

Edgar Filing: FONAR CORP - Form 10-Q

FONAR CORP  
Form 10-Q  
May 20, 2008

FORM 10-Q  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

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

For the quarterly period ended MARCH 31, 2008  
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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 0-10248  
-----

FONAR CORPORATION

-----  
(Exact name of registrant as specified in its charter)

DELAWARE

11-2464137

-----  
(State or other jurisdiction of  
incorporation or organization)

-----  
(I.R.S. Employer Identification No.)

110 Marcus Drive Melville, New York

11747

-----  
(Address of principal executive offices)

-----  
(Zip Code)

(631) 694-2929

-----  
Registrant's telephone number, including area code:

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one): Large accelerated filer  Accelerated filer  Non-accelerated filer

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

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

| Class                                   | Outstanding at April 30, 2008 |
|---|-------------------------------|
| -----                                   | -----                         |
| Common Stock, par value \$.0001         | 4,904,261                     |
| Class B Common Stock, par value \$.0001 | 158                           |

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|  |         |
|--|---------|
| Class C Common Stock, par value \$.0001    | 382,513 |
| Class A Preferred Stock, par value \$.0001 | 313,451 |

FONAR CORPORATION AND SUBSIDIARIES

INDEX

PART I - FINANCIAL INFORMATION PAGE

Item 1. Financial Statements

Condensed Consolidated Balance Sheets - March 31, 2008  
(Unaudited) and June 30, 2007

Condensed Consolidated Statements of Operations for  
the Three Months Ended March 31, 2008 and  
March 31, 2007 (Unaudited)

Condensed Consolidated Statements of Operations for  
the Nine Months Ended March 31, 2008 and  
March 31, 2007 (Unaudited)

Condensed Consolidated Statements of Comprehensive  
Loss for the Three Months Ended  
March 31, 2008 and March 31, 2007 (Unaudited)

Condensed Consolidated Statements of Comprehensive  
Loss for the Nine Months Ended  
March 31, 2008 and March 31, 2007 (Unaudited)

Condensed Consolidated Statements of Cash Flows for  
the Nine Months Ended March 31, 2008 and  
March 31, 2007 (Unaudited)

Notes to Condensed Consolidated Financial Statements (Unaudited)

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

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Item 4. Controls and Procedures

PART II - OTHER INFORMATION

Item 1. Legal Proceedings

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

Item 3. Defaults Upon Senior Securities

Item 4. Submission of Matters to a Vote of Security Holders

Item 5. Other Information

Item 6. Exhibits

Signatures

FONAR CORPORATION AND SUBSIDIARIES

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### CONDENSED CONSOLIDATED BALANCE SHEETS

(000's OMITTED)

| ASSETS  | March 31,<br>2008<br>(UNAUDITED) | June 30,<br>2007 |
|---|----------------------------------|------------------|
|   |                                  |                  |
| <b>Current Assets:</b>  |                                  |                  |
| Cash and cash equivalents   | \$ 2,174                         | \$ 1,470         |
| Marketable securities   | 1,056                            | 1,979            |
| Accounts receivable - net   | 5,524                            | 3,528            |
| Accounts receivable - related parties - net                                 | 485                              | 445              |
| Medical receivables - net   | 1,557                            | 2,781            |
| Management fee receivable - net   | 6,225                            | 5,096            |
| Management fee receivable - related medical practices - net                 | 1,317                            | 1,354            |
| Inventories   | 3,678                            | 4,466            |
| Current portion of advances and notes to related medical practices          | 228                              | 216              |
| Current portion of notes receivable less discount for below market interest | 613                              | 578              |
| Prepaid expenses and other current assets                                   | 1,299                            | 1,103            |
| <b>Total Current Assets</b>   | <b>24,156</b>                    | <b>23,016</b>    |
| Property and equipment - net  | 4,326                            | 5,159            |
| Advances and notes to related medical practices - net                       | 311                              | 474              |
| Notes receivable less discount for below market interest                    | 5,070                            | 5,528            |
| Other intangible assets - net   | 5,324                            | 5,345            |
| Other assets  | 1,776                            | 1,688            |
| <b>Total Assets</b>   | <b>\$ 40,963</b>                 | <b>\$ 41,210</b> |

See accompanying notes to condensed consolidated financial statements (unaudited).

### FONAR CORPORATION AND SUBSIDIARIES CONDENSED CONSOLIDATED BALANCE SHEETS

(000's OMITTED)

| LIABILITIES AND STOCKHOLDERS' EQUITY | March 31,<br>2008<br>(UNAUDITED) | June 30,<br>2007 |
|--------------------------------------|----------------------------------|------------------|
|                                      |                                  |                  |
| <b>Current Liabilities:</b>          |                                  |                  |

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|   |        |        |
|---|--------|--------|
| Current portion of long-term debt and capital leases                        | \$ 474 | \$ 257 |
| Accounts payable  | 3,645  | 3,940  |
| Other current liabilities   | 8,444  | 7,755  |
| Unearned revenue on service contracts                                       | 5,681  | 4,607  |
| Unearned revenue on service contracts - related parties                     | 477    | 460    |
| Customer advances   | 13,296 | 10,039 |
| Customer advances - related party   | 1,514  | 42     |
| Billings in excess of costs and estimated earnings on uncompleted contracts | 3,594  | 3,481  |
|   | -----  | -----  |
| Total Current Liabilities   | 37,125 | 30,581 |
| Long-Term Liabilities:  |        |        |
| Due to related medical practices  | 93     | 93     |
| Long-term debt and capital leases, less current portion                     | 805    | 956    |
| Other liabilities   | 265    | 150    |
|   | -----  | -----  |
| Total Long-Term Liabilities   | 1,163  | 1,199  |
|   | -----  | -----  |
| Total Liabilities   | 38,288 | 31,780 |
|   | -----  | -----  |
| Minority interest   | 167    | 532    |
|   | -----  | -----  |

See accompanying notes to condensed consolidated financial statements (unaudited).

FONAR CORPORATION AND SUBSIDIARIES  
CONDENSED CONSOLIDATED BALANCE SHEETS  
(000's OMITTED, except share data)

| LIABILITIES AND STOCKHOLDERS' EQUITY<br>(continued)   | March 31,<br>2008<br>(UNAUDITED) | June 30,<br>2007 |
|---|----------------------------------|------------------|
|   | -----                            | -----            |
| STOCKHOLDERS' EQUITY  |                                  |                  |
| Class A non-voting preferred stock \$.0001 par value; 1,600,000 authorized, 313,451 issued and outstanding at March 31, 2008 and June 30, 2007  | -                                | -                |
| Common Stock \$.0001 par value; 30,000,000 shares authorized at March 31, 2008 and June 30, 2007, 4,915,904 issued at March 31, 2008 and 4,885,850 at June 30, 2007; 4,904,261 outstanding at March 31, 2008 and 4,874,207 at June 30, 2007 | 1                                | 1                |
| Class B Common Stock \$ .0001 par value; 800,000 shares authorized, (10 votes per share), 158 issued and outstanding at March 31, 2008 and June 30, 2007  | -                                | -                |
| Class C Common Stock \$.0001 par value; 2,000,000 shares authorized, (25 votes per share), 382,513 issued and outstanding at March 31, 2008 and June 30, 2007   | -                                | -                |
| Paid-in capital in excess of par value  | 172,276                          | 172,072          |
| Accumulated other comprehensive loss  | ( 84)                            | ( 104)           |
| Accumulated deficit   | (168,614)                        | (161,872)        |
| Notes receivable from employee stockholders   | ( 396)                           | ( 524)           |

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|  |           |           |
|--|-----------|-----------|
| Treasury stock, at cost - 11,643 shares of common stock<br>at March 31, 2008 and June 30, 2007 | ( 675)    | ( 675)    |
|  | -----     | -----     |
| Total Stockholders' Equity   | 2,508     | 8,898     |
|  | -----     | -----     |
| Total Liabilities and Stockholders' Equity   | \$ 40,963 | \$ 41,210 |
|  | =====     | =====     |

See accompanying notes to condensed consolidated financial statements (unaudited).

