

RadNet, Inc.  
Form 10-Q  
November 09, 2016

**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

**Washington D.C. 20549**

**FORM 10-Q**

(Mark One)

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

For the quarterly period ended September 30, 2016

**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)**

|  |                            |
|--|----------------------------|
| <b>Delaware</b>                        | <b>13-3326724</b>          |
| <b>(State or other jurisdiction of</b> | <b>(I.R.S. Employer</b>    |
| <b>Incorporation or organization)</b>  | <b>Identification No.)</b> |

**1510 Cotner Avenue**



**RADNET, INC.**

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**PART I - FINANCIAL INFORMATION****Item 1. Financial Statements**

## RADNET, INC. AND SUBSIDIARIES

## CONDENSED CONSOLIDATED BALANCE SHEETS

(IN THOUSANDS EXCEPT SHARE AND PER SHARE DATA)

|   | September<br>30,<br>2016<br>(unaudited) | December<br>31,<br>2015 |
|---|---|-------------------------|
| <b>ASSETS</b>                                       |   |                         |
| <b>CURRENT ASSETS</b>                               |   |                         |
| Cash and cash equivalents                           | \$ 358                                  | \$ 446                  |
| Accounts receivable, net                            | 183,229                                 | 162,843                 |
| Current portion of deferred tax assets              | 22,279                                  | 22,279                  |
| Due from affiliates                                 | 3,249                                   | 4,815                   |
| Prepaid expenses and other current assets           | 28,566                                  | 38,986                  |
| Total current assets                                | 237,681                                 | 229,369                 |
| <b>PROPERTY AND EQUIPMENT, NET</b>                  | <b>249,397</b>                          | <b>256,722</b>          |
| <b>OTHER ASSETS</b>                                 |   |                         |
| Goodwill  | 240,640                                 | 239,408                 |
| Other intangible assets                             | 43,330                                  | 45,253                  |
| Deferred financing costs                            | 2,116                                   | 2,841                   |
| Investment in joint ventures                        | 41,868                                  | 33,584                  |
| Deferred tax assets, net of current portion         | 22,939                                  | 24,685                  |
| Deposits and other                                  | 5,428                                   | 4,565                   |
| Total assets  | \$ 843,399                              | \$ 836,427              |
| <b>LIABILITIES AND EQUITY</b>                       |   |                         |
| <b>CURRENT LIABILITIES</b>                          |   |                         |
| Accounts payable, accrued expenses and other        | \$ 114,716                              | \$ 113,813              |
| Due to affiliates                                   | 5,243                                   | 6,564                   |
| Deferred revenue                                    | 1,658                                   | 1,598                   |
| Current portion of notes payable                    | 22,047                                  | 22,383                  |
| Current portion of deferred rent                    | 2,861                                   | 2,563                   |
| Current portion of obligations under capital leases | 6,047                                   | 10,038                  |
| Total current liabilities                           | 152,572                                 | 156,959                 |
| <b>LONG-TERM LIABILITIES</b>                        |   |                         |
| Deferred rent, net of current portion               | 25,889                                  | 26,865                  |
| Line of credit                                      | 1,600                                   | -                       |

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|  |            |            |
|--|------------|------------|
| Notes payable, net of current portion  | 614,982    | 599,914    |
| Obligations under capital lease, net of current portion  | 3,719      | 6,385      |
| Other non-current liabilities  | 4,292      | 9,843      |
| Total liabilities  | 803,054    | 799,966    |
| EQUITY   |            |            |
| RadNet, Inc. stockholders' equity:   |            |            |
| Common stock - \$.0001 par value, 200,000,000 shares authorized; 46,467,404 and 46,281,189 shares issued and outstanding at September 30, 2016 and December 31, 2015, respectively | 4          | 4          |
| Additional paid-in-capital   | 197,881    | 197,297    |
| Accumulated other comprehensive loss   | (166 )     | (153 )     |
| Accumulated deficit  | (161,022 ) | (164,571)  |
| Total RadNet, Inc.'s stockholders' equity  | 36,697     | 32,577     |
| Non-controlling interests  | 3,648      | 3,884      |
| Total equity   | 40,345     | 36,461     |
| Total liabilities and equity   | \$ 843,399 | \$ 836,427 |

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

## RADNET, INC. AND SUBSIDIARIES

## CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(IN THOUSANDS EXCEPT SHARE DATA)

(unaudited)

|  | Three Months Ended<br>September 30, |            | Nine Months Ended<br>September 30, |            |
|--|-------------------------------------|------------|------------------------------------|------------|
|  | 2016                                | 2015       | 2016                               | 2015       |
| <b>NET REVENUE</b>   |                                     |            |                                    |            |
| Service fee revenue, net of contractual allowances and discounts   | \$208,430                           | \$ 192,904 | \$ 613,031                         | \$ 546,337 |
| Provision for bad debts  | (11,253 )                           | (9,433 )   | (33,883 )                          | (25,295 )  |
| Net service fee revenue  | 197,177                             | 183,471    | 579,148                            | 521,042    |
| Revenue under capitation arrangements                              | 27,466                              | 24,895     | 80,448                             | 72,880     |
| Total net revenue  | 224,643                             | 208,366    | 659,596                            | 593,922    |
| <b>OPERATING EXPENSES</b>  |                                     |            |                                    |            |
| Cost of operations, excluding depreciation and amortization        | 192,752                             | 175,631    | 583,640                            | 520,348    |
| Depreciation and amortization                                      | 17,318                              | 14,601     | 49,541                             | 43,836     |
| (Gain) loss on sale and disposal of equipment                      | (66 )                               | 738        | 375                                | 774        |
| Severance costs  | 2,188                               | 167        | 2,528                              | 297        |
| Total operating expenses   | 212,192                             | 191,137    | 636,084                            | 565,255    |
| <b>INCOME FROM OPERATIONS</b>                                      | 12,451                              | 17,229     | 23,512                             | 28,667     |
| <b>OTHER INCOME AND EXPENSES</b>                                   |                                     |            |                                    |            |
| Interest expense   | 11,404                              | 10,546     | 32,830                             | 30,965     |
| Meaningful use incentive   | –                                   | –          | (2,808 )                           | (3,270 )   |
| Equity in earnings of joint ventures                               | (2,576 )                            | (1,992 )   | (8,129 )                           | (6,301 )   |
| Gain on sale of imaging centers                                    | –                                   | (4,823 )   | –                                  | (4,823 )   |
| Gain from return of common stock                                   | –                                   | –          | (5,032 )                           | –          |
| Other expenses   | 174                                 | 8          | 180                                | 418        |
| Total other expenses   | 9,002                               | 3,739      | 17,041                             | 16,989     |
| <b>INCOME BEFORE INCOME TAXES</b>                                  | 3,449                               | 13,490     | 6,471                              | 11,678     |
| Provision for income taxes   | (1,458 )                            | (5,199 )   | (2,531 )                           | (4,300 )   |
| <b>NET INCOME</b>  | 1,991                               | 8,291      | 3,940                              | 7,378      |
| Net income attributable to noncontrolling interests                | 344                                 | 304        | 391                                | 550        |
| <b>NET INCOME ATTRIBUTABLE TO RADNET, INC. COMMON STOCKHOLDERS</b> | \$ 1,647                            | \$ 7,987   | \$ 3,549                           | \$ 6,828   |
| <b>BASIC NET INCOME PER SHARE</b>                                  |                                     |            |                                    |            |
| <b>ATTRIBUTABLE TO RADNET, INC. COMMON STOCKHOLDERS</b>            | \$0.04                              | \$0.18     | \$0.08                             | \$0.16     |

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|  |            |            |            |            |
|--|------------|------------|------------|------------|
| DILUTED NET INCOME PER SHARE                     |            |            |            |            |
| ATTRIBUTABLE TO RADNET, INC. COMMON STOCKHOLDERS | \$0.04     | \$ 0.18    | \$ 0.08    | \$ 0.15    |
| WEIGHTED AVERAGE SHARES                          |            |            |            |            |
| OUTSTANDING                                      |            |            |            |            |
| Basic  | 45,868,629 | 43,637,022 | 46,337,993 | 43,247,002 |
| Diluted  | 46,333,970 | 44,751,936 | 46,748,836 | 44,704,323 |

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



RADNET, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(IN THOUSANDS)

(unaudited)

|  | Three Months<br>Ended September<br>30, |          | <b>Nine Months<br/>Ended<br/>September 30,</b> |          |
|--|--|----------|--|----------|
|  | 2016                                   | 2015     | 2016   | 2015     |
| NET INCOME   | \$ 1,991                               | \$ 8,291 | \$ 3,940                                       | \$ 7,378 |
| Foreign currency translation adjustments                                 | 3                                      | 7        | (166 )   | (34 )    |
| COMPREHENSIVE INCOME   | 1,994                                  | 8,298    | 3,774  | 7,344    |
| Less comprehensive income attributable to non-controlling interests      | 344                                    | 304      | 391  | 550      |
| COMPREHENSIVE INCOME ATTRIBUTABLE TO RADNET, INC.<br>COMMON STOCKHOLDERS | \$1,650                                | \$7,994  | \$3,383  | \$6,794  |

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

## RADNET, INC. AND SUBSIDIARIES

## CONSOLIDATED STATEMENT OF EQUITY

(IN THOUSANDS EXCEPT SHARE DATA)

(unaudited)

|  | Common Stock<br>Shares | Amount | Additional<br>Paid-in<br>Capital | Accumulated<br>Other<br>Comprehensive<br>Loss | Accumulated<br>Deficit | Radnet,<br>Inc.<br>Stockholders<br>Equity | Noncontrolling<br>Interests | Total<br>Equity |
|--|------------------------|--------|----------------------------------|---|------------------------|---|-----------------------------|-----------------|
| BALANCE -<br>JANUARY 1, 2016                                       | 46,281,189             | \$ 4   | \$ 197,297                       | \$ (153 )                                     | \$(164,571 )           | \$ 32,577                                 | \$ 3,884                    | \$ 36,461       |
| Issuance of common<br>stock upon exercise of<br>options/warrants   | 314,448                | —      | 150                              | —   | —                      | 150                                       | —                           | 150             |
| Stock-based<br>compensation  | —                      | —      | 4,659                            | —   | —                      | 4,659                                     | —                           | 4,659           |
| Issuance of restricted<br>stock and other awards                   | 830,303                | —      | —                                | —   | —                      | —   | —                           | —               |
| Return of common stock   | (958,536 )             | —      | (5,032 )                         | —   | —                      | (5,032 )                                  | —                           | (5,032 )        |
| Purchase of<br>noncontrolling interests                            | —                      | —      | (185 )                           | —   | —                      | (185 )                                    | (135 )                      | (320 )          |
| Sale of non-controlling<br>interest                                | —                      | —      | 992                              | —   | —                      | 992                                       | —                           | 992             |
| Distributions paid to<br>noncontrolling interests                  | —                      | —      | —                                | —   | —                      | —   | (492 )                      | (492 )          |
| Change in cumulative<br>foreign currency<br>translation adjustment | —                      | —      | —                                | (13 )   | —                      | (13 )                                     | —                           | (13 )           |
| Net income   | —                      | —      | —                                | —   | 3,549                  | 3,549                                     | 391                         | 3,940           |
| BALANCE -<br>SEPTEMBER 30, 2016                                    | 46,467,404             | \$ 4   | \$ 197,881                       | \$ (166 )                                     | \$(161,022 )           | \$ 36,697                                 | \$ 3,648                    | \$ 40,345       |

