\$175,188	\$160,453	\$524,647	\$487,821

The break-out of our service fee revenue, net of contractual allowances and discounts, is calculated based upon the aggregate payments received from all consolidated imaging centers from dates of service during each respective period illustrated.

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 September 30, 2013, we determined that approximately \$55.6 million of our net deferred tax assets are more likely than not to be realized.

Valuation of Goodwill and Long-Lived Assets

Goodwill at September 30, 2013 totaled \$196.1 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, 2012. Based on our test, we noted no impairment related to goodwill as of October 1, 2012. 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 September 30, 2013.

Recent Accounting Standards

Presentation of Unrecognized Tax Benefits. 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 is effective for annual and interim periods beginning after December 15, 2013. The Company does not expect the adoption of the standard to have a material effect on its statements of financial position, results of operations or cash flows.

Reclassifications Out of Accumulated Other Comprehensive Income. In February 2013, the Financial Accounting Standards Board (FASB) issued guidance for the reporting of amounts reclassified out of accumulated other comprehensive income. The new guidance requires entities to report the effect of significant reclassifications out of accumulated other comprehensive income on the respective line items in net income if the amount being reclassified is required under U.S. generally accepted accounting principles (GAAP) to be reclassified in its entirety to net income. The new guidance does not change the current requirements for reporting net income or other comprehensive income in financial statements and is effective prospectively for reporting periods beginning after December 15, 2012. The adoption of this new guidance in 2013 did not impact our financial position, results of operations or cash flows.

Balance Sheet Offsetting. In December 2012, the FASB issued guidance for new disclosure requirements related to the nature of an entity’s rights of set-off and related arrangements associated with its financial instruments and derivative instruments. The new guidance was effective for annual reporting periods, and interim periods within those years, beginning on or after January 1, 2013. The adoption of this new guidance in 2013 did not impact our financial position, results of operations or cash flows.

Facility Acquisitions and Dispositions

On August 1, 2013, we completed our acquisition of Manhattan Diagnostic Radiology consisting of two multi-modality imaging centers located in New York, New York, for cash consideration of \$507,000 and the settlement of approximately \$1.8 million of equipment leases. The facilities provide MRI, CT, mammography, ultrasound and X-ray services. We have made a fair value determination of the acquired assets and assumed liabilities and approximately \$2.0 million of fixed assets, \$150,000 of other intangible assets and \$161,000 of other assets were recorded with respect to this transaction.

On May 1, 2013, we acquired a 40% equity interest in Orange County Radiation Oncology, LLC, a Radiation Oncology Center located in Orange County, California for cash consideration of \$1.0 million. As of May 1, 2013 we have accounted for this investment under the equity method.

On April 1, 2013, we sold one of our wholly-owned multi-modality imaging centers located in Northfield, New Jersey for \$3.9 million in cash. The net book value associated with the imaging center was \$1.8 million on the date of sale and accordingly a gain of \$2.1 million was recorded with respect to this transaction.

On February 28, 2013, we completed our acquisition of a multi-modality imaging center located in Brooklyn, New York by exercising a \$1.00 purchase option to acquire an initial 50% interest (we acquired this option through our December 31, 2012 acquisition of Lenox Hill Radiology which we valued at approximately \$2.5 million) and then by purchasing the remaining 50% interest from the existing partner for approximately \$2.4 million in cash. We have made a fair value determination of the acquired assets and assumed liabilities and approximately \$813,000 of fixed assets, \$4.2 million of goodwill and \$124,000 of notes payable was recorded with respect to this transaction.

On February 8, 2013, we completed the acquisition of a multi-modality imaging center located in New York, New York for \$1.0 million. The facility provides MRI, CT, mammography, ultrasound and X-ray services. We have made a fair value determination of the acquired assets and assumed liabilities and approximately \$1.0 million of fixed assets was recorded with respect to this transaction.

On February 5, 2013, we sold a 10% interest in a wholly owned limited liability company consisting of two multi-modality imaging centers located in Bel Air, Maryland for approximately \$2.6 million. On the date of sale, we recorded approximately \$439,000 of non-controlling interests and \$2.2 million of additional paid in capital with respect to this transaction.

On January 30, 2013, we purchased for \$430,000 an additional 20.9% interest in a joint venture multi-modality imaging center located in New York, New York of which we initially held a 31.5% interest from our December 31, 2012 acquisition of Lenox Hill Radiology which we valued at approximately \$648,000. This additional 20.9% interest gave us a 52.4% controlling interest and so accordingly, we began consolidating this imaging center, recording all of its assets and liabilities at their fair value at January 30, 2013. We have made a fair value determination of the acquired assets and assumed liabilities and approximately \$358,000 of working capital, \$2.1 million of fixed assets, \$2.0 million of goodwill, \$2.4 million of notes payable and \$979,000 of non-controlling interests was recorded with respect to this transaction.

On January 1, 2013, we completed our acquisition of a breast surgery practice located in Mission Viejo, California for \$350,000. We have made a fair value determination of the acquired assets and assumed liabilities and approximately \$135,000 of working capital, \$30,000 of fixed assets and \$185,000 of goodwill was recorded with respect to this transaction.