FONAR CORPORATION AND SUBSIDIARIES  
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS (UNAUDITED)  
(000's OMITTED, except per share data)

|  | FOR THE THREE MONTHS ENDED |            |
|--|----------------------------|------------|
|  | MARCH 31,                  |            |
|  | 2008                       | 2007       |
|  | -----                      | -----      |
| <b>REVENUES</b>  |                            |            |
| Product sales - net  | \$ 2,348                   | \$ 3,220   |
| Product sales - related parties - net  | -                          | 1          |
| Service and repair fees - net  | 2,515                      | 2,314      |
| Service and repair fees - related parties - net  | 270                        | 243        |
| Management and other fees - net  | 2,110                      | -          |
| Management and other fees - related medical practices - net  | 828                        | 3,004      |
|  | -----                      | -----      |
| Total Revenues - Net   | 8,071                      | 8,782      |
|  | -----                      | -----      |
| <b>COSTS AND EXPENSES</b>  |                            |            |
| Costs related to product sales   | 2,237                      | 3,128      |
| Costs related to product sales - related parties   | -                          | 1          |
| Costs related to service and repair fees   | 1,148                      | 1,203      |
| Costs related to service and repair fees - related parties   | 123                        | 126        |
| Costs related to management and other fees   | 1,342                      | -          |
| Costs related to management and other fees - related medical practices   | 751                        | 2,236      |
| Research and development   | 1,189                      | 1,509      |
| Selling, general and administrative, inclusive of compensatory element of stock issuances of \$ 0 for the three months ended March 31, 2008 and 2007 | 4,311                      | 5,794      |
| (Credit) Provision for bad debts   | ( 309)                     | 100        |
|  | -----                      | -----      |
| Total Costs and Expenses   | 10,792                     | 14,097     |
|  | -----                      | -----      |
| Loss From Operations   | ( 2,721)                   | ( 5,315)   |
| Interest Expense   | ( 105)                     | ( 60)      |
| Investment Income  | 156                        | 178        |
| Interest Income - Related Parties  | 8                          | 10         |
| Other Income   | 1                          | 26         |
| Minority Interest in Income of Partnerships  | ( 34)                      | ( 240)     |
|  | -----                      | -----      |
| NET LOSS   | \$( 2,695)                 | \$( 5,401) |
|  | =====                      | =====      |
| Basic and Diluted Loss Per Common Share  | \$ (0.55)                  | \$ (1.11)  |
|  | =====                      | =====      |
| Weighted Average Number of Common Shares Outstanding   | 4,904,261                  | 4,860,418  |
|  | =====                      | =====      |

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See accompanying notes to condensed consolidated financial statements (unaudited).

FONAR CORPORATION AND SUBSIDIARIES  
 CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS (UNAUDITED)  
 (000's OMITTED, except per share data)

|  | FOR THE NINE MONTHS ENDED<br>MARCH 31, |                    |
|--|--|--------------------|
|  | 2008                                   | 2007               |
| <b>REVENUES</b>  |  |                    |
| Product sales - net  | \$ 8,940                               | \$ 7,619           |
| Product sales - related parties - net  | -                                      | 143                |
| Service and repair fees - net  | 7,444                                  | 6,806              |
| Service and repair fees - related parties - net  | 786                                    | 722                |
| Management and other fees - net  | 6,354                                  | -                  |
| Management and other fees - related medical practices - net  | 2,739                                  | 8,947              |
| License fees and royalties   | 1,158                                  | -                  |
|  | -----                                  | -----              |
| Total Revenues - Net   | 27,421                                 | 24,237             |
|  | -----                                  | -----              |
| <b>COSTS AND EXPENSES</b>  |  |                    |
| Costs related to product sales   | 8,566                                  | 7,939              |
| Costs related to product sales - related parties   | -                                      | 147                |
| Costs related to service and repair fees   | 3,546                                  | 3,503              |
| Costs related to service and repair fees - related parties   | 375                                    | 371                |
| Costs related to management and other fees   | 3,898                                  | -                  |
| Costs related to management and other fees - related medical practices   | 2,241                                  | 6,459              |
| Research and development   | 3,675                                  | 4,320              |
| Selling, general and administrative, inclusive of compensatory element of stock issuances of \$ 0 and \$ 121 for the nine months ended March 31, 2008 and 2007, respectively | 15,544                                 | 18,017             |
| Provision for bad debts  | 279                                    | 286                |
|  | -----                                  | -----              |
| Total Costs and Expenses   | 38,124                                 | 41,042             |
|  | -----                                  | -----              |
| Loss From Operations   | (10,703)                               | (16,805)           |
| Interest Expense   | ( 362)                                 | ( 203)             |
| Investment Income  | 531                                    | 606                |
| Interest Income - Related Parties  | 27                                     | 32                 |
| Other Income   | 7                                      | 104                |
| Minority Interest in Income of Partnerships  | ( 208)                                 | ( 710)             |
| Gain on Sale of Investment   | 571                                    | -                  |
| Gain on Sale of Consolidated Subsidiary  | 3,395                                  | -                  |
|  | -----                                  | -----              |
| <b>NET LOSS</b>  | <b>\$ ( 6,742)</b>                     | <b>\$ (16,976)</b> |
|  | =====                                  | =====              |
| Basic and Diluted Loss Per Common Share  | \$ (1.38)                              | \$ (3.52)          |
|  | =====                                  | =====              |
| Weighted Average Number of Common Shares Outstanding   | 4,895,907                              | 4,817,860          |
|  | =====                                  | =====              |

See accompanying notes to condensed consolidated financial statements (unaudited).

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FONAR CORPORATION AND SUBSIDIARIES  
 CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS  
 (UNAUDITED) (000'S OMITTED)

|   | FOR THE THREE MONTHS ENDED<br>MARCH 31, |            |
|---|---|------------|
|   | 2008                                    | 2007       |
| Net loss  | \$ (2,695)                              | \$ (5,401) |
| Other comprehensive income, net of tax:               |   |            |
| Unrealized gains on marketable securities, net of tax | 12                                      | 40         |
| Total comprehensive loss                              | \$ (2,683)                              | \$ (5,361) |

See accompanying notes to condensed consolidated financial statements (unaudited).

FONAR CORPORATION AND SUBSIDIARIES  
 CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS  
 (UNAUDITED) (000'S OMITTED)

|   | FOR THE NINE MONTHS ENDED<br>MARCH 31, |             |
|---|--|-------------|
|   | 2008                                   | 2007        |
| Net loss  | \$ ( 6,742)                            | \$ (16,976) |
| Other comprehensive income, net of tax:               |  |             |
| Unrealized gains on marketable securities, net of tax | 20                                     | 152         |
| Total comprehensive loss                              | \$ ( 6,722)                            | \$ (16,824) |

See accompanying notes to condensed consolidated financial statements (unaudited).