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



## RADNET, INC. AND SUBSIDIARIES

## CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(IN THOUSANDS)

(unaudited)

|   | <b>Nine Months Ended<br/>September 30,</b> |          |
|---|--|----------|
|   | 2016                                       | 2015     |
| <b>CASH FLOWS FROM OPERATING ACTIVITIES</b>   |  |          |
| Net income  | \$3,940                                    | \$7,378  |
| Adjustments to reconcile net income to net cash provided by operating activities:                                     |  |          |
| Depreciation and amortization   | 49,541                                     | 43,836   |
| Provision for bad debts   | 33,883                                     | 25,295   |
| Gain from return of common stock  | (5,032 )                                   | -        |
| Equity in earnings of joint ventures  | (8,129 )                                   | (6,301 ) |
| Distributions from joint ventures   | 2,929                                      | 6,255    |
| Amortization and write off of deferred financing costs and loan discount  | 4,244                                      | 4,000    |
| Loss on sale and disposal of equipment  | 375  | 774      |
| Gain on sale of imaging centers   | -  | (4,823 ) |
| Stock-based compensation  | 4,918                                      | 6,477    |
| Changes in operating assets and liabilities, net of assets acquired and liabilities assumed in purchase transactions: |  |          |
| Accounts receivable   | (53,277 )                                  | (32,485) |
| Other current assets  | 10,420                                     | (15,628) |
| Other assets  | 751  | (1,254 ) |
| Deferred taxes  | 1,746                                      | 2,750    |
| Deferred rent   | (678 )                                     | 6,034    |
| Deferred revenue  | 60   | (641 )   |
| Accounts payable, accrued expenses and other  | 9,039                                      | (1,602 ) |
| Net cash provided by operating activities   | 54,730                                     | 40,065   |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES</b>   |  |          |
| Purchase of imaging facilities  | (6,603 )                                   | (41,237) |
| Purchase of property and equipment  | (52,110 )                                  | (38,736) |
| Proceeds from sale of equipment   | 63   | 648      |
| Proceeds from sale of imaging facilities  | -  | 35,500   |
| Cash distribution from existing JV partner  | 994  | 443      |
| Equity contributions in existing and purchase of interest in joint ventures   | (1,374 )                                   | (265 )   |
| Net cash used in investing activities   | (59,030 )                                  | (43,647) |
| <b>CASH FLOWS FROM FINANCING ACTIVITIES</b>   |  |          |
| Principal payments on notes and leases payable  | (9,219 )                                   | (6,645 ) |
| Proceeds from borrowings  | 476,503                                    | 74,401   |
| Payments on term loan debt  | (463,022)                                  | (17,548) |

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|  |          |          |
|--|----------|----------|
| Deferred financing costs   | (945 )   | (531 )   |
| Net proceeds (payments) on revolving credit facility                     | 1,600    | (15,300) |
| Distributions paid to non-controlling interests                          | (492 )   | (613 )   |
| Proceeds from sale of non-controlling interests                          | –        | 5,005    |
| Purchase of non-controlling interests                                    | (350 )   | –        |
| Proceeds from issuance of common stock upon exercise of options/warrants | 150      | 594      |
| Net cash provided by financing activities                                | 4,225    | 39,363   |
| EFFECT OF EXCHANGE RATE CHANGES ON CASH                                  | (13 )    | (34 )    |
| NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS                     | (88 )    | 35,747   |
| CASH AND CASH EQUIVALENTS, beginning of period                           | 446      | 307      |
| CASH AND CASH EQUIVALENTS, end of period                                 | \$358    | \$36,054 |
| SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION                         |          |          |
| Cash paid during the period for interest                                 | \$26,819 | \$26,543 |

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 \$14.7 million and \$15.7 million during the nine months ended September 30, 2016 and 2015, respectively, which were not paid for as of September 30, 2016 and 2015, respectively. The offsetting amounts due were recorded in our consolidated balance sheet under accounts payable, accrued expenses and other.

During the nine months ended September 30, 2016 we added capital lease debt of approximately \$1.3 million.

We recognized a non-cash gain from the return of common stock of \$5.0 million in June 2016. See Note 2, Gain from Return of Common Stock.

We transferred \$2.7 million in fixed assets in June 2016 to our new joint venture, Glendale Advanced Imaging LLC. See Note 6, Investment in Joint Ventures.

In the third quarter of 2016, the Company recorded an increase to additional paid-in capital as a result of \$992,000 which was earned as part of an earn out provision included in the Company's 2015 sale of a non-controlling interest in Baltimore County Radiology, LLC. Such amount had not been received in cash as of September 30, 2016.

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

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

**(unaudited)**

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

We are a national provider of freestanding, fixed-site outpatient diagnostic imaging services. At September 30, 2016, we operated directly or indirectly through joint ventures with hospitals, 306 centers located in California, Delaware, Florida, Maryland, New Jersey, New York and Rhode Island. Our centers provide physicians with imaging capabilities to facilitate the diagnosis and treatment of diseases and disorders. Our services include magnetic resonance imaging (MRI), computed tomography (CT), positron emission tomography (PET), nuclear medicine, mammography, ultrasound, diagnostic radiology (X-ray), fluoroscopy and other related procedures. The vast majority of our centers offer multi-modality imaging services. Our multi-modality strategy diversifies revenue streams, reduces exposure to reimbursement changes and provides patients and referring physicians one location for multiple procedures. Our operations comprise a single segment for financial reporting purposes.

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

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

Howard G. Berger, M.D., is our President and Chief Executive Officer, a member of our Board of Directors, and also owns, indirectly, 99% of the equity interests in BRMG. BRMG is responsible for all of the professional medical services at nearly all of our facilities located in California under a management agreement with us, and employs physicians or contracts with various other independent physicians and physician groups to provide the professional medical services at most of our California facilities. We generally obtain professional medical services from BRMG in California, rather than provide such services directly or through subsidiaries, in order to comply with California's prohibition against the corporate practice of medicine. However, as a result of our close relationship with Dr. Berger and BRMG, we believe that we are able to better ensure that medical service is provided at our California facilities in a manner consistent with our needs and expectations and those of our referring physicians, patients and payors than if we obtained these services from unaffiliated physician groups.

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

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



We have determined that BRMG and the NY Groups are VIEs, that we are the primary beneficiary, and consequently, we consolidate the revenue and expenses, assets and liabilities of each. BRMG and the NY Groups on a combined basis recognized \$34.2 million and \$29.4 million of revenue, net of management service fees to RadNet, for the three months ended September 30, 2016 and 2015, respectively, and \$34.2 million and \$29.4 million of operating expenses for the three months ended September 30, 2016 and 2015, respectively. RadNet, Inc. recognized in its condensed consolidated statement of operations \$147.3 million and \$106.7 million of total billed net service fee revenue relating to these VIEs for the three months ended September 30, 2016 and 2015, respectively, of which \$113.1 million and \$77.3 million was for management services provided to these VIEs relating primarily to the technical portion of total billed net service fee revenue for the three months ended September 30, 2016 and 2015, respectively.

For the nine months ended September 30, 2016 and 2015, respectively, the VIEs recognized \$101.2 million and \$83.1 million of revenue, net of management services fees to RadNet, respectively, and \$101.2 million and \$83.1 million of operating expenses. RadNet, Inc. recognized in its condensed consolidated statement of operations \$422.2 million and \$320.6 million of total billed net service fee revenue relating to these VIEs for the nine months ended September 30, 2016 and 2015, respectively, of which \$321.1 million and \$237.5 million was for management services provided to these VIEs relating primarily to the technical portion of total billed net service fee revenue for the nine months ended September 30, 2016 and 2015, respectively.

The cash flows of BRMG and the NY Groups are included in the accompanying consolidated statements of cash flows. All intercompany balances and transactions have been eliminated in consolidation. In our consolidated balance sheets at September 30, 2016 and December 31, 2015, we have included approximately \$104.7 million and \$89.8 million, respectively, of accounts receivable and approximately \$8.7 million and \$8.5 million of accounts payable and accrued liabilities related to BRMG and the NY Groups, respectively.

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

At all of our centers we have entered into long-term contracts with radiology groups in the area to provide physician services at those facilities. These radiology practices provide professional services, including supervision and interpretation of diagnostic imaging procedures, in our diagnostic imaging centers. The radiology practices maintain full control over the provision of professional services. In these facilities we enter into long-term agreements with radiology practice groups (typically 40 years). Under these arrangements, in addition to obtaining technical fees for the use of our diagnostic imaging equipment and the provision of technical services, we provide management services and receive a fee based on the value of the services we provide. Except in New York City, the fee is based on the practice group's professional revenue, including revenue derived outside of our diagnostic imaging centers. In New York City we are paid a fixed fee set in advance for our services. 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 radiology practices; accordingly, we do not consolidate the financial statements of those practices in our consolidated financial statements. Because of the controlling relationship of Dr. Berger and Dr. Crues in the California and New York City practices we consolidate that income.

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X and, therefore, do not include all information and footnotes necessary for conformity with U.S. generally accepted accounting principles for complete financial statements; however, in the opinion of our management, all adjustments consisting of normal recurring adjustments necessary for a fair presentation of the financial position, results of operations and cash flows for the interim periods ended September 30, 2016 and 2015 have been made. The results of operations for any interim period are not necessarily indicative of the results for a full year. These interim condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and related notes thereto contained in our annual report on Form 10-K for the year ended December 31, 2015 filed on March 15, 2016, as amended.

## **NOTE 2 –SIGNIFICANT ACCOUNTING POLICIES**

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

### *Revenues*

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

Service fee revenues are recorded during the period the services are provided based upon the estimated amounts due from the patients and third-party payors. Third-party payors include federal and state agencies (under the Medicare and Medicaid programs), managed care health plans, commercial insurance companies and employers. Estimates of contractual allowances are based on historical collection rates of payor reimbursement contract agreements.

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

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

|  | Three Months Ended    |           | Nine Months Ended     |           |
|--|-----------------------|-----------|-----------------------|-----------|
|  | September 30,<br>2016 | 2015      | September 30,<br>2016 | 2015      |
| Commercial insurance   | \$130,036             | \$114,827 | \$386,383             | \$331,670 |
| Medicare   | 48,740                | 40,840    | 140,089               | 120,039   |
| Medicaid   | 7,554                 | 6,117     | 21,461                | 17,582    |
| Workers' compensation/personal injury                            | 9,449                 | 7,712     | 27,935                | 23,287    |
| Other  | 12,651                | 23,408    | 37,163                | 53,759    |
| Service fee revenue, net of contractual allowances and discounts | 208,430               | 192,904   | 613,031               | 546,337   |
| Provision for bad debts  | (11,253 )             | (9,433 )  | (33,883 )             | (25,295 ) |
| Net service fee revenue  | 197,177               | 183,471   | 579,148               | 521,042   |
| Revenue under capitation arrangements                            | 27,466                | 24,895    | 80,448                | 72,880    |
| Total net revenue  | \$224,643             | \$208,366 | \$659,596             | \$593,922 |

#### *Provision for Bad Debts*

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

impact collection trends, such as changes in the economy, which in turn have an impact on the increased burden of co-payments and deductibles to be made by patients with insurance. These factors continuously change and can have an impact on collection trends and our estimation process.

#### *Deferred Tax Assets*

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

#### *Deferred Financing Costs*

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

*Presentation of Deferred Financing Costs*

In the first quarter of 2016, we adopted Accounting Standards Update (“ASU”) 2015-03, *Simplifying the Presentation of Debt Issuance Costs*, which requires that deferred financing costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of such debt liability, consistent with debt discounts. In a subsequent Staff Announcement, codified as ASU 2015-15, the SEC announced that it would not object to the deferral and presentation of deferred financing costs relating to line-of-credit arrangements as an asset. We have applied the guidance retrospectively to all periods presented in this report. Such retrospective adoption had an insignificant impact to our December 31, 2015 consolidated balance sheet, and had no impact to our consolidated statements of operations, comprehensive loss, stockholders’ equity, and cash flows. The table below summarizes the impacts on the Company’s December 31, 2015 Consolidated Balance Sheet:

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

*Meaningful Use Incentive*

Under the American Recovery and Reinvestment Act of 2009, a program was enacted that provides financial incentives for providers that successfully implement and utilize electronic health record technology to improve patient care. Our software development team in Canada developed a Radiology Information System (RIS) software platform that has been awarded Meaningful Use certification. In order to receive such incentive payments providers must attest that they have demonstrated meaningful use of the certified RIS in each stage of the program. We account for this meaningful use incentive under the Gain Contingency Model outlined in ASC 450-30. Under this model, we record within non-operating income, meaningful use incentive only after Medicare accepts an attestation from the qualified eligible professional demonstrating meaningful use. We recorded approximately \$2.8 million and \$3.3 million during

the nine months ended September 30, 2016, and 2015, respectively, relating to this incentive.

#### *Gain from Return of Common Stock*

In the second quarter of 2016, we determined that certain pre-acquisition financial information of Diagnostic Imaging Group (“DIG”) provided to us by the sellers contained errors. As a result of this, we negotiated and reached a settlement with the sellers of DIG in June 2016 for the return of 958,536 shares of common stock which had a fair value of \$5.0 million on the date of return. Such return has been recognized as a gain from return of common stock in our statement of operations.

#### *Liquidity and Capital Resources*

We had cash and cash equivalents of \$358,000 and accounts receivable of \$183.2 million at September 30, 2016, compared to cash and cash equivalents of \$446,000 and accounts receivable of \$162.8 million at December 31, 2015. We had a working capital balance of \$85.1 million and \$72.4 million at September 30, 2016 and December 31, 2015, respectively. We had net income attributable to RadNet, Inc. common stockholders for the three months ended September 30, 2016 and 2015 of \$1.6 million and \$8.0 million, respectively. We had net income attributable to RadNet, Inc. common stockholders for the nine months ended September 30, 2016 and 2015 of \$3.5 million and \$6.8 million, respectively. We also had stockholders’ equity of \$36.7 million and \$32.6 million at September 30, 2016 and December 31, 2015, respectively.