On December 31, 2012, we completed our acquisition of Lenox Hill Radiology, consisting of three multi-modality imaging centers as well as three additional x-ray facilities all located in New York, New York. We also acquired in this transaction a 31.5% interest in a joint venture multi-modality imaging center in New York, New York and an option to purchase a 50% interest in a multi-modality imaging center located in Brooklyn, New York for \$1.00. The purchase price consisted of approximately \$28.4 million in cash. In the first quarter of 2013, with the services of an external valuation expert, we made a final fair value determination of the acquired assets and assumed liabilities and \$4.5 million of working capital, \$8.7 million of fixed assets, which is approximately \$1.5 million higher than our initial estimate, \$648,000 of joint venture interests, \$2.5 million in a \$1.00 joint venture purchase option, \$100,000 of intangible assets, \$14.0 million of goodwill and indefinite life intangibles which is approximately \$1.3 million lower than our initial estimate, the assumption of approximately \$650,000 of other liabilities, which is approximately \$150,000 higher than our initial estimate, and \$1.3 million of capital lease debt was recorded with respect to this transaction.

Industry Updates

On April 1, 2013, the Centers for Medicare and Medicaid Services (“CMS”) published its Contract Year 2014 Final Call Letter. In the Final Call Letter, CMS made the assumption that Congressional action would be taken to prospectively fix the Medicare physician fee schedule’s sustainable growth rate formula and that there would be a 0% change in the Medicare physician fee schedule rates for 2014. Based on these assumptions, CMS estimated a 3.3% increase in the 2014 Medicare Advantage rates.

On July 8, 2013, CMS released its proposed rule for FY 2014 changes to Medicare’s Hospital Outpatient Prospective Payment System (HOPPS). For 2014, CMS is proposing to 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 paid by Medicare for such services. The comment period for this proposed rule ended on September 6, 2013, and a final rule has not yet been published.

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 INCOME

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
NET REVENUE				
Service fee revenue, net of contractual allowances and discounts	90.8%	91.2%	91.0%	91.4%
Provision for bad debts	-3.9%	-3.9%	-3.8%	-3.8%
Net service fee revenue	86.9%	87.3%	87.2%	87.6%
Revenue under capitation arrangements	9.2%	8.8%	9.0%	8.6%
Total net revenue	96.1%	96.1%	96.2%	96.2%
OPERATING EXPENSES				
Cost of operations, excluding depreciation and amortization	83.3%	79.8%	82.5%	79.9%
Depreciation and amortization	8.1%	8.0%	8.1%	8.5%
Loss on sale and disposal of equipment	0.0%	0.0%	0.1%	0.1%
Severance costs	0.0%	0.0%	0.1%	0.1%
Total operating expenses	91.4%	87.8%	90.7%	88.6%
INCOME FROM OPERATIONS	4.7%	8.3%	5.5%	7.6%
OTHER EXPENSES				
Interest expense	6.1%	8.3%	6.3%	8.1%
Equity in earnings of joint ventures	-0.9%	-0.5%	-0.8%	-0.8%
Gain on sale of imaging centers	0.0%	0.0%	-0.4%	0.0%
Gain on de-consolidation of joint venture	0.0%	-1.7%	0.0%	-0.5%
Other expense (income)	0.0%	-0.8%	0.0%	-0.8%
Total other expenses	5.2%	5.3%	5.2%	5.9%
(LOSS) INCOME BEFORE INCOME TAXES	-0.5%	3.0%	0.3%	1.7%
Provision for income taxes	0.3%	0.0%	-0.1%	-0.1%
NET (LOSS) INCOME	-0.2%	3.0%	0.2%	1.5%
Net income (loss) attributable to noncontrolling interests	0.1%	0.0%	0.0%	0.0%
NET (LOSS) INCOME ATTRIBUTABLE TO RADNET, INC. COMMON STOCKHOLDERS	-0.3%	3.0%	0.2%	1.6%

Three Months Ended September 30, 2013 Compared to the Three Months Ended September 30, 2012

Service Fee Revenue

Service fee revenue for the three months ended September 30, 2013 was \$165.4 million compared to \$152.4 million for the three months ended September 30, 2012, an increase of \$13.0 million, or 8.5%.

Service fee revenue, including only those centers which were in operation throughout the third quarters of both 2013 and 2012 decreased \$8.9 million, or 5.9%. This 5.9% decrease is due to a reduction in volumes during the current year's quarter when compared to the prior year's quarter as well as a reduction in collection rates experienced so far in 2013. This comparison excludes revenue contributions from centers that were acquired or divested subsequent to July 1, 2012. For the three months ended September 30, 2013, service fee revenue from centers that were acquired or divested subsequent to July 1, 2012 and excluded from the above comparison was \$23.0 million. For the three months ended September 30, 2012, service fee revenue from centers that were acquired or divested subsequent to July 1, 2012 and excluded from the above comparison was \$1.1 million.

Provision for Bad Debts

Provision for bad debts increased \$459,000, or 7.0%, to approximately \$7.0 million, or 3.9% of service fee revenue, for the three months ended September 30, 2013 compared to \$6.6 million, or 3.9% of service fee revenue, for the three months ended September 30, 2012. This increase is in line with the increase in service fee revenues.