FONAR CORPORATION AND SUBSIDIARIES  
 CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)  
 (000'S OMITTED)

|   | FOR THE NINE MONTHS ENDED<br>MARCH 31, |             |
|---|--|-------------|
|   | 2008                                   | 2007        |
| Cash Flows from Operating Activities:                                       |  |             |
| Net loss  | \$ ( 6,742)                            | \$ (16,976) |
| Adjustments to reconcile net loss to net cash used in operating activities: |  |             |
| Minority interest in income of partnerships                                 | 208                                    | 710         |
| Depreciation and amortization   | 1,727                                  | 1,987       |
| Provision for bad debts   | 279                                    | 286         |

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|   |          |          |
|---|----------|----------|
| Compensatory element of stock issuances                                     | -        | 121      |
| Stock issued for costs and expenses   | 205      | 1,839    |
| Gain on sale of consolidated subsidiary                                     | ( 3,395) | -        |
| Gain on sale of investment  | ( 571)   | -        |
| (Increase) decrease in operating assets, net:                               |          |          |
| Accounts, management fee and medical receivable(s)                          | (3,351)  | 1,032    |
| Notes receivable  | 424      | 319      |
| Costs and estimated earnings in excess of billings on uncompleted contracts | -        | 2,748    |
| Inventories   | 788      | 928      |
| Principal payments received on sales type lease                             | -        | 279      |
| Prepaid expenses and other current assets                                   | ( 196)   | ( 41)    |
| Other assets  | ( 90)    | ( 65)    |
| Advances and notes to related medical practices                             | 139      | 35       |
| Increase (decrease) in operating liabilities, net:                          |          |          |
| Accounts payable  | ( 294)   | ( 995)   |
| Other current liabilities   | 1,780    | 1,271    |
| Customer advances   | 4,729    | 5,804    |
| Billings in excess of costs and estimated earnings on uncompleted contracts | 113      | ( 1,474) |
| Other liabilities   | 114      | ( 45)    |
| Income taxes payable  | -        | ( 8)     |
| Net cash used in operating activities                                       | ( 4,133) | ( 2,245) |

See accompanying notes to condensed consolidated financial statements (unaudited).

FONAR CORPORATION AND SUBSIDIARIES  
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)  
(000'S OMITTED)

|   | FOR THE NINE MONTHS ENDED<br>MARCH 31, |        |
|---|--|--------|
|   | 2008                                   | 2007   |
| Cash Flows from Investing Activities:                     |  |        |
| Purchases of marketable securities                        | ( 765)                                 | -      |
| Sales of marketable securities                            | 1,708                                  | 2,119  |
| Purchases of property and equipment                       | ( 356)                                 | ( 332) |
| Costs of capitalized software development                 | ( 426)                                 | ( 497) |
| Cost of patents   | ( 113)                                 | ( 406) |
| Proceeds from sale of investment                          | 571                                    | -      |
| Proceeds from sale of consolidated subsidiary             | 4,142                                  | -      |
| Net cash provided by investing activities                 | 4,761                                  | 884    |
| Cash Flows from Financing Activities:                     |  |        |
| Distributions to holders of minority interests            | ( 117)                                 | ( 836) |
| Proceeds from debt  | 265                                    | -      |
| Repayment of long-term debt and capital leases            | ( 200)                                 | ( 155) |
| Net proceeds from exercise of stock options and warrants  | -                                      | 50     |
| Net proceeds from sale of common stock                    | -                                      | 373    |
| Collection of notes receivable from employee stockholders | 128                                    | 184    |
| Net cash provided by (used in) financing activities       | 76                                     | ( 384) |



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|  |          |          |
|--|----------|----------|
| Net Increase (Decrease) in Cash and Cash Equivalents | 704      | ( 1,745) |
| Cash and Cash Equivalents - Beginning of Period      | 1,470    | 4,557    |
| Cash and Cash Equivalents - End of Period            | \$ 2,174 | \$ 2,812 |
|  | =====    | =====    |

See accompanying notes to condensed consolidated financial statements (unaudited).

FONAR CORPORATION AND SUBSIDIARIES  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
MARCH 31, 2008  
(UNAUDITED)

### NOTE 1 - BASIS OF PRESENTATION & LIQUIDITY & CAPITAL RESOURCES

#### Basis of Presentation

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the three and nine months ended March 31, 2008 are not necessarily indicative of the results that may be expected for the fiscal year ending June 30, 2008. For further information, refer to the consolidated financial statements and footnotes thereto included in the Company's Annual Report on Form 10-K filed on October 2, 2007 for the fiscal year ended June 30, 2007.

#### Liquidity and Capital Resources

The Company's principal source of liquidity has been derived from revenues, as well as cash provided by the sale of marketable securities and previous debt and equity financing. The Company's management currently expects this to continue. In addition, at March 31, 2008, the Company had a working capital deficit of approximately \$13.0 million. Cash used from operating activity toward approximately \$4.1 million for the nine months ended March 31, 2008. For the nine months ended March 31, 2008, the Company incurred a net loss of approximately \$6.7 million which included non-cash charges of approximately \$2.2 million.

In July 2007, the Company sold its 50% interest (to an unrelated third party) in an entity that provided management services to a diagnostic center in Orlando, Florida and 20% interest in an unconsolidated entity and received proceeds of approximately \$4.8 million.

Sales levels remain weak and the Company continues to focus its efforts on increased advertising and marketing campaigns and distribution programs to strengthen the demand for Fonar's products. Management believes that Fonar's capital resources will improve if Fonar's MRI scanner products gain wider market recognition and acceptance resulting in increased product sales. If the Company is not successful with its marketing efforts to increase sales, then the Company will experience a shortfall in cash necessary to sustain operations of the Company. Should weak product demand continue, the Company has determined it will be necessary to reduce operating expenses or seek other sources of funds through

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the issuance of equity or debt financing in order to maintain sufficient funds available to operate subsequent to March 31, 2009. The reduction in operating expenses might need to be substantial in order for the Company to generate positive cash flow to sustain the operations of the Company.

FONAR CORPORATION AND SUBSIDIARIES  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
MARCH 31, 2008  
(UNAUDITED)

### NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

#### Principles of Consolidation

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

#### Reverse Stock Split

On April 17, 2007, the Company effected a one-for-twenty-five reverse split of its issued and outstanding common stock, Treasury Shares of Common Stock, Class B Common Stock, Class C Common Stock, Class A Non-Voting Preferred Stock and Preferred Stock. At such time, the Company also reduced the number of its authorized shares available for issuance for each class of stock. The accompanying condensed consolidated financial statements, notes and other references to share and per share data have been retroactively restated to reflect the reverse stock splits for all periods presented.

#### Earnings (Loss) Per Share

Basic earnings (loss) per share ("EPS") is computed based on weighted average shares outstanding and excludes any potential dilution. In accordance with EITF 03-6, "Participating Securities and the Two-Class method under FASB Statement No. 128" ("EITF 03-6"), the Company's participating convertible securities, which include Class B common stock and Class C common stock, are not included in the computation of basic EPS for the three and nine months ended March 31, 2008 and 2007, because the participating securities do not have a contractual obligation to share in the losses of the Company.