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

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

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

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

At September 30, 2016, our credit facilities were comprised of two tranches of term loans and a revolving credit facility. On July 1, 2016 (the “Restatement Effective Date”), we entered into Amendment No. 3 to Credit and Guaranty Agreement (the “Restatement Amendment”) pursuant to which we amended and restated our then existing credit facilities on the terms set forth in the Amended and Restated First Lien Credit and Guaranty Agreement dated July 1, 2016 (as amended from time to time, the “First Lien Credit Agreement”). Pursuant to the First Lien Credit Agreement, we have issued \$485 million of senior secured term loans (the “First Lien Term Loans”) and established a \$117.5 million senior secured revolving credit facility (the “Revolving Credit Facility”). We have also entered into a Second Lien Credit and Guaranty Agreement dated March 25, 2014 (as amended from time to time, the “Second Lien Credit Agreement”) pursuant to which we issued \$180 million of secured term loans (the “Second Lien Term Loans”).

Included in our condensed consolidated balance sheet at September 30, 2016 is \$635.5 million of senior secured term loan debt (net of unamortized discounts of \$17.5 million), broken down by loan agreement as follows (in thousands):

|                       | As of September 30, 2016 |            |                      |
|-----------------------|--------------------------|------------|----------------------|
|                       | Face Value               | Discount   | Total Carrying Value |
| First Lien Term Loans | \$485,000                | \$(15,278) | \$469,722            |

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|                        |            |            |            |
|------------------------|------------|------------|------------|
| Second Lien Term Loans | \$ 168,000 | \$(2,193 ) | \$ 165,807 |
| Total                  | \$ 653,000 | \$(17,471) | \$ 635,529 |

Our \$117.5 million Revolving Credit Facility had a \$1.6 million aggregate principal amount outstanding as of September 30, 2016.

As of September 30, 2016, we were in compliance with all covenants under our First Lien Credit Agreement and our Second Lien Credit Agreement.

Details on the First Lien Credit Agreement and the Second Lien Credit Agreement follow.

Restatement Amendment and the First Lien Credit Agreement

On July 1, 2016, we entered into the Restatement Amendment pursuant to which we amended and restated our then existing credit facilities on the terms set forth in the First Lien Credit Agreement. As of the Restatement Effective Date, our first lien credit facilities consisted of a Credit and Guaranty Agreement that we entered into on October 10, 2012 (the “Original First Lien Credit Agreement”), as subsequently amended by a first amendment dated April 3, 2013 (the “2013 Amendment”), a second amendment dated March 25, 2014 (the “2014 Amendment”), and a joinder agreement dated April 30, 2015 (the “2015 Joinder” and collectively with the Original First Lien Credit Agreement, the 2013 Amendment and the 2014 Amendment, the “Prior First Lien Credit Agreement”). The First Lien Credit Agreement increased the aggregate principal amount of First Lien Term Loans to \$485.0 million and increased the Revolving Credit Facility to \$117.5 million. Proceeds from the First Lien Credit Agreement were used to repay the previously outstanding first lien loans under the Prior First Lien Credit Agreement, make a \$12.0 million principal payment of the Second Lien Term Loans, pay costs and expenses related to the First Lien Credit Agreement and provide approximately \$10.0 million for general corporate purposes.



*Interest.* The interest rates payable on the First Lien Term Loans are (a) the Adjusted Eurodollar Rate (as defined in the First Lien Credit Agreement) plus 3.75% per annum or (b) the Base Rate (as defined in the First Lien Credit Agreement) plus 2.75% per annum. As applied to the First Lien Term Loans, the Adjusted Eurodollar Rate has a minimum floor of 1.0%. The six month Adjusted Eurodollar Rate (as defined in the First Lien Credit Agreement) at July 1, 2016, the day of the Restatement Amendment, was 0.92%. Prior to the Restatement Amendment, the interest rates payable on first lien term loans under the Prior First Lien Credit Agreement were the Adjusted Eurodollar Rate (as defined in the Prior First Lien Credit Agreement) plus 3.25% per annum or the Base Rate (as defined in the Prior First Lien Credit Agreement) plus 2.25% per annum.

*Payments.* The scheduled quarterly principal payments of the First Lien Term Loans is approximately \$6.1 million, beginning in December 2016, with the balance due at maturity. Prior to the Restatement Amendment, the quarterly principal payments on the first lien term loans under the Prior First Lien Credit Agreement were approximately \$6.2 million.

*Maturity Date.* The maturity date for the First Lien Term Loans shall be on the earliest to occur of (i) the seventh anniversary of the Restatement Effective Date, (ii) the date on which all First Lien Term Loans shall become due and payable in full under the First Lien Credit Agreement, whether by acceleration or otherwise, and (iii) September 25, 2020 if our indebtedness under the Second Lien Credit Agreement has not been repaid, refinanced or extended prior to such date.

*Incremental Feature:* Under the First Lien Credit Agreement, we can elect to request 1) an increase to the existing Revolving Credit Facility and/or 2) additional First Lien Term Loans, provided that the aggregate amount of such increases or additions does not exceed (A) an amount not in excess of \$100.0 million minus any incremental loans requested under the similar provisions of the Second Lien Credit Agreement or (B) if the First Lien Leverage Ratio would not exceed 3.50:1.00 after giving effect to such incremental facilities, an uncapped amount, in each case subject to the conditions and limitations set forth in the First Lien Credit Agreement. Each lender approached to provide all or a portion of any incremental facility may elect or decline, in its sole discretion, to provide any incremental commitment or loan.

*Revolving Credit Facility:* The First Lien Credit Agreement provides for a \$117.5 million Revolving Credit Facility. The termination date of the Revolving Credit Facility is the earliest to occur of: (i) July 1, 2021, (ii) the date the Revolving Credit Facility is permanently reduced to zero pursuant to section 2.13(b) of the First Lien Credit Agreement, which addresses voluntary commitment reductions, (iii) the date of the termination of the Revolving Credit Facility due to specific events of default pursuant to section 8.01 of the First Lien Credit Agreement, and (iv) September 25, 2020 if our indebtedness under the Second Lien Credit Agreement has not been repaid, refinanced or extended prior to such date. Amounts borrowed under the Revolving Credit Facility bear interest based on types of borrowings as follows: (i) unpaid principal on loans under the Revolving Credit Facility at the Adjusted Eurodollar Rate (as defined in the First Lien Credit Agreement) plus 3.75% per annum or the Base Rate (as defined in the First Lien Credit Agreement) plus 2.75% per annum, (ii) letter of credit fees at 3.75% per annum and fronting fees for

letters of credit at 0.25% per annum, in each case on the average aggregate daily maximum amount available to be drawn under all letters of credit issued under the First Lien Credit Agreement, and (iii) commitment fee of 0.5% per annum on the unused revolver balance.

Second Lien Credit Agreement:

On March 25, 2014, we entered into the Second Lien Credit Agreement to provide for, among other things, the borrowing of \$180.0 million of Second Lien Term Loans. The proceeds from the Second Lien Term Loans were used to redeem our 10 3/8% senior unsecured notes, due 2018, to pay the expenses related to the transaction and for general corporate purposes. On July 1, 2016, in conjunction with the Restatement Amendment, a \$12.0 million principal payment was made on the Second Lien Term Loans.

The Second Lien Credit Agreement provides for the following:

*Interest.* The interest rates payable on the Second Lien Term Loans are (a) the Adjusted Eurodollar Rate (as defined in the Second Lien Credit Agreement) plus 7.0% or (b) the Base Rate (as defined in the Second Lien Credit Agreement) plus 6.0%. The Adjusted Eurodollar Rate has a minimum floor of 1.0% on the Second Lien Term Loans. The three month Adjusted Eurodollar Rate at September 30, 2016 was 0.85%. The rate paid on the Second Lien Term Loan at September 30, 2016 was 8%.

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

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

### **NOTE 3 – RECENT ACCOUNTING STANDARDS**

In August 2016, the Financial Accounting Standards Board (“FASB”) issued ASU 2016-15, Statement of Cash Flows (Topic 230) – Classification of Certain Cash Receipts and Cash Payments. ASU 2016-15 clarifies how entities should classify certain cash receipts and cash payments in the statement of cash flows and amends certain disclosure requirements. The update is effective for fiscal years beginning after December 15, 2018, and interim periods within fiscal years beginning after 15 December 2019. Early adoption is permitted, including adoption in an interim period. We are currently evaluating the impact of the GAAP update on our results of operations and cash flows.

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

In February 2016, the FASB issued ASU No. 2016-02 (“ASU 2016-02”), *Leases*, (Topic 842): Amendments to the FASB Accounting Standards Codification. ASU 2016-02 amends the existing accounting standards for lease accounting, including requiring lessees to recognize most leases on their balance sheets and making targeted changes

to lessor accounting. The new standard requires a modified retrospective transition approach for all leases existing at, or entered into after, the date of initial application, with an option to use certain transition relief. The amendments in this update are effective for fiscal years (and interim reporting periods within fiscal years) beginning after December 15, 2018. Early adoption of the amendments is permitted for all entities. We are currently evaluating the impact of the GAAP update on our results of operations and cash flows.

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

In September 2015, the FASB issued ASU No. 2015-16 (“ASU 2015-16”), *Business Combinations*, (Topic 805): Simplifying the Accounting for Measurement-Period Adjustments. ASU 2015-16 eliminates the requirement to retrospectively apply adjustments made to provisional amounts recognized in a business combination. An entity will now recognize any adjustments in the reporting period in which the amounts are determined, calculated as if the accounting had been completed at the acquisition date. Disclosure is required for the portion of adjustments recorded in current-period earnings that would have been recorded in previous reporting periods had they been recognized as of the acquisition date. The update is effective for fiscal years (and interim reporting periods within fiscal years) beginning after December 15, 2015. Early adoption is permitted for financial statements that have not been previously issued. The update has been adopted and has had no material effect on our results of operations and cash flows.

In August 2014, the FASB issued ASU No. 2014-15 (“ASU 2014-15”), *Presentation of Financial Statements* (Subtopic 205-40): Going Concern. In connection with preparing financial statements for each annual and interim reporting period, an entity’s management should evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about the entity’s ability to continue as a going concern within one year after the date that the financial statements are issued. If conditions or events raise substantial doubt about an entity’s ability to continue as a going concern, but the substantial doubt is alleviated as a result of consideration of management’s plans, the entity should disclose information. The update is effective for the annual period ending after December 15, 2016, and for annual periods and interim periods thereafter. Early application is permitted. The GAAP update is expected to have minimal impact on our financial disclosures.

In May 2014, the FASB issued ASU No. 2014-09 (“ASU 2014-09”), *Revenue from Contracts with Customers*, (Topic 606). ASU 2014-09 requires an entity to recognize revenue when it transfers promised goods or services to customers in an amount that reflects what it expects in exchange for the goods or services. It also requires more detailed disclosures to enable users of the financial statements to understand the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers. The update was effective for fiscal years (and interim reporting periods within fiscal years) beginning after December 15, 2016, which has been extended to December 31, 2017. We are currently evaluating the impact of the GAAP update on our results of operations and cash flows.

#### NOTE 4 – EARNINGS PER SHARE

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

|  | Three Months Ended<br>September 30, |            | Nine Months Ended<br>September 30, |            |
|--|-------------------------------------|------------|------------------------------------|------------|
|  | 2016                                | 2015       | 2016                               | 2015       |
| Net income attributable to RadNet, Inc.'s common stockholders                        | \$1,647                             | \$7,987    | \$3,549                            | \$6,828    |
| <b>BASIC NET INCOME PER SHARE ATTRIBUTABLE TO RADNET, INC.'S COMMON STOCKHOLDERS</b> |                                     |            |                                    |            |
| Weighted average number of common shares outstanding during the period               | 45,868,629                          | 43,637,022 | 46,337,993                         | 43,247,002 |
| Basic net income per share attributable to RadNet, Inc.'s common stockholders        | \$0.04                              | \$0.18     | \$0.08                             | \$0.16     |

#### DILUTED NET INCOME PER SHARE ATTRIBUTABLE TO RADNET, INC.'S COMMON

## STOCKHOLDERS

|   |            |            |            |            |
|---|------------|------------|------------|------------|
| Weighted average number of common shares outstanding during the period                    | 45,868,629 | 43,637,022 | 46,337,993 | 43,247,002 |
| Add nonvested restricted stock subject only to service vesting                            | 260,389    | 437,689    | 190,428    | 484,810    |
| Add additional shares issuable upon exercise of stock options and warrants                | 204,952    | 677,225    | 220,415    | 972,511    |
| Weighted average number of common shares used in calculating diluted net income per share | 46,333,970 | 44,751,936 | 46,748,836 | 44,704,323 |
| Diluted net income per share attributable to RadNet, Inc.'s common stockholders           | \$0.04     | \$0.18     | \$0.08     | \$0.15     |

## NOTE 5 – ACQUISITIONS

In the third quarter of 2016, we recorded a measurement period adjustment associated with our acquisition of DIG on October 1, 2015. This adjustment stemmed from the final valuation report received from a third party valuation expert and amounted to a decrease to our intangible and fixed assets of approximately \$121,000.