Revenue Under Capitation Arrangements

Revenue under capitation arrangements for the three months ended September 30, 2013 was \$16.8 million compared to \$14.6 million for the three months ended September 30, 2012, an increase of \$2.2 million, or 15.0%.

Revenue under capitation arrangements, including only those centers which were in operation throughout the third quarters of both 2013 and 2012 increased \$1.9 million, or 13.1%. This 13.1% increase is due to additional capitation contracts entered into subsequent to the third quarter of 2012. This comparison excludes revenue contributions from centers that were acquired or divested subsequent to July 1, 2012. For the three months ended September 30, 2013, service fee revenue from centers that were acquired or divested subsequent to July 1, 2012 and excluded from the above comparison was \$290,000.

Operating Expenses

Cost of operations for the three months ended September 30, 2013 increased approximately \$18.6 million, or 13.9%, from \$133.2 million for the three months ended September 30, 2012 to \$151.8 million for the three months ended September 30, 2013. The following table sets forth our cost of operations and total operating expenses for the three months ended September 30, 2013 and 2012 (in thousands):

	Three Months Ended September 30, 2013	2012
Salaries and professional reading fees, excluding stock-based compensation	\$ 80,128	\$ 73,400
Stock-based compensation	463	433
Building and equipment rental	16,630	14,637
Medical supplies	9,260	9,598
Other operating expenses *	45,289	35,155
Cost of operations	151,770	133,223
	14,762	13,369

Depreciation and amortization				
Loss (gain) on sale and disposal of equipment	(5	)	(45)
Severance costs	72		66	
Total operating expenses	\$	166,599	\$	146,613

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

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

Salaries and professional reading fees increased \$6.7 million, or 9.2%, to \$80.1 million for the three months ended September 30, 2013 compared to \$73.4 million for the three months ended September 30, 2012.

Salaries and professional reading fees, including only those centers which were in operation throughout the third quarters of both 2013 and 2012, decreased \$741,000, or 1.0%. This 1.0% decrease is in line with our decrease in procedure volumes at these centers. This comparison excludes expenses from centers that were acquired or divested subsequent to July 1, 2012. For the three months ended September 30, 2013, salaries and professional reading fees from centers that were acquired or divested subsequent to July 1, 2012 and excluded from the above comparison was approximately \$7.8 million. For the three months ended September 30, 2012, salaries and professional reading fees from centers that were acquired or divested subsequent to April 1, 2012 and excluded from the above comparison was approximately \$319,000.

Stock-based compensation

Stock-based compensation increased \$30,000, or 6.9%, to approximately \$463,000 for the three months ended September 30, 2013 compared to \$433,000 for the three months ended September 30, 2012

Building and equipment rental

Building and equipment rental expenses increased \$2.0 million, or 13.6%, to \$16.6 million for the three months ended September 30, 2013 compared to \$14.6 million for the three months ended September 30, 2012.

Building and equipment rental expenses, including only those centers which were in operation throughout the third quarters of both 2013 and 2012, increased \$177,000, or 1.2%. This comparison excludes expenses from centers that were acquired or divested subsequent to July 1, 2012. For the three months ended September 30, 2013, building and equipment rental expenses from centers that were acquired or divested subsequent to July 1, 2012 and excluded from the above comparison was approximately \$2.0 million. For the three months ended September 30, 2012, building and equipment rental expenses from centers that were acquired or divested subsequent to July 1, 2012 and excluded from the above comparison was \$199,000.

Medical supplies

Medical supplies expense decreased \$338,000, or 3.5%, to \$9.3 million for the three months ended September 30, 2013 compared to \$9.6 million for the three months ended September 30, 2012.

Medical supplies expenses, including only those centers which were in operation throughout the third quarters of both 2013 and 2012, decreased \$1.2 million, or 12.5%. This 12.5% decrease is primarily due to an increase in rebates we received from certain vendors. This comparison excludes expenses from centers that were acquired or divested subsequent to July 1, 2012. For the three months ended September 30, 2013, medical supplies expense from centers that were acquired or divested subsequent to July 1, 2012 and excluded from the above comparison was \$889,000. For the three months ended September 30, 2012, medical supplies expense from centers that were acquired or divested subsequent to July 1, 2012 was \$32,000.

Other operating expenses

Other operating expenses increased \$10.1 million, or 28.8%, to \$45.3 million for the three months ended September 30, 2013 compared to \$35.2 million for the three months ended September 30, 2012.

Other operating expenses, including only those centers which were in operation throughout the third quarters of both 2013 and 2012, increased \$2.8 million, or 8.4%. This 8.4% increase is primarily due to an increase in insurance costs as well as increases in certain outside accounting and consulting services. This comparison excludes expenses from centers that were acquired or divested subsequent to July 1, 2012. For the three months ended September 30, 2013, other operating expense from centers that were acquired or divested subsequent to July 1, 2012 and excluded from the above comparison was \$7.7 million. For the three months ended September 30, 2012, other operating expense from centers that were acquired or divested subsequent to July 1, 2012 was \$422,000.