Diluted EPS reflects the potential dilution from the exercise or conversion of all dilutive securities into common stock based on the average market price of common shares outstanding during the period. The number of common shares potentially issuable upon the exercise of certain options and warrants or conversion of the participating convertible securities that were excluded from the diluted EPS calculation was approximately 278,000 and 279,000 because they were antidilutive as a result of net losses for the nine month periods ended March 31, 2008 and 2007, respectively.

#### Stock Options and Warrants and Similar Equity Instruments

In December 2004, the Financial Accounting Standard Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 123 (revised 2004), "Share-Based Payment" SFAS 123R. SFAS 123R requires the compensation cost relating to stock-based payment transactions be recognized in financial statements. That cost will be measured based on the fair value of the equity or liability instruments issued on the grant date of such instruments, and will be recognized over the period during which an individual is required to provide service in exchange for the award (typically the vesting period). SFAS 123R covers a wide range of stock-based compensation arrangements including stock

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options, restricted stock plans, performance-based awards, stock appreciation rights, and employee stock purchase plans. SFAS 123R replaces SFAS 123 and supersedes APB Opinion 25.

FONAR CORPORATION AND SUBSIDIARIES  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
MARCH 31, 2008  
(UNAUDITED)

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Stock Options and Warrants and Similar Equity Instruments (Continued)

On July 1, 2005, the Company adopted SFAS 123R using the modified prospective method, in which compensation cost is recognized beginning with the effective date (a) based on the requirements of SFAS 123R for all share-based payments granted after the effective date and (b) based on the fair value as measured under SFAS 123 for all awards granted to employees prior to the effective date of SFAS 123R that remain unvested on the effective date.

The adoption of SFAS 123R's fair value method did not have a significant impact on our result of operations. SFAS 123R requires the benefits of tax deductions in excess of recognized compensation cost to be reported as a financing cash flow, rather than as an operating cash flow as required under current literature. It is unlikely that the Company will have near term benefits from tax deductions. This requirement will reduce net operating cash flows and increase net financing cash flows in periods after adoption. The Company cannot estimate what those amounts will be in the future because of various factors, including but not limited to the timing of employee exercises and whether the Company will be in a taxable position. At this time, there would be no tax impact related to the prior periods since the Company has a net loss.

For the period ending prior to July 1, 2005, as permitted under SFAS No. 148, "Accounting for Stock-Based Compensation Transactions and Disclosure", which amended SFAS No. 123, "Accounting for Stock-Based Compensation", the Company had elected to continue to follow the intrinsic value method in accounting for its stock-based employee compensation arrangements as defined by Accounting Principles Board Opinion ("APB") No. 25 "Accounting for Stock Issued to Employees", and related interpretations including FASB Interpretation No. 44, "Accounting for Certain Transactions Involving Stock Compensation", an interpretation of APB No. 25. No stock-based employee compensation cost was reflected in operations, as all options granted under those plans had an exercise price equal to the market value of the underlying common stock on the date of grant.

Recent Accounting Pronouncements

In February 2006, the FASB issued SFAS NO. 155, Accounting for Certain Hybrid Financial Instruments--An Amendment of FASB No. 133 and 140. The purpose of SFAS statement No. 155 is to simplify the accounting for certain hybrid financial instruments by permitting fair value re-measurement for any hybrid financial instrument that contains an embedded derivative that otherwise would require bifurcation. SFAS No. 155 also eliminates the restriction on passive derivative instruments that a qualifying special-purpose entity may hold. SFAS No. 155 is effective for all financial instruments acquired or issued after the beginning of any entity's first fiscal year beginning after September 15, 2006. The adoption of this standard on July 1, 2007 did not have a material effect on the Company's consolidated financial statements.

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FONAR CORPORATION AND SUBSIDIARIES  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
MARCH 31, 2008  
(UNAUDITED)

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Recent Accounting Pronouncements (Continued)

In March 2006, the FASB issued SFAS No. 156, Accounting for Servicing of Financial Assets, an Amendment of SFAS No. 140. SFAS No. 156 requires separate recognition of a servicing asset and a servicing liability each time an entity undertakes an obligation to service a financial asset by entering into a servicing contract. This statement also requires that servicing assets and liabilities be initially recorded at fair value and subsequently adjusted to the fair value at the end of each reporting period. This statement is effective in fiscal years beginning after September 15, 2006. The adoption of this standard on July 1, 2007 did not have a material effect on the Company's consolidated financial statements.

In September, 2006, the FASB issued SFAS No. 157, "Fair Value Measurements", which defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. This standard applies under other accounting pronouncements that require or permit fair value measurements, but does not require any new fair value measurements. SFAS No. 157 will become effective for the Company in fiscal 2009. We are currently assessing the impact of SFAS No. 157; however, we do not believe the adoption of this standard will have a material effect on the Company's condensed consolidated financial statements.

In February, 2007, the FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities (FAS 159). SFAS 159 provides Companies with an option to report selected financial assets and liabilities at fair value. SFAS 159's objective is to reduce both complexity in accounting for financial instruments and the volatility in earnings caused by measuring related assets and liabilities differently. SFAS 159 also establishes presentation and disclosure requirements designed to facilitate comparisons between Companies that choose different measurement attributes for similar types of assets and liabilities. SFAS 159 requires Companies to provide additional information that will help investors and other users of financial statements to more easily understand the effect of the Company's choice to use fair value on its earnings. It also requires entities to display the fair value of those assets and liabilities for which the Company has chosen to use fair value on the face of the balance sheet. SFAS 159 is effective as of the beginning of an entity's first fiscal year beginning after November 15, 2007. Early adoption is permitted as of the beginning of the previous fiscal year provided that the entity makes that choice in the first 120 days of that fiscal year and also elects to apply the provisions of SFAS 157. The Company did not early adopt SFAS 159. The Company is currently assessing the impact of SFAS 159; however the Company does not believe the adoption of this standard will have a material effect on its consolidated financial statements.

FONAR CORPORATION AND SUBSIDIARIES  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
MARCH 31, 2008  
(UNAUDITED)

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

## Edgar Filing: FONAR CORP - Form 10-Q

### Recent Accounting Pronouncements (Continued)

In June 2006, the EITF reached a consensus on Issue No. 06-3 ("EITF 06-3"), "Disclosure Requirements for Taxes Assessed by a Governmental Authority on Revenue-Producing Transactions." The consensus allows companies to choose between two acceptable alternatives based on their accounting policies for transactions in which the company collects taxes on behalf of a governmental authority, such as sales taxes. Under the gross method, taxes collected are accounted for as a component of sales revenue with an offsetting expense. Conversely, the net method allows a reduction to sales revenue. If such taxes are reported gross and are significant, companies should disclose the amount of those taxes. The guidance should be applied to financial reports through retrospective application for all periods presented, if amounts are significant, for interim and annual reporting beginning after December 15, 2006 with early adoption is permitted. The adoption of this standard on July 1, 2007 did not have a material effect on the Company's condensed consolidated financial statements.