On July 1, 2016, we purchased for approximately \$320,000 an additional 10.8% interest in the Park West joint venture, a concern which was part of the Lenox Hill 2012 acquisition, increasing our ownership percentage from 52.4% to 63.2%. The difference between the consideration paid and the fair value of the non-controlling interest purchased was recorded as an adjustment to additional paid-in capital.

In the second quarter of 2016, we recorded certain measurement period adjustments associated with our acquisition of DIG on October 1, 2015. These adjustments were the result of a preliminary valuation report received from a third party and resulted in an increase to fixed assets acquired by \$1.2 million and the recognition of an unfavorable lease contract liability of \$1.0 million. The recognition of these adjustments also resulted in related depreciation expense of \$123,000 in the second quarter relating to the period from October 1, 2015 to December 31, 2015 and \$123,000 related to the period from January 1, 2016 to March 31, 2016. Also, amounts previously owed to DIG of \$5.0 million were reduced to \$3.4 million on June 15, 2016 when we remitted a payment of \$1.6 million to a payor on behalf of DIG.

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

## **NOTE 6 – INVESTMENT IN JOINT VENTURES**

We have twelve unconsolidated joint ventures with ownership interests ranging from 35% to 55%. 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, since RadNet does not have a controlling financial interest in such ventures.

### *Acquisition of new facilities*

On August 15, 2016 our joint venture, Franklin Imaging, LLC, acquired a single multi-modality imaging center located in Rosedale, Maryland for cash consideration of \$1.0 million and the assumption of capital lease debt of \$241,000. Franklin Imaging, LLC made a fair value determination of the acquired assets and approximately \$600,000 of fixed assets, \$30,000 of other assets and goodwill of \$648,000 was recorded in respect to the transaction.

### *Formation of new joint ventures*

On April 1, 2016, Community Imaging Partners Inc., a wholly owned subsidiary of RadNet, entered into a joint venture with Mt. Airy Health Services, LLC, a partnership of Frederick Memorial Hospital and Carroll Hospital Center. On August 31, 2016, Community Imaging Partners Inc. contributed \$200,000 for a 40% economic interest in the partnership and funded an additional \$440,000 in relation to a capital call. Mt. Airy Health Services, LLC, contributed \$300,000 for a 60% economic interest and an additional \$660,000 in relation to the capital call.

On May 9, 2016, RadNet, through a newly formed subsidiary, Glendale Advanced Imaging LLC, entered into a joint venture with Dignity Health, a California nonprofit public benefit corporation. On June 1, 2016, RadNet contributed net assets of \$2.2 million for a 55% economic interest and Dignity Health contributed net assets of \$1.8 million for a 45% economic interest.

***Joint Venture investment and financial information***

The following table is a summary of our investment in joint ventures during the nine months ended September 30, 2016 (in thousands):

|   |    |        |   |
|---|----|--------|---|
| Balance as of<br>December 31, 2015                    | \$ | 33,584 |   |
| Equity in earnings<br>in these joint<br>ventures      |    | 8,129  |   |
| Distribution of<br>earnings                           |    | (2,929 | ) |
| Equity contributions<br>in existing joint<br>ventures |    | 3,084  |   |
| Balance as of<br>September 30, 2016                   | \$ | 41,868 |   |

We earned management service fees from the centers underlying these joint ventures of approximately \$2.9 million and \$2.6 million for the three months ended September 30, 2016 and 2015, respectively, and \$8.7 million and \$6.4 million for the nine months ended September 30, 2016 and 2015 respectively. At the end of the period we eliminate from total fees recorded the uncollected portion of these fees that are associated with our ownership interests and offset this with an increase to our equity earnings.



The following table is a summary of key financial data for these joint ventures as of September 30, 2016 and for the nine months ended September 30, 2016 and 2015 (in thousands):

| Balance Sheet Data:   | September<br>30, 2016 | December<br>31, 2015 |
|---|-----------------------|----------------------|
| Current assets  | \$ 33,452             | \$ 28,186            |
| Noncurrent assets   | 96,766                | 91,660               |
| Current liabilities   | (9,786 )              | (15,258 )            |
| Noncurrent liabilities  | (42,633 )             | (44,059 )            |
| Total net assets  | \$ 77,799             | \$ 60,529            |
| <br>  |                       |                      |
| Book value of RadNet joint venture interests  | \$ 36,873             | \$ 28,397            |
| Cost in excess of book value of acquired joint venture interests                    | 4,995                 | 4,970                |
| Elimination of intercompany profit remaining on Radnet's consolidated balance sheet |                       | 217                  |
| Total value of Radnet joint venture interests                                       | \$ 41,868             | \$ 33,584            |
| <br>  |                       |                      |
| Total book value of other joint venture partner interests                           | \$ 40,926             | \$ 32,132            |

| Income statement data for the nine months ended September 30, | 2016       | 2015      |
|---|------------|-----------|
| Net revenue   | \$ 119,920 | \$ 85,305 |
| Net income  | \$ 18,001  | \$ 13,489 |

## NOTE 7 – STOCK-BASED COMPENSATION

### Stock Incentive Plans

#### *Options*

We have one long-term equity incentive plan, the 2006 Equity Incentive Plan, which we amended and restated as of April 20, 2015 (the “Restated Plan”). The Restated Plan was approved by our stockholders at our annual stockholders meeting on June 11, 2015. As of September 30, 2016, we have reserved for issuance under the Restated Plan 12,000,000 shares of common stock. We can issue options, stock awards, stock appreciation rights and cash awards under the Restated Plan. Certain options granted under the Restated Plan to employees are intended to qualify as incentive stock options under existing tax regulations. Stock options generally vest over two to five years and expire five to ten years from the date of grant.

As of September 30, 2016, we had outstanding options to acquire 375,626 shares of our common stock, of which options to acquire 191,667 shares were exercisable. During the nine months ended September 30, 2016, we granted additional options under our Restated Plan conferring the right to acquire 170,626 shares of common stock.

The following summarizes all of our option transactions for the nine months ended September 30, 2016:

| <b>Outstanding Options<br/>Under the 2006 Plan</b> | <b>Shares</b> | <b>Weighted<br/>Average<br/>Exercise<br/>Price<br/>per<br/>Common<br/>Share</b> | <b>Weighted<br/>Average<br/>Remaining<br/>Contractual<br/>Life<br/>(in years)</b> | <b>Aggregate<br/>Intrinsic<br/>Value</b> |
|--|---------------|---|---|--|
| Balance, December 31, 2015                         | 931,667       | \$ 4.69   |   |  |
| Granted  | 170,626       | 6.01  |   |  |
| Exercised  | (526,667)     | 2.96  |   |  |
| Canceled, forfeited or expired                     | (150,000)     | 7.51  |   |  |
| Balance, September 30, 2016                        | 375,626       | 6.82  | 4.70  | \$ 452,333                               |
| Exercisable at September 30, 2016                  | 191,667       | 7.89  | 1.11  | 142,933                                  |

Aggregate intrinsic value in the table above represents the total pretax intrinsic value (the difference between our closing stock price on September 30, 2016 and the exercise price, multiplied by the number of in-the-money options) that would have been received by the holder had all holders exercised their options on September 30, 2016. Total intrinsic value of options exercised during the nine months ended September 30, 2016 and 2015 was approximately \$1.7 million and \$6.1 million, respectively.

As of September 30, 2016, total unrecognized stock-based compensation expense related to non-vested employee option awards was approximately \$477,000, which is expected to be recognized over a weighted average period of approximately 3.2 years.

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

The Restated Plan permits the award of restricted stock. As of September 30, 2016, we have issued a total of 4,256,511 RSA’s, of which 568,145 were unvested.

The following summarizes the activity related to all unvested RSA’s during the nine months ended September 30, 2016:

|                                      | RSA's     | Weighted-Average<br>Remaining<br>Contractual<br>Term (Years) | Weighted-Average<br>Fair Value |
|--------------------------------------|-----------|--|--------------------------------|
| RSA's unvested at December 31, 2015  | 771,342   |  | \$ 5.17                        |
| Changes during the period            |           |  |                                |
| Granted                              | 795,303   |  | \$ 6.16                        |
| Vested                               | (998,499) |  | \$ 5.13                        |
| Forfeited                            | —         |  | \$ 0.00                        |
| RSA's unvested at September 30, 2016 | 568,145   | 0.81   | \$ 6.19                        |

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

### ***Other stock bonus awards***

The Restated Plan also permits the award of stock bonuses not subject to any future service period. These awards are valued and expensed based on the closing price of our common stock on the date of award. During the nine months ended September 30, 2016, stock bonus awards issued under the Restated Plan amounted to 35,000 shares of common stock with an intrinsic value of approximately \$246,000.

### ***Restated Plan Summary***

In sum, of the 12,000,000 shares of common stock reserved for issuance under the Restated Plan, at September 30, 2016, we had issued 12,060,887 total shares between options, RSA's and other stock awards. With options cancelled and RSA's forfeited amounting to 2,975,009 and 59,053 shares, respectively, there remain 2,973,175 shares available under the Restated Plan for future issuance.

### ***Nonqualified Deferred Compensation Plan***

On May 5, 2016, RadNet, Inc. adopted a Nonqualified Deferred Compensation Plan that is intended to provide nonqualified deferred compensation for selected participants. As part of the plan, selected participants may defer stock units granted.

## **NOTE 8 – 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, 2016 |           |         |                  |                  |
|------------------------|--------------------------|-----------|---------|------------------|------------------|
|                        | Level 1                  | Level 2   | Level 3 | Total Fair Value | Total Face Value |
| First Lien Term Loans  | \$-                      | \$484,394 | \$-     | \$484,394        | \$485,000        |
| Second Lien Term Loans | \$-                      | 166,320   | \$-     | 166,320          | \$168,000        |

|                        | As of December 31, 2015 |           |         |                  |                  |
|------------------------|-------------------------|-----------|---------|------------------|------------------|
|                        | Level 1                 | Level 2   | Level 3 | Total Fair Value | Total Face Value |
| First Lien Term Loans  | \$-                     | \$444,258 | \$-     | \$444,258        | \$451,023        |
| Second Lien Term Loans | -                       | 173,700   | -       | 173,700          | 180,000          |

The carrying value of our Revolving Credit Facility at September 30, 2016 was \$1.6 million, which approximated its fair value. There was no balance outstanding under the Revolving Credit Facility at December 31, 2015.

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



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

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

### **Forward-Looking Statements**

This report 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 our current expectations about future events and are based on currently available financial, economic and competitive data and on current business plans.

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

Forward-looking statements are not guarantees of future performance and our actual results may differ significantly from the results discussed in the forward-looking statements. Factors that might cause such differences include, but are not limited to, the factors included in “Risk Factors,” in our annual report on Form 10-K for the fiscal year ended December 31, 2015, as amended or supplemented by the information in Part II – Item 1A below. 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. We assume no obligation to revise or update any forward-looking statements for any reason, except as required by law.

### **Overview**

We are a national provider of freestanding, fixed-site outpatient diagnostic imaging services. At September 30, 2016, we operated directly or indirectly through joint ventures with hospitals, 306 centers located in California, Delaware, Florida, Maryland, New Jersey, New York and Rhode Island. Our centers provide physicians with imaging capabilities to facilitate the diagnosis and treatment of diseases and disorders. Our services include magnetic resonance imaging (MRI), computed tomography (CT), positron emission tomography (PET), nuclear medicine, mammography, ultrasound, diagnostic radiology (X-ray), fluoroscopy and other related procedures. The vast majority of our centers offer multi-modality imaging services. Our multi-modality strategy diversifies revenue streams, reduces exposure to reimbursement changes and provides patients and referring physicians one location for multiple procedures. Our operations comprise a single segment for financial reporting purposes.

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

We derive substantially all of our revenue, directly or indirectly, from fees charged for the diagnostic imaging services performed at our facilities. For the nine months ended September 30, 2016 and 2015, we performed 4,589,685 and 4,183,494 diagnostic imaging procedures, respectively, and generated total net revenue of \$659.6 million and \$593.9 million, respectively.