Depreciation and amortization

Depreciation and amortization increased \$1.4 million, or 10.4%, to \$14.8 million for the three months ended September 30, 2013 compared to \$13.4 million for the three months ended September 30, 2012.

Depreciation and amortization, including only those centers which were in operation throughout the third quarters of both 2013 and 2012, decreased \$94,000, or 0.7%. This 0.7% decrease is primarily due to certain assets completing their depreciation schedules subsequent to the end of our third quarter of 2012. This comparison excludes expenses from centers that were acquired or divested subsequent to July 1, 2012. For the three months ended September 30, 2013, depreciation and amortization from centers that were acquired or divested subsequent to July 1, 2012 and excluded from the above comparison was \$1.6 million. For the three months ended September 30, 2012, medical supplies expense from centers that were acquired or divested subsequent to July 1, 2012 was \$141,000.

(Gain) loss on sale and disposal of equipment

We recorded a net gain on sale of equipment of approximately \$5,000 for the three months ended September 30, 2013 primarily related to the difference between the net book value of certain equipment sold and proceeds we received from the sale. We recorded a net gain on the sale of equipment of approximately \$45,000 for the three months ended September 30, 2012 primarily 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 September 30, 2013 decreased approximately \$2.8 million, or 20.4%, to \$11.1 million for the three months ended September 30, 2013 compared to \$13.9 million for the three months ended September 30, 2012. Interest expense for the three months ended September 30, 2013 included \$1.2 million of amortization of deferred loan costs and discount on issuance of debt. Interest expense for the three months ended September 30, 2012 included \$767,000 of amortization of deferred loan costs and discount on issuance of debt as well as \$276,000 of amortization of Accumulated Other Comprehensive Loss associated with fair value adjustments to our interest rate swaps accumulated prior to April 6, 2010, the date of our debt refinancing. See “Liquidity and Capital Resources” below for more details on our debt refinancing. Excluding these adjustments to interest expense for each period, interest expense decreased approximately \$3.0 million for the three months ended September 30, 2013 compared to the three months ended September 30, 2012. This decrease was primarily due to a reduction in interest relating to our interest rate swaps, which contractually ended in November 2012, and a reduction in interest expense on the line of credit loan which had lower outstanding balances on a year over year basis.

Equity in earnings from unconsolidated joint ventures

For the three months ended September 30, 2013, we recognized equity in earnings from unconsolidated joint ventures of \$1.6 million compared to \$909,000 for the three months ended September 30, 2012. Equity in earnings for the three months ended September 30, 2012 was affected by a one-time valuation adjustment to net accounts receivable.

Nine Months Ended September 30, 2013 Compared to the Nine Months Ended September 30, 2012

Service Fee Revenue

Service fee revenue for the nine months ended September 30, 2013 was \$496.4 million compared to \$463.7 million for the nine months ended September 30, 2012, an increase of \$32.7 million, or 7.1%.

Service fee revenue, including only those centers which were in operation throughout the first nine months of both 2013 and 2012 decreased \$30.6 million, or 6.8%. This 6.8% decrease is due to a reduction in volumes during the first nine months of 2013 when compared to the same period last year as well as a reduction in collection rates experienced so far in 2013. This comparison excludes revenue contributions from centers that were acquired or divested subsequent to January 1, 2012. For the nine months ended September 30, 2013, service fee revenue from centers that were acquired or divested subsequent to January 1, 2012 and excluded from the above comparison was \$75.2 million.

For the nine months ended September 30, 2012, service fee revenue from centers that were acquired or divested subsequent to January 1, 2012 and excluded from the above comparison was \$11.9 million.

Provision for Bad Debts

Provision for bad debts increased \$1.3 million, or 7.0%, to \$20.8 million, or 3.8% of service fee revenue, for the nine months ended September 30, 2013 compared to \$19.5 million, or 3.8% of service fee revenue, for the nine months ended September 30, 2012. This increase is in line with the increase in service fee revenues.

Revenue Under Capitation Arrangements

Revenue under capitation arrangements for the nine months ended September 30, 2013 was \$49.0 million compared to \$43.5 million for the nine months ended September 30, 2012, an increase of \$5.5 million, or 12.6%.

Revenue under capitation arrangements, including only those centers which were in operation throughout the first nine months of both 2013 and 2012 increased \$3.3 million, or 8.0%. This 8.0% increase is due to additional capitation contracts entered into subsequent to the year ended 2012. This comparison excludes revenue contributions from centers that were acquired or divested subsequent to January 1, 2012. For the nine months ended September 30, 2013, revenue under capitation contracts from centers that were acquired or divested subsequent to July 1, 2012 and excluded from the above comparison was \$5.1 million. For the nine months ended September 30, 2012, service fee revenue from centers that were acquired or divested subsequent to January 1, 2012 and excluded from the above comparison was \$2.9 million.