In March 2007, the FASB ratified the Emerging Issues Task Force (EITF) consensus on EITF Issue No. 06-10, "Accounting for Collateral Assignment Split Dollar Life Insurance." This EITF indicates that an employer should recognize a liability for postretirement benefits related to collateral assignment split-dollar life insurance arrangements. In addition, the EITF provides guidance for the recognition of an asset related to a collateral assignment split-dollar life insurance arrangement. The EITF is effective for fiscal years beginning after December 15, 2007. The Company will adopt the EITF as required and management does not expect it to have any impact on the Company's consolidated results of operations, financial condition and liquidity.

Effective January 1, 2007, the Company adopted the provisions of FASB Interpretation No. 48, "Accounting for Uncertainty in Income Taxes - an interpretation of FASB Statement No. 109" ("FIN 48"). FIN 48 prescribes a recognition threshold and a measurement attribute for the financial statement recognition and measurement attribute for the financial statement recognition and measurement of tax positions taken or expected to be taken in a corporate tax return. For those benefits to be recognized, a tax position must be more-likely-than-not to be sustained upon examination by taxing authorities. Differences between tax positions taken or expected to be taken in a tax return and the benefit recognized and measured pursuant to the interpretation are referred to as "unrecognized benefits". A liability is recognized (or amount of net operating loss carry forward or amount of tax refundable is reduced) for an unrecognized tax benefit because it represents an enterprise's potential future obligation to the taxing authority for a tax position that was not recognized as a result of applying the provisions of FIN 48.

In accordance with FIN 48, interest costs related to unrecognized tax benefits are required to be calculated (if applicable) and would be classified as "Interest expense, net". Penalties if incurred would be recognized as a component of "General and administrative" expenses.

FONAR CORPORATION AND SUBSIDIARIES  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
MARCH 31, 2008  
(UNAUDITED)

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

#### Recent Accounting Pronouncements (Continued)

The Company files corporate income tax returns in the United States (federal)

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and in various state and local jurisdictions. In most instances, the Company is no longer subject to federal, state and local income tax examinations by tax authorities for years prior to 2003.

The adoption of the provisions of FIN 48 did not have a material impact on the Company's condensed consolidated financial position and results of operations. As of March 31, 2008, no liability for unrecognized tax benefits was required to be recorded.

The Company recognized a deferred tax asset of approximately \$75 million as of March 31, 2008, primarily relating to net operating loss carryforwards of approximately \$165 million, available to offset future taxable income through 2028.

The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible. The Company considers projected future taxable income and tax planning strategies in making this assessment. At present, the Company does not have a sufficient history of income to conclude that it is more-likely-than-not that the Company will be able to realize all of its tax benefits in the near future and therefore a valuation allowance was established for the full value of the deferred tax asset. A valuation allowance will be maintained until sufficient positive evidence exists to support the reversal of any portion or all of the valuation. Should the Company become profitable in future periods with supportable trends, the valuation allowance will be reversed accordingly.

In December 2007, the FASB issued SFAS No. 141R, "Business Combinations" ("SFAS 141R"), which replaces SFAS No. 141, "Business Combinations". SFAS 141R establishes principles and requirements for determining how an enterprise recognizes and measures the fair value of certain assets and liabilities acquired in a business combination, including noncontrolling interests, contingent consideration, and certain acquired contingencies. SFAS 141R also requires acquisition-related transaction expenses and restructuring costs be expensed as incurred rather than capitalized as a component of the business combination. SFAS 141R will be applicable prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. SFAS 141R would have an impact on accounting for any businesses acquired after the effective date of this pronouncement.

FONAR CORPORATION AND SUBSIDIARIES  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
MARCH 31, 2008  
(UNAUDITED)

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Recent Accounting Pronouncements (Continued)

In December 2007, the FASB issued SFAS No. 160, "Noncontrolling Interests in Consolidated Financial Statements - An Amendment of ARB No. 51" ("SFAS 160"). SFAS 160 establishes accounting and reporting standards for the noncontrolling interest in a subsidiary (previously referred to as minority interests). SFAS 160 also requires that a retained noncontrolling interest upon the deconsolidation of a subsidiary be initially measured at its fair value. Upon adoption of SFAS 160, the Company will be required to report its noncontrolling interests as a separate component of stockholders' equity. The Company will also be required to present net income allocable to the noncontrolling interest and net income attributable to the stockholders of the Company separately in its consolidated statements of income. Currently, minority interests are reported as

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a liability in the Company's consolidated balance sheets and the related income attributable to the minority interests is reflected as an expense in arriving at net loss. SFAS 160 is effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2008. SFAS 160 requires retroactive adoption of the presentation and disclosure requirements for existing minority interests. All other requirements of SFAS 160 shall be applied prospectively.

In March 2008, the FASB issued SFAS No. 161, "Disclosures about Derivative Instruments and Hedging Activities—an amendment of FASB Statement No 133" ("SFAS No. 161"). SFAS No. 161 changes the disclosure requirements for derivative instruments and hedging activities. Entities are required to provide enhanced disclosures about (a) how and why an entity uses derivative instruments, (b) how derivative instruments and related hedged items are accounted for under SFAS No. 133 and its related interpretations, and (c) how derivative instruments and related hedged item affect an entity's financial position, financial performance and cash flows. The guidance in SFAS No. 161 is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008, with early application encouraged. This Statement encourages, but does not require, comparative disclosures for earlier periods at initial adoption. The Company does not believe that the implementation of SFAS No. 161 will have any impact on the Company's consolidated financial statements.

### Reclassifications

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

FONAR CORPORATION AND SUBSIDIARIES  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
MARCH 31, 2008  
(UNAUDITED)

### NOTE 3 - MEDICAL RECEIVABLES, ACCOUNTS RECEIVABLE AND MANAGEMENT FEE RECEIVABLE

#### Medical Receivables

The Company was assigned medical receivables valued at \$11,775,000, in connection with the satisfaction of the management fees and termination fees related to a Termination and Replacement Agreement dated May 23, 2005. The balance of the net medical receivables as of March 31, 2008 was \$1,557,000.

#### Accounts Receivable and Management Fee Receivable

Receivables, net is comprised of the following at March 31, 2008:

|  | Gross<br>Receivable | (000's Omitted)<br>Allowance for<br>doubtful accounts | Net      |
|--|---------------------|---|----------|
|  | -----               | -----   | -----    |
| Receivables from equipment sales and service contracts                 | \$ 6,599            | \$ 1,075  | \$ 5,524 |
|  | =====               | =====   | =====    |
| Receivables from equipment sales and service contracts-related parties | \$ 1,104            | \$ 619  | \$ 485   |
|  | =====               | =====   | =====    |
| Management fee receivables   | \$ 8,360            | \$ 2,135  | \$ 6,225 |
|  | =====               | =====   | =====    |

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|  |                   |                   |                   |
|--|-------------------|-------------------|-------------------|
| Management fee receivables<br>from related medical<br>practices ("PC's") | \$ 3,410<br>===== | \$ 2,093<br>===== | \$ 1,317<br>===== |
|--|-------------------|-------------------|-------------------|

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

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

In the case of contracts with the MRI facilities, fees were charged by the Company during fiscal 2007 based on the number of procedures performed. In the case of the physical therapy and rehabilitation practices the Company's previously managed, flat fees were charged on a monthly basis. Fees are subject to adjustment on an annual basis, but must be based on mutual agreement. The per procedure charges to the MRI facilities during fiscal 2007 ranged from \$275 to \$500 per MRI scan.