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



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

Howard G. Berger, M.D., is our President and Chief Executive Officer, a member of our Board of Directors, and also owns, indirectly, 99% of the equity interests in BRMG. BRMG is responsible for all of the professional medical services at nearly all of our facilities located in California under a management agreement with us, and employs physicians or contracts with various other independent physicians and physician groups to provide the professional medical services at most of our California facilities. We generally obtain professional medical services from BRMG in California, rather than provide such services directly or through subsidiaries, in order to comply with California’s prohibition against the corporate practice of medicine. However, as a result of our close relationship with Dr. Berger and BRMG, we believe that we are able to better ensure that medical service is provided at our California facilities in a manner consistent with our needs and expectations and those of our referring physicians, patients and payors than if we obtained these services from unaffiliated physician groups.

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

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

We have determined that BRMG and the NY Groups are VIEs, and that we are the primary beneficiary, and consequently, we consolidate the revenue and expenses, assets and liabilities of each. BRMG and the NY Groups on a combined basis recognized \$34.2 million and \$29.4 million of revenue, net of management service fees to RadNet, for the three months ended September 30, 2016 and 2015, respectively, and \$34.2 million and \$29.4 million of operating expenses for the three months ended September 30, 2016 and 2015, respectively. RadNet, Inc. recognized in its condensed consolidated statement of operations \$147.3 million and \$106.7 million of total billed net service fee revenue relating to these VIEs for the three months ended September 30, 2016 and 2015, respectively, of which \$113.1 million and \$77.3 million was for management services provided to these VIEs relating primarily to the technical portion of total billed net service fee revenue for the three months ended September 30, 2016 and 2015, respectively.

For the nine months ended September 30, 2016 and 2015, respectively, the VIEs recognized \$101.2 million and \$83.1 million of revenue, net of management services fees to RadNet, respectively, and \$101.2 million and \$83.1 million of operating expenses. RadNet, Inc. recognized in its condensed consolidated statement of operations \$422.2 million and \$320.6 million of total billed net service fee revenue relating to these VIEs for the nine months ended September 30, 2016 and 2015, respectively, of which \$321.1 million and \$237.5 million was for management services provided to these VIEs relating primarily to the technical portion of total billed net service fee revenue for the nine months ended September 30, 2016 and 2015, respectively.

The cash flows of BRMG and the NY Groups are included in the accompanying consolidated statements of cash flows. All intercompany balances and transactions have been eliminated in consolidation. In our consolidated balance sheets at September 30, 2016 and December 31, 2015, we have included approximately \$104.7 million and \$89.8 million, respectively, of accounts receivable and approximately \$8.7 million and \$8.5 million of accounts payable and accrued liabilities related to BRMG and the NY Groups, respectively.

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

At all of our centers we have entered into long-term contracts with radiology groups in the area to provide physician services at those facilities. These radiology practices provide professional services, including supervision and interpretation of diagnostic imaging procedures, in our diagnostic imaging centers. The radiology practices maintain full control over the provision of professional services. In these facilities we enter into long-term agreements with radiology practice groups (typically 40 years). Under these arrangements, in addition to obtaining technical fees for the use of our diagnostic imaging equipment and the provision of technical services, we provide management services and receive a fee based on the value of the services we provide. Except in New York City, the fee is based on the practice group's professional revenue, including revenue derived outside of our diagnostic imaging centers. In New York City we are paid a fixed fee set in advance for our services. 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 radiology practices; accordingly, we do not consolidate the financial statements of those practices in our consolidated financial statements. Because of the controlling relationship of Dr Berger and Dr Crues in the California and New York City practices we consolidate that income.

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

### **Critical Accounting Policies**

The Securities and Exchange Commission defines critical accounting estimates as those that are both most important to the portrayal of a company's financial condition and results of operations and require management's most difficult, subjective or complex judgment, often as a result of the need to make estimates about the effect of matters that are inherently uncertain and may change in subsequent periods. In Note 2 to our consolidated financial statements in our annual report on Form 10-K for the year ended December 31, 2015, as amended, we discuss our significant accounting policies, including those that do not require management to make difficult, subjective or complex judgments or estimates. The most significant areas involving management's judgments and estimates are described below.

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

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

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

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

During the period covered in this report, there were no material changes to the critical accounting estimates we use, and have described in our annual report on Form 10-K for the fiscal year ended December 31, 2015, as amended.

### ***Revenues***

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

Service fee revenues are recorded during the period the services are provided based upon the estimated amounts due from the patients and third-party payors. Third-party payors include federal and state agencies (under the Medicare and Medicaid programs), managed care health plans, commercial insurance companies and employers. Estimates of contractual allowances are based on historical collection rates of payor reimbursement contract agreements.

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

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

|  | Three Months Ended<br>September 30, |           | Nine Months Ended<br>September 30, |           |
|--|-------------------------------------|-----------|------------------------------------|-----------|
|  | 2016                                | 2015      | 2016                               | 2015      |
| Commercial insurance   | \$130,036                           | \$114,827 | \$386,383                          | \$331,670 |
| Medicare   | 48,740                              | 40,840    | 140,089                            | 120,039   |
| Medicaid   | 7,554                               | 6,117     | 21,461                             | 17,582    |
| Workers' compensation/personal injury                            | 9,449                               | 7,712     | 27,935                             | 23,287    |
| Other  | 12,651                              | 23,408    | 37,163                             | 53,759    |
| Service fee revenue, net of contractual allowances and discounts | 208,430                             | 192,904   | 613,031                            | 546,337   |
| Provision for bad debts  | (11,253 )                           | (9,433 )  | (33,883 )                          | (25,295 ) |
| Net service fee revenue  | 197,177                             | 183,471   | 579,148                            | 521,042   |
| Revenue under capitation arrangements                            | 27,466                              | 24,895    | 80,448                             | 72,880    |
| Total net revenue  | \$224,643                           | \$208,366 | \$659,596                          | \$593,922 |

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

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

an impact on collection trends and our estimation process.

### ***Accounts Receivable***

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

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

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

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

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

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

Goodwill at September 30, 2016 totaled \$240.6 million. Indefinite Lived Intangible Assets at September 30, 2016 totaled \$7.9 million and are associated with the value of certain trade name intangibles. Goodwill and trade name intangibles are recorded as a result of business combinations. Management evaluates goodwill and trade name intangibles, at a minimum, on an annual basis and whenever events and changes in circumstances suggest that the carrying amount may not be recoverable. Impairment of goodwill is tested at the reporting unit level by comparing the reporting unit's carrying amount, including goodwill, to the fair value of the reporting unit. The fair value of a reporting unit is estimated using a combination of the income or discounted cash flows approach and the market approach, which uses comparable market data. If the carrying amount of the reporting unit exceeds its fair value, goodwill is considered impaired and a second step is performed to measure the amount of impairment loss, if any. Impairment of trade name intangibles is tested at the subsidiary level by comparing the subsidiary's trade name carrying amount to its respective fair value. We tested both goodwill and trade name intangibles for impairment on October 1, 2015, noting no impairment, and have not identified any indicators of impairment through September 30, 2016.

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

We evaluate our long-lived assets (property and equipment) and intangibles, other than goodwill, for impairment whenever indicators of impairment exist. The accounting standards require that if the sum of the undiscounted expected future cash flows from a long-lived asset or definite-lived intangible is less than the carrying value of that asset, an asset impairment charge must be recognized. The amount of the impairment charge is calculated as the excess of the asset's carrying value over its fair value, which generally represents the discounted future cash flows from that asset or in the case of assets we expect to sell, at fair value less costs to sell. No indicators of impairment were identified with respect to our long-lived assets as of September 30, 2016.

## Recent Accounting Standards

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

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



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

In September 2015, the FASB issued ASU No. 2015-16 (“ASU 2015-16”), *Business Combinations*, (Topic 805): Simplifying the Accounting for Measurement-Period Adjustments. ASU 2015-16 eliminates the requirement to retrospectively apply adjustments made to provisional amounts recognized in a business combination. An entity will now recognize any adjustments in the reporting period in which the amounts are determined, calculated as if the accounting had been completed at the acquisition date. Disclosure is required for the portion of adjustments recorded in current-period earnings that would have been recorded in previous reporting periods had they been recognized as of the acquisition date. The update is effective for fiscal years (and interim reporting periods within fiscal years) beginning after December 15, 2015. Early adoption is permitted for financial statements that have not been previously issued. The update has been adopted and has had no material effect on our results of operations and cash flows.

In August 2014, the FASB issued ASU No. 2014-15 (“ASU 2014-15”), *Presentation of Financial Statements* (Subtopic 205-40): Going Concern. In connection with preparing financial statements for each annual and interim reporting period, an entity’s management should evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about the entity’s ability to continue as a going concern within one year after the date that the financial statements are issued. If conditions or events raise substantial doubt about an entity’s ability to continue as a going concern, but the substantial doubt is alleviated as a result of consideration of management’s plans, the entity should disclose information. The update is effective for the annual period ending after December 15, 2016, and for annual periods and interim periods thereafter. Early application is permitted. The impact of the GAAP update is expected to have minimal impact on our financial disclosures.

In May 2014, the FASB issued ASU No. 2014-09 (“ASU 2014-09”), *Revenue from Contracts with Customers*, (Topic 606). ASU 2014-09 requires an entity to recognize revenue when it transfers promised goods or services to customers in an amount that reflects what it expects in exchange for the goods or services. It also requires more detailed disclosures to enable users of the financial statements to understand the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers. The update was effective for fiscal years (and interim reporting periods within fiscal years) beginning after December 15, 2016, which has recently been extended to December 31, 2017. We are currently evaluating the impact of the GAAP update on our results of operations and cash flows.

## **Industry Updates**

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

## **Results of Operations**

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

|  | Three Months<br>Ended<br>September 30,<br>2016 |             | Nine Months<br>Ended<br>September 30,<br>2015 |             |
|--|--|-------------|---|-------------|
| <b>NET REVENUE</b>   |  |             |   |             |
| Service fee revenue, net of contractual allowances and discounts       | 88.4%  | 88.6%       | 88.4%   | 88.2%       |
| Provision for bad debts  | -4.8%  | -4.3%       | -4.9%   | -4.1%       |
| Net service fee revenue  | 83.6%  | 84.3%       | 83.5%   | 84.1%       |
| Revenue under capitation arrangements                                  | 11.6%  | 11.4%       | 11.6%   | 11.8%       |
| Total net revenue  | 95.2%  | 95.7%       | 95.1%   | 95.9%       |
| <b>OPERATING EXPENSES</b>  |  |             |   |             |
| Cost of operations, excluding depreciation and amortization            | 81.7%  | 80.6%       | 84.2%   | 84.0%       |
| Depreciation and amortization  | 7.3%   | 6.7%        | 7.1%  | 7.1%        |
| Loss on sale and disposal of equipment                                 | 0.0%   | 0.3%        | 0.1%  | 0.1%        |
| Severance costs  | 0.9%   | 0.1%        | 0.4%  | 0.0%        |
| Total operating expenses   | 89.9%  | 87.7%       | 91.8%   | 91.2%       |
| <b>INCOME FROM OPERATIONS</b>  | <b>5.3%</b>                                    | <b>7.9%</b> | <b>3.3%</b>                                   | <b>4.6%</b> |
| <b>OTHER INCOME AND EXPENSES</b>                                       |  |             |   |             |
| Interest expense   | 4.8%   | 4.8%        | 4.7%  | 5.0%        |
| Meaningful use incentive   | 0.0%   | 0.0%        | -0.4%   | -0.5%       |
| Equity in earnings of joint ventures                                   | -1.1%  | -0.9%       | -1.2%   | -1.0%       |
| Gain on sale of imaging centers  | 0.0%   | -2.2%       | 0.0%  | -0.8%       |
| Gain on return of common stock   | 0.0%   | 0.0%        | -0.7%   | 0.0%        |
| Other expenses   | 0.1%   | 0.0%        | 0.0%  | 0.1%        |
| Total other expenses   | 3.8%   | 1.7%        | 2.4%  | 2.8%        |
| <b>INCOME BEFORE INCOME TAXES</b>                                      | <b>1.5%</b>                                    | <b>6.2%</b> | <b>0.9%</b>                                   | <b>1.8%</b> |
| Provision for income taxes   | -0.6%  | -2.4%       | -0.4%   | -0.7%       |
| <b>NET INCOME</b>  | <b>0.9%</b>                                    | <b>3.8%</b> | <b>0.5%</b>                                   | <b>1.1%</b> |
| Net income attributable to noncontrolling interests                    | 0.1%   | 0.1%        | 0.1%  | 0.1%        |
| <b>NET INCOME ATTRIBUTABLE TO RADNET, INC.<br/>COMMON STOCKHOLDERS</b> | <b>0.8%</b>                                    | <b>3.7%</b> | <b>0.4%</b>                                   | <b>1.0%</b> |

*Three Months Ended September 30, 2016 Compared to the Three Months Ended September 30, 2015*

*Service Fee Revenue*

Service fee revenue for the three months ended September 30, 2016 was \$208.4 million compared to \$192.9 million for the three months ended September 30, 2015, an increase of \$15.5 million, or 8.1%.