Operating Expenses

Cost of operations for the nine months ended September 30, 2013 increased approximately \$44.8 million, or 11.1%, from \$405.2 million for the nine months ended September 30, 2012 to \$450.0 million for the nine months ended September 30, 2013. The following table sets forth our cost of operations and total operating expenses for the nine months ended September 30, 2013 and 2012 (in thousands):

	Nine Months Ended September 30,	
	2013	2012
Salaries and professional reading fees, excluding stock-based compensation	\$241,349	\$222,368
Stock-based compensation	2,045	2,139
Building and equipment rental	49,421	45,117
Medical supplies	27,553	29,263
Other operating expenses *	129,662	106,290
Cost of operations	450,030	405,177
Depreciation and amortization	44,050	43,154
Loss (gain) on sale and disposal of equipment	357	255
Severance costs	312	678
Total operating expenses	\$494,749	\$449,264

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

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

Salaries and professional reading fees increased \$19.0 million, or 8.5%, to \$241.3 million for the nine months ended September 30, 2013 compared to \$222.4 million for the nine months ended September 30, 2012.

Salaries and professional reading fees, including only those centers which were in operation throughout the first nine months of both 2013 and 2012, decreased \$2.9 million, or 1.3%. This 1.3% decrease is in line with our decrease in procedure volumes at these centers. This comparison excludes expenses from centers that were acquired or divested subsequent to January 1, 2012. For the nine months ended September 30, 2013, salaries and professional reading fees from centers that were acquired or divested subsequent to January 1, 2012 and excluded from the above comparison

was approximately \$28.2 million. For the nine months ended September 30, 2012, salaries and professional reading fees from centers that were acquired subsequent to January 1, 2012 and excluded from the above comparison was approximately \$6.4 million.

Stock-based compensation

Stock-based compensation decreased \$94,000, or 4.4%, to approximately \$2.0 million for the nine months ended September 30, 2013 compared to \$2.1 million for the nine months ended September 30, 2012.

Building and equipment rental

Building and equipment rental expenses increased \$4.3 million, or 9.5%, to \$49.4 million for the nine months ended September 30, 2013 compared to \$45.1 million for the nine months ended September 30, 2012.

Building and equipment rental expenses, including only those centers which were in operation throughout the first nine months of both 2013 and 2012, decreased \$771,000, or 1.8%. This 1.8% decrease is primarily due to equipment lease buy-outs occurring subsequent to January 1, 2013. This comparison excludes expenses from centers that were acquired or divested subsequent to January 1, 2012. For the nine months ended September 30, 2013, building and equipment rental expenses from centers that were acquired or divested subsequent to January 1, 2012 and excluded from the above comparison was approximately \$6.5 million. For the nine months ended September 30, 2012, building and equipment rental expenses from centers that were acquired or divested subsequent to January 1, 2012 and excluded from the above comparison was \$1.4 million.

Medical supplies

Medical supplies expense decreased \$1.7 million, or 5.8%, to \$27.6 million for the nine months ended September 30, 2013 compared to \$29.3 million for the nine months ended September 30, 2012.

Medical supplies expenses, including only those centers which were in operation throughout the first nine months of both 2013 and 2012, decreased \$4.4 million, or 15.4%. This 15.4% decrease is primarily due to an increase in rebates we received from certain vendors subsequent to January 1, 2013. This comparison excludes expenses from centers that were acquired or divested subsequent to January 1, 2012. For the nine months ended September 30, 2013, medical supplies expense from centers that were acquired or divested subsequent to January 1, 2012 and excluded from the above comparison was \$3.3 million. For the nine months ended September 30, 2012, medical supplies expense from centers that were acquired or divested subsequent to January 1, 2012 was \$625,000

Other operating expenses

Other operating expenses increased \$23.4 million, or 22.0%, to \$129.7 million for the nine months ended September 30, 2013 compared to \$106.3 million for the nine months ended September 30, 2012.

Other operating expenses, including only those centers which were in operation throughout the first nine months of both 2013 and 2012, increased \$2.7 million, or 2.6%. This 2.6% increase is primarily due to an increase in insurance costs as well as increases in certain outside accounting and consulting services. This comparison excludes expenses from centers that were acquired or divested subsequent to January 1, 2012. For the nine months ended September 30, 2013, other operating expense from centers that were acquired or divested subsequent to January 1, 2012 and excluded from the above comparison was \$23.9 million. For the nine months ended September 30, 2012, other operating expense from centers that were acquired or divested subsequent to January 1, 2012 was \$3.2 million.

Depreciation and amortization

Depreciation and amortization increased \$896,000, or 2.8%, to \$44.1 million for the three months ended September 30, 2013 compared to \$43.2 million for the nine months ended September 30, 2012.

Depreciation and amortization, including only those centers which were in operation throughout the first nine months of both 2013 and 2012, decreased \$2.9 million, or 6.9%. This 6.9% decrease is primarily due to several assets completing their depreciation schedules subsequent to January 1, 2013. This comparison excludes expenses from centers that were acquired or divested subsequent to January 1, 2012. For the nine months ended September 30, 2013, depreciation and amortization from centers that were acquired or divested subsequent to January 1, 2012 and excluded from the above comparison was \$4.7 million. For the nine months ended September 30, 2012, depreciation and amortization from centers that were acquired or divested subsequent to January 1, 2012 was \$850,000.