As of June 22, 2007, an unrelated third party purchased the stock of the professional corporations owning the eight New York sites managed by the Company, previously owned by Dr. Raymond V. Damadian, the President, Chairman of the Board and principal stockholder of Fonar. In connection with the sale, new management agreements were substituted for the existing management agreements, providing, however, for the same management services. The fees in fiscal 2008, however, are currently flat monthly fees in the aggregate amount of \$682,500 per month.

FONAR CORPORATION AND SUBSIDIARIES  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
MARCH 31, 2008  
(UNAUDITED)

NOTE 3 - MEDICAL RECEIVABLES, ACCOUNTS RECEIVABLE AND MANAGEMENT FEE RECEIVABLE  
(Continued)

Accounts Receivable and Management Fee Receivable (Continued)

Dr. Damadian still owns the four MRI facilities in Georgia and Florida managed by the Company. No MRI facilities or other medical facilities are owned by the Company.

Collection by the Company of its management fee receivables may be impaired by the uncollectibility of the PC's medical fees from third party payors, particularly insurance carriers covering automobile no-fault and workers compensation claims due to longer payment cycles and rigorous informational requirements and certain other disallowed claims. Approximately 44% and 39% of the PC's net revenues for both the nine months ended March 31, 2008 and 2007, respectively, were derived from no-fault and personal injury protection claims. The Company considers the aging of its accounts receivable in determining the amount of allowance for doubtful accounts and contractual allowances. The Company generally takes all legally available steps to collect its receivables. Credit losses associated with the receivables are provided for in the condensed consolidated financial statements and have historically been within management's expectations.

Certain no-fault insurers have raised issues concerning whether the Company's clients, the "P.C.'s," are in compliance with certain laws, including, but not



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limited to, laws governing their corporate structure and/or licensing, their entitlement or standing to seek and/or obtain no-fault benefits, and/or laws prohibiting the corporate practice of medicine, fee-splitting and/or physician self referrals. To the extent any claims are asserted against the P.C.'s, the settlement of such claims could result in the P.C.'s waiving their rights to collect certain of their insurance claims. Management believes that the Company and the P.C.'s are not in violation of any of the above mentioned laws. Since the resolution or settlement of these claims with the insurance companies could have a material impact on the collection of management fees by the Company from its P.C.'s, the Company has provided reserves for uncollectable fees related to this matter.

On February 8, 2006, the Deficit Reduction Act of 2005 (DRA) was signed into law by President George W. Bush. The DRA would result in caps on Medicare and Medicaid payment rates for most imaging services, including MRI and CT, furnished in physicians' offices and other non-hospital based settings. Under the cap, payments for these imaging services could not exceed the hospital outpatient payment rates for those services. This change applied to services furnished by the P.C.'s on or after January 1, 2007. Although the professional corporations managed by the Company bill for scans on a "global" basis, which means a single fee per scan, the limitation is applicable only to the technical component of the services, which is the payment or portion of the payment attributable to the non-professional services. If the fee for the technical component of the service (without including geographic adjustments) exceeds the hospital outpatient payment amount for the service (also without including geographic adjustments), under the Physician Fee Schedule, then the payment would be limited to the Physician Fee Schedule rate.

FONAR CORPORATION AND SUBSIDIARIES  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
MARCH 31, 2008  
(UNAUDITED)

NOTE 3 - MEDICAL RECEIVABLES, ACCOUNTS RECEIVABLE AND MANAGEMENT FEE RECEIVABLE  
(Continued)

Accounts Receivable and Management Fee Receivable (Continued)

Currently, a statute in the State of Florida required all drivers, licensed in the State of Florida, to carry a \$10,000 no-fault insurance policy covering personal injury protection benefits. This statute expired in October 2007 but will be in effect again in a slightly revised form on January 1, 2008. Management does not believe that the expiration of this statute will have a material impact on the Company's condensed consolidated financial position or results of consolidated operations in the future.

While the Company has prepared certain estimates of the impact of the above discussed changes and possible changes, it is not possible to fully quantify their impact on its business. There can be no assurance that the impact of these changes will not be greater than estimated or that any future health care legislation or reimbursement changes will not adversely affect the Company's business.

Net revenues from management and other fees charged to the related P.C.'s accounted for approximately 10% and 36.9% of the consolidated net revenues for the nine months ended March 31, 2008 and 2007, respectively. Product sales and service repair fees from related parties amounted to approximately 2.9% and 3.6% of consolidated net revenues for the nine months ended March 31, 2008 and 2007 respectively.

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HMCA entered into a management agreement in September 2007 with Integrity Healthcare Management Inc ("Integrity"). Under the terms of the agreement, Integrity will provide the billings and collections for HMCA's facilities as well as assist in the management of the facilities. The existing management agreements between the facilities and HMCA will remain in place. Integrity will receive as compensation an annual fee equal to one-half of the increase in the consolidated cash flow of HMCA and the facilities over the period from July 1, 2006 through June 30, 2007. The term of the agreement is one year with an automatic year to year renewal, but may be terminated by either party without cause at the end of any year. As of March 31, 2008, no management fees were earned by Integrity. Integrity is a subsidiary of Health Diagnostics, LLC. The Chief Operating Officer of Health Diagnostics, LLC, Timothy Damadian, is a son of the President and Chief Executive Officer of Fonar, Dr. Raymond Damadian. In July 2007, Integrity and related parties sold a business (consisting of management companies and diagnostic centers) to Health Diagnostics, LLC and subsequently accepted a three year employment position (non-equity) with Health Diagnostics, LLC as chief operating officer. At the time, Health Diagnostics, LLC purchased the above business, Fonar sold its entire 20% interest in a Bronx diagnostic business and its entire 50% interest in a Florida management company to Healthcare Diagnostic, LLC (see Note 8). From time to time Health Diagnostics, LLC may purchase MRI systems from Fonar. As of March 31, 2008, Health Diagnostics, LLC had placed an order with Fonar to purchase six Upright(TM) MRI systems.

FONAR CORPORATION AND SUBSIDIARIES  
 NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
 MARCH 31, 2008  
 (UNAUDITED)

NOTE 3 - MEDICAL RECEIVABLES, ACCOUNTS RECEIVABLE AND MANAGEMENT FEE RECEIVABLE  
 (Continued)

Unaudited Financial Information of Unconsolidated Managed Medical Practices

Audited financial information related to the unconsolidated related and unrelated P.C.'s managed by the Company is not available. Substantially all of these medical practices' books and records are maintained on a cash basis, they depreciate their equipment on an accelerated tax basis and have a December 31 year end.