*Provision for Bad Debts*

Provision for bad debts increased \$1.8 million, or 19.3%, to approximately \$11.3 million, or 5.4% of service fee revenue, for the three months ended September 30, 2016 compared to \$9.4 million, or 4.9% of service fee revenue, for the three months ended September 30, 2015.

*Net Service Fee Revenue*

Total net service fee revenue for the three months ended September 30, 2016 was \$197.2 million compared to \$183.5 million for the three months ended September 30, 2015, an increase of \$13.7 million or 7.5%.

Total net service fee revenue, including only those centers which were in operation throughout the third quarters of both 2016 and 2015 had an increase of \$487,000, or 0.3%. This comparison excludes revenue contributions from centers that were acquired or divested subsequent to July 1, 2015. For the three months ended September 30, 2016, net service fee revenue from centers that were acquired or divested subsequent to July 1, 2015 and excluded from the above comparison was \$24.4 million. For the three months ended September 30, 2015, net service fee revenue from centers that were acquired or divested subsequent to July 1, 2015 and excluded from the above comparison was \$11.2 million.

*Revenue Under Capitation Arrangements*

Revenue under capitation arrangements for the three months ended September 30, 2016 was \$27.4 million compared to \$24.9 million for the three months ended September 30, 2015, an increase of \$2.6 million or 10.3%.

Revenue under capitation arrangements, including only those centers which were in operation throughout the third quarters of both 2016 and 2015 had an increase of \$350,000, or 1.4%. This comparison excludes revenue contributions from centers that were acquired or divested subsequent to July 1, 2015. For the three months ended September 30, 2016, revenue under capitation arrangements from centers that were acquired or divested subsequent to July 1, 2015 and excluded from the above comparison was \$2.2 million. For the three months ended September 30, 2015, revenue under capitation arrangements from centers that were acquired or divested subsequent to July 1, 2015 and excluded from the above comparison was \$0.

### *Operating Expenses*

Cost of operations for the three months ended September 30, 2016 increased approximately \$17.1 million, or 9.8%, from \$175.6 million for the three months ended September 30, 2015 to \$192.8 million for the three months ended September 30, 2016. The following table sets forth our cost of operations and total operating expenses for the three months ended September 30, 2016 and 2015 (in thousands):

|  | <b>Three Months<br/>Ended September<br/>30,</b> |           |
|--|---|-----------|
|  | 2016  | 2015      |
| Salaries and professional reading fees, excluding stock-based compensation | \$100,220                                       | \$95,131  |
| Stock-based compensation   | 1,157   | 906       |
| Building and equipment rental  | 17,611  | 18,129    |
| Medical supplies   | 13,190  | 10,809    |
| Other operating expenses *   | 60,574  | 50,656    |
| Cost of operations   | 192,752   | 175,631   |
| Depreciation and amortization  | 17,318  | 14,601    |
| (Gain) loss on sale and disposal of equipment                              | (66 )   | 738       |
| Severance costs  | 2,188   | 167       |
| Total operating expenses   | \$212,192                                       | \$191,137 |

\* 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 \$5.1 million, or 5.4%, to \$100.2 million for the three months ended September 30, 2016 compared to \$95.1 million for the three months ended September 30, 2015.

Salaries and professional reading fees, when including only those centers which were in operation throughout the third quarters of both 2016 and 2015, decreased \$651,000, or 0.7%. This comparison excludes expenses from centers that were acquired or divested subsequent to July 1, 2015. For the three months ended September 30, 2016, salaries and professional reading fees from centers that were acquired or divested subsequent to July 1, 2015 and excluded from the above comparison was \$9.2 million. For the three months ended September 30, 2015, salaries and professional reading fees from centers that were acquired or divested subsequent to July 1, 2015 and excluded from the above comparison was \$3.4 million.

### **Stock-based compensation**

Stock-based compensation increased \$251,000, or 27.7%, to approximately \$1.2 million for the three months ended September 30, 2016 compared to \$906,000 for the three months ended September 30, 2015. This increase was driven

by stock bonus awards granted during the three months ended September 30, 2016. See Note 7 to the condensed consolidated financial statements contained herein.

### **Building and equipment rental**

Building and equipment rental expenses decreased \$518,000 or 2.9%, to \$17.6 million for the three months ended September 30, 2016 compared to \$18.1 million for the three months ended September 30, 2015.

Building and equipment rental expenses, limited to only those centers which were in operation throughout the third quarters of both 2016 and 2015, decreased \$1.4 million, or 8.2% as a result of negotiating favorable lease terms at existing sites. This comparison excludes expenses from centers that were acquired or divested subsequent to July 1, 2015. For the three months ended September 30, 2016, building and equipment rental expenses from centers that were acquired or divested subsequent to July 1, 2015 and excluded from the above comparison was \$2.1 million. For the three months ended September 30, 2015, building and equipment rental expenses from centers that were acquired or divested subsequent to July 1, 2015 and excluded from the above comparison was \$1.2 million.

### **Medical supplies**

Medical supplies expense increased \$2.4 million, or 22%, to \$13.2 million for the three months ended September 30, 2016 compared to \$10.8 million for the three months ended September 30, 2015.

Medical supplies expenses, including only those centers which were in operation throughout the third quarters of both 2016 and 2015, increased \$1.2 million, or 11.7% due to reduced rebates received from vendors in the current quarter over the same period in 2015. This comparison excludes expenses from centers that were acquired or divested subsequent to July 1, 2015. For the three months ended September 30, 2016, medical supplies expenses from centers that were acquired or divested subsequent to July 1, 2015 and excluded from the above comparison was \$1.7 million. For the three months ended September 30, 2015, medical supplies expenses from centers that were acquired or divested subsequent to July 1, 2015 and excluded from the above comparison was \$451,000.

### **Other operating expenses**

Other operating expenses increased \$9.9 million, or 19.6%, to \$60.6 million for the three months ended September 30, 2016 compared to \$50.6 million for the three months ended September 30, 2015.

Other operating expenses, limited only those centers which were in operation throughout the third quarters of both 2016 and 2015, increased \$4.0 million, or 8.4%. This 8.4% increase primarily relates to increased insurance, contract labor, temporary services and legal fees. This comparison excludes expenses from centers that were acquired or divested subsequent to July 1, 2015. For the three months ended September 30, 2016, other operating expense from centers that were acquired or divested subsequent July 1, 2015 and excluded from the above comparison was \$8.7 million. For the three months ended September 30, 2015, other operating expenses from centers that were acquired or divested subsequent to July 1, 2015 and excluded from the above comparison was \$2.8 million.

### **Depreciation and amortization**

Depreciation and amortization increased \$2.7 million, or 18.6%, to \$17.3 million for the three months ended September 30, 2016 compared to \$14.6 million for the three months ended September 30, 2015.

Depreciation and amortization, including only those centers which were in operation throughout the third quarters of both 2016 and 2015, increased \$422,000, or 3.0%. This comparison excludes expenses from centers that were acquired or divested subsequent to July 1, 2015. For the three months ended September 30, 2016, depreciation expense from centers that were acquired or divested subsequent to July 1, 2015 and excluded from the above comparison was \$2.7 million. For the three months ended September 30, 2015, depreciation expense from centers that were acquired or divested subsequent to July 1, 2015 and excluded from the above comparison was \$407,000.



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

We recorded a gain on sale of equipment of approximately \$66,000 for the three months ended September 30, 2016 and a loss on disposal of equipment of approximately \$738,000 for the three months ended September 30, 2015.

### **Severance Costs**

We incurred severance expenses of \$2.2 million for the three months ended September 30, 2016 related to the integration of acquisitions in the state of New York. We incurred \$167,000 for the three months ended September 30, 2015.

### ***Interest expense***

Interest expense for the three months ended September 30, 2016 increased approximately \$858,000, or 8.1%, to \$11.4 million for the three months ended September 30, 2016 compared to \$10.5 million for the three months ended September 30, 2015. Interest expense for the three months ended September 30, 2016 included \$1.6 million of combined non-cash amortization of deferred loan costs, discount on issuance of debt, write-off of deferred loan costs due to refinancing and other non-cash items. Interest expense for the three months ended September 30, 2015 included \$1.4 million of combined non-cash amortization of deferred loan costs of \$709,000, discount on issuance of debt and other non-cash items. Excluding these non-cash amounts for each period, interest expense increased approximately \$652,000 for the three months ended September 30, 2016 compared to the three months ended September 30, 2015. This increase was primarily due to interest on the Restated Amendment and First Lien Credit Agreement. See “Liquidity and Capital Resources” below for more details on our credit facilities.

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

For the three months ended September 30, 2016, we recognized equity in earnings from unconsolidated joint ventures of \$2.6 million against \$2.0 million earned over the same period ended September 30, 2015, a 29.3% increase. This increase relates mainly to equity in earnings stemming from the September 30, 2015 sale of 10 wholly owned centers from our subsidiary New Jersey Imaging Partners to New Jersey Imaging Networks, a joint venture where we hold a 49% non-controlling interest.

***Gain on Sale of Imaging Center***

We recognized a gain on the sale of 10 wholly owned imaging centers to the New Jersey Imaging Networks in the amount of \$4.8 million for the three months ending September 30, 2015.

***Provision for income taxes***

We had an income tax expense for the three months ended September 30, 2016 of \$1.5 million or 42.3% of income before income taxes, compared to the three months ended September 30, 2015 with an income tax expense of \$5.2 million or 38.5% of the income before income taxes.

***Nine Months Ended September 30, 2016 Compared to the Nine Months Ended September 30, 2015***

***Service Fee Revenue***

Service fee revenue for the nine months ended September 30, 2016 was \$613.0 million compared to \$546.3 million for the nine months ended September 30, 2015, an increase of \$66.7 million, or 12.2%.

***Provision for Bad Debts***

Provision for bad debts increased \$8.6 million, or 34.0%, to approximately \$33.9 million, or 5.5% of service fee revenue for the nine months ended September 30, 2016 compared to \$25.3 million, or 4.6% of service fee revenue, for the nine months ended September 30, 2015.

***Net Service Fee Revenue***

Net Service Fee Revenue for the nine months ended September 30, 2016 was \$579.1 million compared to \$521.0 million for the nine months ended September 30, 2015, an increase of \$58.1 million or 11.1%.

Net Service Fee Revenue, including only those centers which were in operation throughout the third quarters of both 2016 and 2015 had an increase of \$13.1 million, or 2.8%, as a result of increased procedure volumes for high reimbursement modalities and higher management fee revenue. This comparison excludes revenue contributions from centers that were acquired or divested subsequent to January 1, 2015. For the nine months ended September 30, 2016, net service fee revenue from centers that were acquired or divested subsequent to January 1, 2015 and excluded from the above comparison was \$92.7 million. For the nine months ended September 30, 2015, net service fee revenue from centers that were acquired or divested subsequent to January 1, 2015 and excluded from the above comparison was \$47.7 million.

### ***Revenue Under Capitation Arrangements***

Revenue under capitation arrangements for the nine months ended September 30, 2016 was \$80.4 million compared to \$72.9 million for the nine months ended September 30, 2015, an increase of \$7.6 million or 10.4%.

Revenue under capitation arrangements, including only those centers which were in operation throughout the first three quarters of both 2016 and 2015 increased \$1.0, or 1.4%. This comparison excludes revenue contributions from centers that were acquired or divested subsequent to January 1, 2015. For the nine months ended September 30, 2016, revenue under capitation arrangements from centers that were acquired or divested subsequent to January 1, 2015 and excluded from the above comparison was \$7.1 million. For the nine months ended September 30, 2015, capitation revenue from centers that were acquired or divested subsequent to January 1, 2015 and excluded from the above comparison was \$487,000.

### ***Operating Expenses***

Cost of operations for the nine months ended September 30, 2016 increased approximately \$63.3 million, or 12.2%, from \$520.3 million for the nine months ended September 30, 2015 to \$583.6 million for the nine months ended September 30, 2016. The following table sets forth our cost of operations and total operating expenses for the nine months ended September 30, 2016 and 2015 (in thousands):

|  | Nine Months Ended<br>September 30, |           |
|--|------------------------------------|-----------|
|  | 2016                               | 2015      |
| Salaries and professional reading fees, excluding stock-based compensation | \$305,848                          | \$278,243 |
| Stock-based compensation   | 4,918                              | 6,475     |
| Building and equipment rental  | 56,277                             | 52,852    |
| Medical supplies   | 38,619                             | 36,330    |
| Other operating expenses *   | 177,978                            | 146,448   |
| Cost of operations   | 583,640                            | 520,348   |
| Depreciation and amortization  | 49,541                             | 43,836    |
| Loss on sale and disposal of equipment                                     | 375                                | 774       |
| Severance costs  | 2,528                              | 297       |
| Total operating expenses   | \$636,084                          | \$565,255 |

\* 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 \$27.6 million, or 9.8%, to \$308.1 million for the nine months ended September 30, 2016 compared to \$280.6 million for the nine months ended September 30, 2015.