(Gain) loss on sale and disposal of equipment

We recorded a net loss on sale of equipment of approximately \$357,000 for the nine months ended September 30, 2013 primarily related to the difference between the net book value of certain equipment sold and proceeds we received from the sale. We recorded a net loss on the sale of equipment of approximately \$255,000 for the nine months ended September 30, 2012 primarily 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 nine months ended September 30, 2013 decreased approximately \$6.4 million, or 15.6%, to \$34.5 million for the nine months ended September 30, 2013 compared to \$40.9 million for the nine months ended September 30, 2012. Interest expense for the nine months ended September 30, 2013 included \$3.3 million of amortization of deferred loan costs and discount on issuance of debt. Interest expense for the nine months ended September 30, 2012 included \$2.5 million of amortization of deferred loan costs and discount on issuance of debt as well as \$827,000 of amortization of Accumulated Other Comprehensive Loss associated with fair value adjustments to our interest rate swaps accumulated prior to April 6, 2010, the date of our debt refinancing. See “Liquidity and Capital Resources” below for more details on our debt refinancing. Excluding these adjustments to interest expense for each period, interest expense decreased approximately \$6.4 million for the nine months ended September 30, 2013 compared to the nine months ended September 30, 2012. This decrease was primarily due to a reduction in interest relating to our interest rate swaps, which contractually ended in November 2012, and a reduction in interest expense on the line of credit loan which had lower outstanding balances on a year over year basis.

Gain on Sale of Imaging Center

On April 1, 2013, we sold one of our wholly-owned multi-modality imaging centers located in Northfield, New Jersey for \$3.9 million in cash. The net book value associated with the imaging center was \$1.8 million on the date of sale and accordingly a gain of \$2.1 million was recorded with respect to this transaction.

Other income

For the nine months ended September 30, 2012, we recorded approximately \$3.9 million of other income primarily related to fair value adjustments on our interest rate swaps.

Equity in earnings from unconsolidated joint ventures

For the nine months ended September 30, 2013, we recognized equity in earnings from unconsolidated joint ventures of \$4.5 million compared to \$4.2 million for the nine months ended September 30, 2012 for a 7.8% increase of \$324,000. This increase is in line with an increase in procedure volumes at these joint ventures.

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 removes non-cash and certain other charges that occur in the affected period and provides 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) income to Adjusted EBITDA for the three and nine months ended September 30, 2013 and 2012, respectively:

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

	Three Months		Nine Months	
	Ended		Ended	
	September 30,		September 30,	
	2013	2012	2013	2012
Net (loss) Income Attributable to RadNet, Inc. Common Stockholders	\$(467)	\$5,053	\$877	\$7,888
Plus provision for Income taxes	(483)	30	766	696
Minus other expense (Income)	4	(1,360)	152	(3,851)
Plus interest expense	11,052	13,875	34,542	40,917
Plus severance costs	72	66	312	678
Plus (gain) loss on sale and disposal of equipment	(5)	(45)	357	255
Minus gain on sale of imaging center	–	(2,777)	(2,108)	(2,777)
Plus depreciation and amortization	14,762	13,369	44,050	43,154
Plus non cash employee stock-based compensation	463	433	2,045	2,139
Adjusted EBITDA	\$25,398	\$28,644	\$80,993	\$89,099

Liquidity and Capital Resources

We had cash and cash equivalents of \$268,000 and accounts receivable of \$134.3 million at September 30, 2013, compared to cash and cash equivalents of \$362,000 and accounts receivable of \$129.2 million at December 31, 2012. We had a working capital balance of \$46.8 million and \$36.9 million at September 30, 2013 and December 31, 2012, respectively. We had net income attributable to RadNet, Inc. common stockholders for the nine months ended September 30, 2013 and 2012 of \$877,000 and \$7.9 million, respectively. We also had stockholders' equity (deficit) of \$362,000 and (\$6.7 million) at September 30, 2013 and December 31, 2012, 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. However, we have no formal plan of doing so at this time.

Included in our condensed consolidated balance sheet at September 30, 2013 are \$198.3 million of senior notes (net of unamortized discounts of \$1.7 million), \$375.3 million of senior secured term loan debt (net of unamortized discounts of \$11.0 million) and \$3.4 million aggregate principal amount outstanding under the revolving credit facility.

Accordingly, the par values outstanding of our senior notes and senior secured term loan are \$200 million and \$386.3 million, respectively.

Sources and Uses of Cash

Cash provided by operating activities was \$42.5 million and \$55.6 million for the nine months ended September 30, 2013 and 2012, respectively.

Cash used in investing activities was \$40.6 million and \$43.7 million for the nine months ended September 30, 2013 and 2012, respectively. For the nine months ended September 30, 2013, we purchased property and equipment for approximately \$39.9 million, acquired the assets and businesses of additional imaging facilities for approximately

\$5.9 million (see Note 2 to the condensed consolidated financial statements of this quarterly report), and purchased additional equity interests in non-consolidated joint ventures for \$1.8 million. Offsetting our cash used in investing activities were \$2.6 million in proceeds from the sale of a non-controlling interest in one of our consolidated joint ventures, \$3.9 million in proceeds from the sale of a wholly-owned multi-modality imaging center, and \$510,000 of proceeds from the sale of imaging equipment.