Summarized statement of operations data for the three months ended March 31, 2008 and 2007 related to the unconsolidated medical practices managed by the Company is as follows:

|                        | (000's omitted) (Income Tax-Cash Basis) |          |
|------------------------|---|----------|
|                        | For the three months                    |          |
|                        | ended March 31,                         |          |
|                        | 2008                                    | 2007     |
|                        | -----                                   | -----    |
| Patient Revenue - Net  | \$ 4,603                                | \$ 4,799 |
|                        | =====                                   | =====    |
| Income from Operations | \$ 172                                  | \$ 228   |
|                        | =====                                   | =====    |
| Net Income             | \$ 55                                   | \$ 7     |
|                        | =====                                   | =====    |

Summarized statement of operations data for the nine months ended March 31, 2008 and 2007 related to the unconsolidated medical practices managed by the company is as follows:

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(000's omitted) (Income Tax-Cash Basis)

|                               | For the nine months<br>ended March 31, |          |
|-------------------------------|--|----------|
|                               | 2008                                   | 2007     |
| Patient Revenue - Net         | \$12,955                               | \$14,586 |
|                               | =====                                  | =====    |
| (Loss) Income from Operations | \$ (306)                               | \$ 747   |
|                               | =====                                  | =====    |
| Net (Loss) Income             | \$ (698)                               | \$ 55    |
|                               | =====                                  | =====    |

FONAR CORPORATION AND SUBSIDIARIES  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
MARCH 31, 2008  
(UNAUDITED)

### NOTE 4 - INVENTORIES

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

|   | (000's omitted)   |                  |
|---|-------------------|------------------|
|   | March 31,<br>2008 | June 30,<br>2007 |
| Purchased parts, components<br>and supplies | \$ 2,293          | \$ 3,285         |
| Work-in-process                             | 1,385             | 1,181            |
|   | -----             | -----            |
|   | \$ 3,678          | \$ 4,466         |
|   | =====             | =====            |

### NOTE 5 - COSTS AND ESTIMATED EARNINGS ON UNCOMPLETED CONTRACTS AND CUSTOMER ADVANCES

1) Information relating to uncompleted contracts as of March 31, 2008 is as follows:

|  | (000's omitted) |            |
|--|-----------------|------------|
| Costs incurred on uncompleted<br>contracts |                 | \$ 2,116   |
| Estimated earnings                         |                 | 845        |
|  |                 | -----      |
| Less: Billings to date                     |                 | 2,961      |
|  |                 | 6,555      |
|  |                 | -----      |
|  |                 | \$ (3,594) |
|  |                 | =====      |

Included in the accompanying condensed consolidated balance sheet at March 31, 2008 under the following captions:

|  |       |
|--|-------|
| Costs and estimated earnings in excess of<br>Billings on uncompleted contracts       | \$ -  |
| Less: billings in excess of costs and estimated<br>Earnings on uncompleted contracts | 3,594 |
|  | ----- |

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\$ (3,594)

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2) Customer advances consist of the following as of March 31, 2008:

|   | Total     | Related<br>Party | Other     |
|---|-----------|------------------|-----------|
|   | -----     | -----            | -----     |
| Total Advances                                    | \$ 21,365 | \$ 1,514         | \$ 19,851 |
| Less: Advances<br>on contracts under construction | 6,555     | -                | 6,555     |
|   | -----     | -----            | -----     |
|   | \$ 14,810 | \$ 1,514         | \$ 13,296 |
|   | =====     | =====            | =====     |

FONAR CORPORATION AND SUBSIDIARIES  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
MARCH 31, 2008  
(UNAUDITED)

NOTE 6 -STOCKHOLDERS' EQUITY

Common Stock

During the three months ended March 31, 2008:

- a) None.

During the nine months ended March 31, 2008:

- a) The Company issued 30,000 shares of common stock for costs and expenses of \$204,457.
- b) The Company issued 54 shares of common stock to employees as compensation valued at \$317 under a stock bonus plan.

NOTE 7 - OTHER CURRENT LIABILITIES

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

(000's omitted)

|  | March 31,<br>2008 | June 30,<br>2007 |
|--|-------------------|------------------|
|  | -----             | -----            |
| Royalties  | \$ 609            | \$ 635           |
| Accrued salaries, commissions<br>and payroll taxes | 1,457             | 1,106            |
| Accrued interest                                   | 757               | 573              |
| Litigation accruals                                | 193               | 193              |
| Sales tax payable (see Note 11)                    | 3,241             | 3,037            |
| Professional fees                                  | 826               | 989              |
| Insurance premiums                                 | 617               | 197              |
| Penalty - 401k plan (see Note 11)                  | 250               | 250              |
| Other  | 494               | 775              |
|  | -----             | -----            |
|  | \$ 8,444          | \$ 7,755         |

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FONAR CORPORATION AND SUBSIDIARIES  
 NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
 MARCH 31, 2008  
 (UNAUDITED)

NOTE 8 - SALE OF INVESTMENT AND CONSOLIDATED SUBSIDIARY

Sale of Investment

On July 31, 2007, the Company sold its 20% equity interest in an unconsolidated entity (management company for a diagnostic center) to an unrelated third party (see Note 3). The selling price was \$629,195. The Company realized a gain on the sale of the equity interest of \$571,161.

The gain was calculated as follows:

|                               |                 |        |
|-------------------------------|-----------------|--------|
|                               | (000's omitted) |        |
| Selling Price:                |                 | \$ 629 |
| Less: Closing costs           |                 | ( 58)  |
| Selling Price - Net cash paid |                 | 571    |
| Cost Basis                    |                 | -      |
|                               |                 | -----  |
| Gain on sale of investment    |                 | \$ 571 |
|                               |                 | =====  |

Sale of Consolidated Subsidiary

On July 31, 2007, the Company sold its 50% interest (to an unrelated third party) (see Note 3) in an entity that provided management services to a diagnostic center in Orlando, FL. The Company continues to manage other diagnostic centers in the Florida region.

The unrelated third party purchased all assets and assumed all liabilities of the diagnostic center which included cash, the management fee receivable, furniture and fixtures and other miscellaneous assets. The purchase price for the 50% interest was \$4,500,000 and after closing costs the amount received was \$4,256,000.

The following is the calculation of the gain on sale of the 50% interest in a consolidated subsidiary:

|   |                 |          |
|---|-----------------|----------|
|   | (000's omitted) |          |
| Selling Price:                          |                 | \$ 4,500 |
| Less: Closing costs                     |                 | ( 243)   |
|   |                 | -----    |
| Selling Price - Net cash paid:          |                 | 4,257    |
| Assets sold:                            |                 |          |
| Cash                                    | \$ 114          |          |
| Management fee receivable               | 1,166           |          |
| Property and equipment - net            | 23              |          |
| Other assets                            | 15              |          |
| Minority interest                       | (456)           |          |
|   |                 | -----    |
| Subtotal                                |                 | 862      |
|   |                 | -----    |
| Gain on sale of consolidated subsidiary |                 | \$3,395  |
|   |                 | =====    |

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### NOTE 9 - SEGMENT AND RELATED INFORMATION

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

The accounting policies of the segments are the same as those described in the summary of significant accounting policies as disclosed in the Company's 10-K as of June 30, 2007. All inter-segment sales are market-based. The

Company evaluates performance based on income or loss from operations.