Salaries and professional reading fees, including only those centers which were in operation throughout the first three quarters of both 2016 and 2015, increased \$4.7 million or 1.8%. This comparison excludes expenses from centers that were acquired or divested subsequent to January 1, 2015. For the nine months ended September 30, 2016, salaries and professional reading fees from centers that were acquired or divested subsequent to January 1, 2015 and excluded from the above comparison was \$38.5 million. For the nine months ended September 30, 2015, salaries and professional reading fees from centers that were acquired or divested subsequent to January 1, 2015 and excluded from the above comparison was approximately \$15.6 million.

### **Stock-based compensation**

Stock-based compensation decreased \$1.6 million, or 24.1%, to approximately \$4.9 million for the nine months ended September 30, 2016 compared to \$6.5 million for the nine months ended September 30, 2015. This decrease was driven by the lower fair value of RSA's awarded and vested in the first nine months of 2016 as compared to RSA's awarded and vested in the same period in 2015.

### **Building and equipment rental**

Building and equipment rental expenses increased \$3.4 million or 6.5%, to \$56.3 million for the nine months ended September 30, 2016 compared to \$52.9 million for the nine months ended September 30, 2015.

Building and equipment rental expenses, including only those centers which were in operation throughout the first three quarters of both 2016 and 2015, decreased \$1.9 million, or 4.0%, mainly due to favorable lease negotiations at existing facilities. This comparison excludes expenses from centers that were acquired or divested subsequent to January 1, 2015. For the nine months ended September 30, 2016, building and equipment rental expenses from centers that were acquired or divested subsequent to January 1, 2015 and excluded from the above comparison was \$10.7 million. For the nine months ended September 30, 2015, building and equipment rental expenses from centers that were acquired or divested subsequent to January 1, 2015 and excluded from the above comparison was approximately \$5.4 million.

### **Medical supplies**

Medical supplies expense increased \$4.7 million, or 13.8%, to \$38.6 million for the nine months ended September 30, 2016 compared to \$33.9 million for the nine months ended September 30, 2015.

Medical supplies expenses, including only those centers which were in operation throughout the first three quarters of both 2016 and 2015, increased \$1.1 million, or 3.5%. This comparison excludes expenses from centers that were acquired or divested subsequent to January 1, 2015. For the nine months ended September 30, 2016, medical supplies expenses from centers that were acquired or divested subsequent to January 1, 2015 and excluded from the above comparison was \$5.8 million. For the nine months ended September 30, 2015, medical supplies expense from centers that were acquired or divested subsequent to January 1, 2015 and excluded from the above comparison was \$2.2 million.

### **Other operating expenses**

Other operating expenses increased \$29.2 million, or 20.0%, to \$175.7 million for the nine months ended September 30, 2016 compared to \$146.4 million for the nine months ended September 30, 2015.

Other operating expenses, including only those centers which were in operation throughout the first three quarters of both 2016 and 2015, increased \$7.6 million, or 5.8%. This 5.8% increase was primarily related to insurance, temporary labor and legal expenses. This comparison excludes expenses from centers that were acquired or divested subsequent to January 1, 2015. For the nine months ended September 30, 2016, other operating expense from centers that were acquired or divested subsequent to January 1, 2015 and excluded from the above comparison was \$36.6 million. For the nine months ended September 30, 2015, other operating expense from centers that were acquired or divested subsequent to January 1, 2015 was \$15.0 million.

### **Depreciation and amortization**

Depreciation and amortization increased \$5.7 million, or 13.0%, to \$49.5 million for the nine months ended September 30, 2016 compared to \$43.8 million for the nine months ended September 30, 2015.

Depreciation and amortization, including only those centers which were in operation throughout the first three quarters of both 2016 and 2015, increased \$734,000, or 1.8%. This comparison excludes expenses from centers that were acquired or divested subsequent to January 1, 2015. For the nine months ended September 30, 2016, depreciation expense from centers that were acquired or divested subsequent to January 1, 2015 and excluded from the above comparison was \$8.3 million. For the nine months ended September 30, 2015, depreciation and amortization from centers that were acquired or divested subsequent to January 1, 2015 and excluded from the above comparison was \$3.3 million.

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

We recorded a loss on sale of equipment of approximately \$375,000 for the nine months ended September 30, 2016 and approximately \$774,000 for the nine months ended September 30, 2015.

### ***Interest expense***

Interest expense for the nine months ended September 30, 2016 increased approximately \$1.9 million, or 6.0%, to \$32.8 million for the nine months ended September 30, 2016 compared to \$31.0 million for the nine months ended September 30, 2015. Interest expense for the nine months ended September 30, 2016 included \$4.3 million of combined non-cash amortization of deferred loan costs, discount on issuance of debt, write-off of deferred financing costs due to refinancing of \$709,000 and other non-cash interest. Interest expense for the nine months ended September 30, 2015 included \$4.1 million of non-cash amortization of deferred loan costs, discount on issuance of debt and other non-cash interest. Excluding these non-cash amounts for each period, interest expense increased approximately \$1.6 million for the nine months ended September 30, 2016 compared to the nine months ended September 30, 2015. This increase was primarily due to interest on the Restated Amendment and First Lien Credit Agreement. See “Liquidity and Capital Resources” below for more details on our credit facilities. See “Liquidity and Capital Resources” below for more details on our outstanding credit facilities.

### *Meaningful use incentive*

For the nine months ended September 30, 2016 and September 30, 2015, we recognized other income from meaningful use incentive in the amount of \$2.8 million and \$3.3 million, respectively. These amounts were earned under a Medicare program to promote the use of electronic health record technology. See Note 1 to the condensed consolidated financial statements contained herein for more detail regarding this meaningful use incentive.

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

For the nine months ended September 30, 2016 we recognized equity in earnings from unconsolidated joint ventures of \$8.1 million versus \$6.3 million for the nine months ended September 30, 2015, an increase of \$1.8 million or 6.0%. The 6% increase relates mainly to equity in earnings stemming from the September 30, 2015 sale of 10 wholly owned centers from our subsidiary New Jersey Imaging Partners to New Jersey Imaging Networks, a joint venture where we hold a 49% non-controlling interest.

***Gain on Sale of Imaging Center***

We recognized a gain on the sale of 10 wholly owned imaging centers to the New Jersey Imaging Networks in the amount of \$4.8 million for the nine months ending September 30, 2015.

***Gain from return of common stock***

For the nine months ended September 30, 2016, we recorded a gain on return of common stock of \$5.0 million. For more details, please see Note 2 to the condensed consolidated financial statements included in this report.

***Provision for income taxes***

We had a tax provision for the nine months ended September 30, 2016 of \$2.5 million or 39.1% of income before income taxes, compared to a tax provision for the nine months ended September 30, 2015 of \$4.3 million or 36.8% of income before income taxes.

***Adjusted EBITDA***

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

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



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

Adjusted EBITDA is most comparable to the GAAP financial measure, net income (loss) attributable to RadNet, Inc. common stockholders. The following is a reconciliation of GAAP net income (loss) attributable to RadNet, Inc. common stockholders to Adjusted EBITDA for the three and nine months ended September 30, 2016 and 2015, respectively:

|   | Three Months<br>Ended<br>September 30, |          | Nine Months<br>Ended<br>September 30, |          |
|---|--|----------|---------------------------------------|----------|
|   | 2016                                   | 2015     | 2016                                  | 2015     |
| Net income attributable to RadNet, Inc. common stockholders | \$1,647                                | \$7,987  | \$3,549                               | \$6,828  |
| Plus interest expense                                       | 11,404                                 | 10,546   | 32,830                                | 30,965   |
| Plus provision for income taxes                             | 1,458                                  | 5,199    | 2,531                                 | 4,300    |
| Plus depreciation and amortization                          | 17,318                                 | 14,601   | 49,541                                | 43,836   |
| Less (gain) plus loss on sale and disposal of equipment     | (66 )                                  | 738      | 375                                   | 774      |
| Plus severance costs  | 2,188                                  | 167      | 2,528                                 | 297      |
| Plus other expenses   | 174                                    | 8        | 180                                   | 418      |
| Plus non-cash employee stock-based compensation             | 1,157                                  | 906      | 4,918                                 | 6,477    |
| Less gain on sale of imaging center                         | –                                      | (4,823 ) | –                                     | (4,823 ) |
| Plus acquisition related working capital adjustment         | –                                      | –        | 6,072                                 | –        |
| Plus fees for refinance                                     | 606                                    | –        | 606                                   | –        |
| Less gain on return of common stock                         | –                                      | –        | (5,032 )                              | –        |
| Adjusted EBITDA   | \$35,886                               | \$35,329 | \$98,098                              | \$89,072 |

## Liquidity and Capital Resources

We had cash and cash equivalents of \$358,000 and accounts receivable of \$183.2 million at September 30, 2016, compared to cash and cash equivalents of \$446,000 and accounts receivable of \$162.8 million at December 31, 2015. We had a working capital balance of \$85.1 million and \$72.4 million at September 30, 2016 and December 31, 2015, respectively. We had net income attributable to RadNet, Inc. common stockholders for the three months ended September 30, 2016 and 2015 of \$1.6 million and \$8.0 million, respectively. We had net income attributable to RadNet, Inc. common stockholders for the nine months ended September 30, 2016 and 2015 of \$3.5 million and \$6.8 million, respectively. We also had stockholders' equity of \$36.7 million and \$32.6 million at September 30, 2016 and December 31, 2015, respectively.

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

Based on our current level of operations, we believe that cash flow from operations and available cash, together with available borrowings from our credit facilities, will be adequate to meet our liquidity needs. Our future liquidity

requirements will be for working capital, capital expenditures, debt service and general corporate purposes. Our ability to meet our working capital and debt service requirements, however, is subject to future economic conditions and to financial, business and other factors, many of which are beyond our control. If we are not able to meet such requirements, we may be required to seek additional financing. There can be no assurance that we will be able to obtain financing from other sources on terms acceptable to us, if at all.

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

### *Sources and Uses of Cash*

Cash provided by operating activities was \$54.7 million and \$40.1 million for the nine months ended September 30, 2016 and September 30, 2015, respectively.

Cash used in investing activities was \$59.0 million and \$43.6 million for the nine months ended September 30, 2016 and 2015, respectively. For the nine months ended September 30, 2016, we purchased property and equipment for approximately \$52.1 million and acquired imaging facilities for \$5.0 million.

Cash provided by financing activities was \$4.2 million and \$39.4 million for the nine months ended September 30, 2016 and September 30, 2015, respectively. The cash used in financing activities for the nine months ended September 30, 2016, was primarily due to amounts received from borrowings under our Revolving Credit Facility and proceeds received from our refinancing activity, offset by principal payments on first lien term loans under the Prior First Lien Credit Agreement, Second Lien Term Loans, equipment notes and capital leases. (See Note 2 to the condensed consolidated financial statements herein).

### *Credit Facilities*

At September 30, 2016, our credit facilities were comprised of two tranches of term loans and a revolving credit facility. On July 1, 2016 (the “Restatement Effective Date”), we entered into Amendment No. 3 to Credit and Guaranty Agreement (the “Restatement Amendment”) pursuant to which we amended and restated our then existing credit facilities on the terms set forth in the Amended and Restated First Lien Credit and Guaranty Agreement dated July 1, 2016 (as amended from time to time, the “First Lien Credit Agreement”). Pursuant to the First Lien Credit Agreement, we have issued \$485 million of senior secured term loans (the “First Lien Term Loans”) and established a \$117.5 million senior secured revolving credit facility (the “Revolving Credit Facility”). We have also entered into a Second Lien Credit and Guaranty Agreement dated March 25, 2014 (as amended from time to time, the “Second Lien Credit Agreement”) pursuant to which we issued \$180 million of secured term loans (the “Second Lien Term Loans”).

Included in our condensed consolidated balance sheet at September 30, 2016 is \$635.5 million of senior secured term loan debt (net of unamortized discounts of \$17.5 million), broken down by loan agreement as follows (in thousands):

|                        | As of September 30, 2016 |            |                      |
|------------------------|--------------------------|------------|----------------------|
|                        | Face Value               | Discount   | Total Carrying Value |
| First Lien Term Loans  | \$485,000                | \$(15,278) | \$469,722            |
| Second Lien Term Loans | \$168,000                | \$(2,193)  | \$165,807            |
| Total                  | \$653,000                | \$(17,471) | \$635,529            |

Our \$117.5 million Revolving Credit Facility had a \$1.6 million aggregate principal amount outstanding as of September 30, 2016.