Cash used in financing activities was \$1.9 million and \$14.0 million for the nine months ended September 30, 2013 and 2012, respectively. The cash used in financing activities for the nine months ended September 30, 2013, was primarily due to principal payments on our notes, leases and line of credit, offset in part by net proceeds from borrowings under our credit amendment of April 2013 (See Note 1 to the condensed consolidated financial statement of this quarterly report).

Financing Activities

2010 Credit Agreement

In April 2010, we completed a series of transactions for an aggregate of \$585 million. As part of the transactions that were completed, our wholly owned subsidiary, Radnet Management, Inc., issued and sold \$200.0 million in 10 3/8% senior unsecured notes due 2018 (the “senior notes”). The senior notes initially issued on April 6, 2010 in a private placement were subsequently publicly offered for exchange enabling holders of the outstanding senior notes to exchange the outstanding notes for publicly registered exchange notes with nearly identical terms. The exchange offer was completed on February 14, 2011. Additional information regarding the senior notes is provided in Note 1 to our unaudited condensed consolidated financial statements included in Item 1, Part 1 of this quarterly report.

In addition to the issuance of senior notes, Radnet Management entered into a Credit and Guaranty Agreement with a syndicate of lenders (the “Credit Agreement”), whereby Radnet Management obtained \$385.0 million in senior secured first-lien bank financing, consisting of (i) a \$285.0 million, six-year term loan facility and (ii) a \$100.0 million, five-year revolving credit facility, including a swing line subfacility and a letter of credit subfacility (collectively, the “Credit Facilities”).

2012 Refinancing

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

The termination date for the \$350 million term loan is the earliest to occur of (i) the sixth anniversary of the closing date (October 10, 2012), (ii) the date on which all of the term loans shall become due and payable in full under the Refinance Agreement whether by acceleration or otherwise and (iii) October 1, 2017 if our senior notes due 2018 have not been refinanced by such date. The termination date for the \$101.25 million revolving credit facility is the earliest to occur of (i) the fifth anniversary of the closing date, (ii) the date the revolving credit facility is permanently reduced to zero pursuant to section 2.13(b) of the Refinance Agreement, (iii) the date of the termination of the revolving credit facility pursuant to section 8.01 of the Refinance Agreement and (iv) October 1, 2017 if our senior notes due 2018 have not been refinanced by such date.

In connection with the refinancing of the Credit Facilities, Radnet Management used the net proceeds to repay in full its existing six year term loan facility for \$277.9 million in principal amount outstanding, which would have matured on April 6, 2016, and its revolving credit facility for \$59.8 million in principal amount outstanding, which would have matured on April 6, 2015.

The terms and conditions of the Refinance Agreement are more fully described in Note 1 to our unaudited condensed consolidated financial statements included above in Item 1, Part I of this quarterly report.

2013 Amendment to the Refinance Agreement

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

The amendment provides for the following:

Interest. The interest rate spread over LIBOR for the senior secured term loans was reduced from 4.25% to 3.25% and the interest rate spread over the alternative base rate for the senior secured term loans was reduced from 3.25% to 2.25%. The minimum LIBOR rate underlying the senior secured term loans was reduced from 1.25% to 1.0%. The minimum alternative base rate was reduced from 2.25% to 2.0%. On a same principal basis of \$348.3 million, the rate changes listed above will result in a reduction of interest expense by approximately \$19.9 million over the same financing period of the 2012 Refinance Agreement.

Payments. Commencing on June 28, 2013, we began making quarterly amortization payments on the term loan facility under the amendment in the amount of \$975,000, with the remaining principal balance to be paid at maturity.

The other material terms of the amendment remain unchanged compared to the Refinance Agreement, as described above under the heading “2012 Refinancing.”

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.

After 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.

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 \$200 million outstanding senior notes. Variable rate interest obligations relate primarily to amounts borrowed under our outstanding credit facilities, which allows elections of either LIBOR or prime rates of interest. Under the amendment to the Refinance Agreement's LIBOR election facility, borrowed funds bear a 1.00% floor or 6 month LIBOR plus an applicable margin of 3.25%. At September 30, 2013, we had \$386.3 million outstanding subject to a LIBOR election. As the LIBOR floor exceeds the current spot rate of 6 month LIBOR, the spot rate would have to increase more than 63 basis points before an additional interest expense would be accrued. An increase of 163 basis points would be necessary to realize a hypothetical 1% increase in the borrowing rate and an annual increase of \$3.86 million of interest expense. At September 30, 2013, an additional \$4.38 million was tied to the prime rate. A hypothetical 1% increase in the prime rate for 2012-2013 would have resulted in an annual increase of approximately \$43,750.

ITEM 4. Controls and Procedures

We maintain disclosure controls and procedures that are designed to provide reasonable assurance that material information is: (1) gathered and communicated to our management, including our principal executive and financial officers, on a timely basis; and (2) recorded, processed, summarized, reported and filed with the SEC as required under the Securities Exchange Act of 1934, as amended.