As of September 30, 2016, we were in compliance with all covenants under our First Lien Credit Agreement and our Second Lien Credit Agreement.

Details on the First Lien Credit Agreement and the Second Lien Credit Agreement follow.

Restatement Amendment and the First Lien Credit Agreement

On July 1, 2016, we entered into the Restatement Amendment pursuant to which we amended and restated our then existing credit facilities on the terms set forth in the First Lien Credit Agreement. As of the Restatement Effective Date, our first lien credit facilities consisted of a Credit and Guaranty Agreement that we entered into on October 10, 2012 (the “Original First Lien Credit Agreement”), as subsequently amended by a first amendment dated April 3, 2013 (the “2013 Amendment”), a second amendment dated March 25, 2014 (the “2014 Amendment”), and a joinder agreement dated April 30, 2015 (the “2015 Joinder” and collectively with the Original First Lien Credit Agreement, the 2013 Amendment and the 2014 Amendment, the “Prior First Lien Credit Agreement”). The First Lien Credit Agreement increased the aggregate principal amount of First Lien Term Loans to \$485.0 million and increased the Revolving Credit Facility to \$117.5 million. Proceeds from the First Lien Credit Agreement were used to repay the previously outstanding first lien loans under the Prior First Lien Credit Agreement, make a \$12.0 million principal payment of the Second Lien Term Loans, pay costs and expenses related to the First Lien Credit Agreement and provide approximately \$10.0 million for general corporate purposes.

*Interest.* The interest rates payable on the First Lien Term Loans are (a) the Adjusted Eurodollar Rate (as defined in the First Lien Credit Agreement) plus 3.75% per annum or (b) the Base Rate (as defined in the First Lien Credit Agreement) plus 2.75% per annum. As applied to the First Lien Term Loans, the Adjusted Eurodollar Rate has a minimum floor of 1.0%. The six month Adjusted Eurodollar Rate (as defined in the First Lien Credit Agreement) at July 1, 2016, the day of the Restatement Amendment, was 0.92%. Prior to the Restatement Amendment, the interest rates payable on first lien term loans under the Prior First Lien Credit Agreement were the Adjusted Eurodollar Rate (as defined in the Prior First Lien Credit Agreement) plus 3.25% per annum or the Base Rate (as defined in the Prior First Lien Credit Agreement) plus 2.25% per annum.

*Payments.* The scheduled quarterly amortization of the First Lien Term Loans is approximately \$6.1 million, beginning in December 2016, with the balance due at maturity. Prior to the Restatement Amendment, the quarterly amortization payments on the first lien term loans under the Prior First Lien Credit Agreement were approximately \$6.2 million.

*Maturity Date.* The maturity date for the First Lien Term Loans shall be on the earliest to occur of (i) the seventh anniversary of the Restatement Effective Date, (ii) the date on which all First Lien Term Loans shall become due and payable in full under the First Lien Credit Agreement, whether by acceleration or otherwise, and (iii) September 25, 2020 if our indebtedness under the Second Lien Credit Agreement has not been repaid, refinanced or extended prior to such date.

*Incremental Feature:* Under the First Lien Credit Agreement, we can elect to request 1) an increase to the existing Revolving Credit Facility and/or 2) additional First Lien Term Loans, provided that the aggregate amount of such increases or additions does not exceed (A) an amount not in excess of \$100.0 million minus any incremental loans requested under the similar provisions of the Second Lien Credit Agreement or (B) if the First Lien Leverage Ratio would not exceed 3.50:1.00 after giving effect to such incremental facilities, an uncapped amount, in each case subject to the conditions and limitations set forth in the First Lien Credit Agreement. Each lender approached to provide all or a portion of any incremental facility may elect or decline, in its sole discretion, to provide any incremental commitment or loan.

*Revolving Credit Facility:* The First Lien Credit Agreement provides for a \$117.5 million Revolving Credit Facility. The termination date of the Revolving Credit Facility is the earliest to occur of: (i) July 1, 2021, (ii) the date the Revolving Credit Facility is permanently reduced to zero pursuant to section 2.13(b) of the First Lien Credit Agreement, which addresses voluntary commitment reductions, (iii) the date of the termination of the Revolving Credit Facility due to specific events of default pursuant to section 8.01 of the First Lien Credit Agreement, and (iv) September 25, 2020 if our indebtedness under the Second Lien Credit Agreement has not been repaid, refinanced or extended prior to such date. Amounts borrowed under the Revolving Credit Facility bear interest based on types of borrowings as follows: (i) unpaid principal on loans under the Revolving Credit Facility at the Adjusted Eurodollar Rate (as defined in the First Lien Credit Agreement) plus 3.75% per annum or the Base Rate (as defined in the First Lien Credit Agreement) plus 2.75% per annum, (ii) letter of credit fees at 3.75% per annum and fronting fees for letters of credit at 0.25% per annum, in each case on the average aggregate daily maximum amount available to be drawn under all letters of credit issued under the First Lien Credit Agreement, and (iii) commitment fee of 0.5% per annum on the unused revolver balance.

Second Lien Credit Agreement:

On March 25, 2014, we entered into the Second Lien Credit Agreement to provide for, among other things, the borrowing of \$180.0 million of Second Lien Term Loans. The proceeds from the Second Lien Term Loans were used to redeem our 10 3/8% senior unsecured notes, due 2018, to pay the expenses related to the transaction and for general corporate purposes. On July 1, 2016, in conjunction with the Restatement Amendment, a \$12.0 million principal payment was made on the Second Lien Term Loans.

The Second Lien Credit Agreement provides for the following:

*Interest.* The interest rates payable on the Second Lien Term Loans are (a) the Adjusted Eurodollar Rate (as defined in the Second Lien Credit Agreement) plus 7.0% or (b) the Base Rate (as defined in the Second Lien Credit Agreement) plus 6.0%. The Adjusted Eurodollar Rate has a minimum floor of 1.0% on the Second Lien Term Loans. The three month Adjusted Eurodollar Rate at September 30, 2016 was 0.85%. The rate paid on the Second Lien Term Loan at September 30, 2016 was 8%.

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

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

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

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

We maintain research and development facilities in Prince Edward Island, Canada and Budapest, Hungary for which expenses are paid in the local currency. Accordingly, we do have currency risk resulting from fluctuations between such local currency and the United States dollar. At the present time, we do not have any foreign currency exchange contracts to mitigate this risk. At September 30, 2016, a hypothetical 1% decline in the currency exchange rates between the United States Dollar against the Canadian Dollar and the Hungarian Forint would have resulted in an annual increase of approximately \$30,000 in operating expenses.

***Interest Rate Sensitivity*** We pay interest on various types of debt instruments to our suppliers and lending institutions. The agreements entail either fixed or variable interest rates. Instruments which have fixed rates are mainly leases on radiology equipment. Variable rate interest obligations relate primarily to amounts borrowed under our outstanding credit facilities. As described in the Liquidity and Capital Resources section above, we can elect Adjusted Eurodollar or Base Rate interest rate options on the First Lien Term Loans, the Second Lien Term Loans and the Revolving Credit Facility.

At September 30, 2016, we had \$479.0 million outstanding subject to a six month Adjusted Eurodollar election on First Lien Term Loans and \$168.0 million outstanding subject to a three month Adjusted Eurodollar election on Second Lien Term Loans. Based on our current Adjusted Eurodollar elections, the contractual Adjusted Eurodollar Rate floor of 1% exceeds the respective current spot rates. For the First Lien Term Loans, an increase of 108 basis points would be necessary to realize a hypothetical 1% increase in the borrowing rate and an annual increase of \$4.8 million of interest expense. For the Second Lien Term Loans, an increase of 115 basis points would be required to realize a hypothetical 1% increase in the borrowing rate and an annual increase of \$1.7 million of interest expense. At September 30, 2016, we had an additional \$7.7 million in debt instruments tied to the prime rate. A hypothetical 1% increase in the prime rate for 2015-2016 would have resulted in an annual increase in interest expense of approximately \$77,000 on those instruments.

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

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



We maintain disclosure controls and procedures that are designed to provide reasonable assurance that material information is (1) gathered and communicated to our management, including our principal executive and financial officers, on a timely basis; and (2) recorded, processed, summarized, reported and filed with the SEC as required under the Securities Exchange Act of 1934, as amended. Under the supervision of our management, including our Chief Executive Officer and Chief Financial Officer, we conducted an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures under Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934, as amended, as of September 30, 2016. Based on this evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were not effective for their intended purpose as of September 30, 2016 because of deficiencies in the design and operating effectiveness of certain information technology general controls (“ITGC’s) and information technology dependent manual controls related to the revenue and accounts receivable process that caused a material weakness in our internal control over financial reporting as described in more detail below.

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

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

Our management, under the supervision of our Chief Executive Officer and Chief Financial Officer, conducted an assessment of the effectiveness of its internal control over financial reporting as of September 30, 2016 based on the criteria established in Internal Control - Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Based on this assessment, our management concluded that our internal control over financial reporting was not effective at that reasonable assurance level as of September 30, 2016 because of the material weakness described below.

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

Our management initially identified certain control deficiencies in connection with the review of our controls at December 31, 2015 and concluded that, as of September 30, 2016, the following control deficiencies related to the Company’s revenue and accounts receivable process continue to aggregate to a material weakness in the Company’s internal control over financial reporting:

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

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

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

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

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

Our management, with oversight of our Audit Committee, has been actively engaged in developing [and implementing?] a remediation plan to address the material weakness reported. During the nine months ended September 30, 2016, the Company began to implement remediation efforts as follows:

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

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

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

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

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

Except for the remediation efforts described above, management did not identify any change in internal control over financial reporting occurring during the quarter ended September 30, 2016 that materially affected, or was reasonably likely to materially affect, our internal control over financial reporting.

## **PART II – OTHER INFORMATION**

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

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

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

For information about the risks and uncertainties related to our business, please see the risk factors described in our annual report on Form 10-K for the year ended December 31, 2015, as amended. The risks described in our Form 10-K, as amended, are not the only risks facing our Company. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business, financial condition and/or operating results.

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

None.

### **ITEM 3. Defaults Upon Senior Securities**

None.

**ITEM 4. Mine Safety Disclosures**

Not applicable.

**ITEM 5. Other Information**

None.

**ITEM 6. Exhibits**

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

**SIGNATURES**

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

RADNET, INC.  
(Registrant)

Date: November 9, 2016 By: /s/ Howard G. Berger, M.D.  
Howard G. Berger, M.D., President and Chief Executive Officer  
(Principal Executive Officer)

Date: November 9, 2016 By: /s/ Mark D. Stolper  
Mark D. Stolper, Chief Financial Officer  
(Principal Financial and Accounting Officer)

## INDEX TO EXHIBITS

| <u>Exhibit<br/>Number</u> | <u>Description</u>  |
|---------------------------|---|
| 10.1†                     | Amendment No. 3 to Credit and Guaranty Agreement, dated as of July 1, 2016, by and among Radnet Management, Inc., RadNet, Inc., certain subsidiaries and affiliates of RadNet, Inc., the lenders party thereto from time to time, and Barclays Bank PLC, as administrative agent and collateral agent, including Annex I thereto, Amended and Restated First Lien Credit and Guaranty Agreement, dated as of July 1, 2016, by and among Radnet Management, Inc., RadNet, Inc., certain subsidiaries and affiliates of RadNet, Inc., the lenders party thereto from time to time, and Barclays Bank PLC, as administrative agent and collateral agent (incorporated by reference to Exhibit 10.1 to our Current Report on Form 8-K filed with the Securities and Exchange Commission on July 5, 2016). |
| 31.1                      | Certification of Howard G. Berger, M.D. pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.  |
| 31.2                      | Certification of Mark D. Stolper pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.   |
| 32.1*                     | Certification of Howard G. Berger, M.D. pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.   |
| 32.2*                     | Certification of Mark D. Stolper pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.  |
| 101.INS**                 | XBRL Instance Document  |
| 101.SCH**                 | XBRL Schema Document  |
| 101.CAL**                 | XBRL Calculation Linkbase Document  |
| 101.LAB**                 | XBRL Label Linkbase Document  |
| 101.PRE**                 | XBRL Presentation Linkbase Document   |
| 101.DEF**                 | XBRL Definition Linkbase Document   |

† Confidential treatment has been requested with respect to the omitted portion of this Exhibit, which portion has been filed separately with the Securities and Exchange Commission.

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

filing.

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