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 resulting in the overstatement of a deferred tax asset and an understatement in an unrecognized tax benefit liability related to the historical tax treatment of certain mark-to-market adjustments recorded in relation to its interest rate swaps. We have concluded that such deficiency represented a material weakness in internal control over financial reporting. As a result of this discovery, our Chief Executive Officer and Chief Financial Officer have concluded that our disclosure controls and procedures were not effective as of September 30, 2013, the last day of the period covered by this Report.

This material weakness resulted in an error in our accounting for income taxes and contributed to our restatement of previously issued financial statements more fully described in Note 1a to the Unaudited Consolidated Financial Statements included herein. Based on our assessment, management has now concluded that, as of May 27, 2011, our internal control over the accounting for income taxes was not effective due to the identification of a material weakness.

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, we have taken or will take 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.

However, the material weakness will not be considered remediated until the applicable remedial controls operate for a sufficient period of time and management has concluded, through testing, that these controls are operating effectively.

We intend that the remediation of the material weakness related to controls over the accounting for income taxes will be completed as of December 31, 2013. However, we cannot make any assurances that we will successfully remediate this material weakness within the anticipated timeframe and thus reduce to remote the likelihood that material misstatements concerning accounting for income taxes will not be prevented or detected in a timely manner.

Changes in Internal Control over Financial Reporting

No changes were made in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) of the Exchange Act) during our most recent fiscal quarter that has materially affected, or is likely to materially affect, our internal control over financial reporting.

Limitations on Disclosure Controls and Procedures.

Our management, including our chief executive officer and chief financial officer, does 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 a risk factor described in our annual report on Form 10-K for the year ended December 31, 2012, as supplemented and amended by the risk factors in Part II, Item 1A of our quarterly report on Form 10-Q for the quarter ended March 31, 2013, and should be read in conjunction with the other risk factors therein. The risks described below and in our Form 10-K, as amended, are not the only risks facing our Company. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business, financial condition and/or operating results.

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

From time to time, changes designed to contain healthcare costs have been implemented, some of which have resulted in decreased reimbursement rates for diagnostic imaging services that impact our business. For services for which we bill Medicare directly, we are paid under the Medicare Physician Fee Schedule, which is updated on an annual basis. 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, 2013, the SGR formula results in a decrease to the physician Medicare fee schedule reimbursement by 26.5%. Congress, however, enacted ATRA which provides, in part, that Medicare physician fee schedule rates for 2012 are extended through December 31, 2013. Therefore, the Medicare fee schedule rates for 2013 are neither subject to the 26.5% SGR formula-driven reduction nor are they subject to any increase over and above the 2012 fee schedule rates.

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 July 8, 2013, CMS released its proposed rule for FY 2014 changes to Medicare's Hospital Outpatient Prospective Payment System (HOPPS). For 2014, CMS is proposing to 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. The comment period for this proposed rule ended on September 6, 2013, and a final rule has not yet been published.

We have identified material weaknesses in our internal controls over financial reporting.

Maintaining effective internal controls over financial reporting is necessary for us to produce reliable financial statements. The Board of Directors of the Company concluded on November 8, 2013 that material weaknesses in the internal control over financial reporting exist at the Company, and consequently the Board of Directors determined that management's report on internal control over financial reporting as of December 31, 2012, included in the Company's Annual Report on Form 10-K for the year then ended, should no longer be relied upon. These material weaknesses led to the need for the restatement of the Company's financial statements for the year ended December 31, 2012. These material weaknesses are discussed further within Item 9A "Controls and Procedures" of this Annual Report on Form 10-K/A. The existence of one or more material weaknesses precludes a conclusion by management that a corporation's internal control over financial reporting is effective.

The Company is currently in the process of remediating this material weakness in internal control over financial reporting by, among other things, designing and implementing additional controls to ensure the quality of information delivered to, and improve the review of completed work received from, our outside tax consultant and improve controls over our identification and assessment of uncertain tax positions. If we fail to remediate this material weakness or fail to otherwise maintain effective controls over financial reporting in the future, it could result in a material misstatement of our financial statements that would not be prevented or detected on a timely basis. Management continues to devote significant time and attention to remediating this material weakness and improving our internal controls, and we expect to continue to incur costs associated with implementing appropriate processes, which could include fees for additional audit and consulting services, which could negatively affect our financial condition and operating results.

ITEM 2 Unregistered Sales of Equity Securities and Use of Proceeds

None

ITEM 3 Defaults Upon Senior Securities

None

ITEM 4 Mine Safety Disclosures

Not applicable.

ITEM 5 Other Information

None

ITEM 6 Exhibits

Reference is made to the Exhibit Index included herein.

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: November 13,
2013

By: /s/ Howard G. Berger, M.D.

Howard G. Berger, M.D., President and Chief Executive Officer (Principal Executive Officer)

Date: November 13,
2013

By: /s/ Mark D. Stolper

Mark D. Stolper, Chief Financial Officer
(Principal Financial and Accounting Officer)

INDEX TO EXHIBITS

<u>Exhibit Number</u>	<u>Description</u>
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.