FONAR CORPORATION AND SUBSIDIARIES  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
MARCH 31, 2008  
(UNAUDITED)

### NOTE 9 - SEGMENT AND RELATED INFORMATION (Continued)

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

(000's omitted)

|  | Medical<br>Equipment | Management<br>of<br>Diagnostic<br>Imaging<br>Centers | Totals     |
|--|----------------------|--|------------|
| For the three months ended March 31, 2008: |                      |  |            |
| Net revenues from external customers       | \$ 5,133             | \$ 2,938   | \$ 8,071   |
| Inter-segment net revenues                 | \$ 208               | \$ -   | \$ 208     |
| Loss from operations                       | \$ (2,510)           | \$ (211)   | \$ (2,721) |
| Depreciation and amortization              | \$ 353               | \$ 230   | \$ 583     |
| Capital expenditures                       | \$ 353               | \$ 28  | \$ 381     |

For the three months ended March 31, 2007:

|                                      |            |          |            |
|--------------------------------------|------------|----------|------------|
| Net revenues from external customers | \$ 5,778   | \$ 3,004 | \$ 8,782   |
| Inter-segment net revenues           | \$ 269     | \$ -     | \$ 269     |
| Loss from operations                 | \$ (4,718) | \$ (597) | \$ (5,315) |
| Depreciation and amortization        | \$ 391     | \$ 275   | \$ 666     |
| Capital expenditures                 | \$ 415     | \$ 81    | \$ 496     |

(000's omitted)

|   | Medical<br>Equipment | Management<br>of<br>Diagnostic<br>Imaging<br>Centers | Totals      |
|---|----------------------|--|-------------|
| For the nine months ended March 31, 2008: |                      |  |             |
| Net revenues from external customers      | \$ 18,328            | \$ 9,093   | \$ 27,421   |
| Inter-segment net revenues                | \$ 662               | \$ -   | \$ 662      |
| Loss from operations                      | \$ (9,944)           | \$ (759)   | \$ (10,703) |
| Depreciation and amortization             | \$ 1,032             | \$ 695   | \$ 1,727    |
| Capital expenditures                      | \$ 793               | \$ 102   | \$ 895      |
| Identifiable assets                       | \$ 22,488            | \$ 18,475  | \$ 40,963   |

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For the nine months ended March 31, 2007:

|   |             |            |             |
|---|-------------|------------|-------------|
| Net revenues from external customers    | \$ 15,290   | \$ 8,947   | \$ 24,237   |
| Inter-segment net revenues              | \$ 782      | \$ -       | \$ 782      |
| Loss from operations                    | \$ (15,330) | \$ (1,475) | \$ (16,805) |
| Depreciation and amortization           | \$ 1,164    | \$ 823     | \$ 1,987    |
| Compensatory element of stock issuances | \$ 116      | \$ 5       | \$ 121      |
| Capital expenditures                    | \$ 1,098    | \$ 137     | \$ 1,235    |
| Identifiable assets - June 30, 2007     | \$ 26,030   | \$ 22,449  | \$ 48,479   |

FONAR CORPORATION AND SUBSIDIARIES  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
MARCH 31, 2008  
(UNAUDITED)

### NOTE 10 - SUPPLEMENTAL CASH FLOW INFORMATION

During the nine months ended March 31, 2008 and March 31, 2007, the Company paid \$178,000 and \$203,000 for interest, respectively.

The Company paid no income taxes during the nine months ended March 31, 2008 and 2007, respectively.

### NOTE 11 - COMMITMENTS AND CONTINGENCIES

#### Litigation

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

Certain no-fault insurers have raised issues concerning whether the Company's clients the "P.C.'s" are in compliance with certain laws, including, but not limited to, laws governing their corporate structure and/or licensing, their entitlement or standing to seek and/or obtain no-fault benefits, and/or laws prohibiting the corporate practice of medicine, fee-splitting and/or physician self referrals. To the extent any claims are asserted against the P.C.'s, the settlement of such claims could result in the P.C.'s waiving their rights to collect certain of their insurance claims. Management believes that the Company and the P.C.'s are not in violation of any of the above mentioned laws. Since the resolution or settlement of these claims with the insurance companies could have a material impact on the collection of management fees by the Company from its P.C.'s, the Company has provided reserves for uncollectable fees related to this matter.

#### Other Matters

In March 2007, the Company and New York State taxing authorities conducted a conference to discuss a sales tax matter to determine if certain sales transactions are subject to sales tax withholdings. At the present time, such discussions are ongoing and the Company cannot yet determine the outcome. Management is of the belief the resolution of this matter will not materially impact the consolidated financial statements. The Company has recorded a provision of \$250,000 to cover any potential tax liability including interest. Such amount is the Company's best estimate of the tax liability. Management is unable to determine the outcome of this uncertainty.

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The Company is also delinquent in filing sales tax returns for certain states, for which the Company has transacted business. As of March 31, 2008, the Company has recorded tax obligations of approximately \$1,900,000 plus interest and penalties of approximately \$1,290,000. The Company is in the process of determining the regulatory requirements in order to become compliant.

FONAR CORPORATION AND SUBSIDIARIES  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
MARCH 31, 2008  
(UNAUDITED)

NOTE 11 - COMMITMENTS AND CONTINGENCIES (Continued)

Other Matters (Continued)

The Company has determined they may not be in compliance with the Department of Labor and Internal Revenue Service regulations concerning the requirements to file Form 5500 to report activity of its 401(k) Employee Benefit Plan. The filings do not require the Company to pay tax, however they may be subject to penalty for non-compliance. The Company has recorded provisions for any potential penalties totaling \$250,000. Such amount is the Company's best estimate of potential penalties. Management is unable to determine the outcome of this uncertainty. The Company has engaged outside counsel to handle such matters to determine the necessary requirements to ensure compliance.

Such non-compliance could impact the eligibility of the plan.

NOTE 12 - LICENSE FEES AND ROYALTIES

In July 2000, the Company entered into a non-exclusive sales representative agreement with an unrelated third party. The agreement requires the third party to sell at least two Fonar MRI scanners or if it does not, pay an amount equal to the Company's gross margin on the unsold MRI scanners. As the third party did not sell any scanners in the past contract year, the Company received the gross margin payment on two scanners of \$1.2 million in November 2007. The amount is shown in the Company's condensed consolidated statements of operations as revenue, license fees and royalties for the nine months ended March 31, 2008.

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

For the nine month period ended March 31, 2008, we reported a net loss of \$6.7 million on revenues of \$27.4 million as compared to net loss of \$17.0 million on revenues of \$24.2 million for the nine month period ended March 31, 2007.

For the three month period ended March 31, 2008, we reported a net loss of \$2.7 million on revenues of \$8.1 million as compared to a net loss of \$5.4 million on revenues of \$8.8 million for the three month period ended March 31, 2007.

We note an improvement in our revenues and a reduction of our net loss for the nine months ended March 31, 2008 as compared to the nine months ended March 31, 2007. Net losses decreased by 60.3%, (\$6.7 million as compared to \$17.0 million), on a revenue increase of 13.1% (\$27.4 million as compared to \$24.2 million).



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Operating losses have decreased by 36.3% (\$10.7 million for the first nine months of fiscal 2008 as compared to \$16.8 million for the first nine months of fiscal 2007). The decrease in the net loss was principally due to increased revenues, a decrease in selling, general and administrative expenses and gains realized on the sale in July 2007 of our 50% interest in a consolidated entity and our 20% interest in unconsolidated entity to an unrelated third party. We received proceeds of approximately \$4.8 million and recognized gains of approximately \$4.0 million in the aggregate. Both entities were engaged in the business of managing MRI facilities.

We believe the improvements in our operating results have resulted in part from reduced apprehension on the part of FONAR UPRIGHT(R), Multi-Position(TM) MRI ("FONAR UPRIGHT(R) MRI") customers regarding the anticipated negative impact of the Deficit Reduction Act (DRA) on scanner income and the magnitude of the impact. We believe direct experience by FONAR UPRIGHT(R) MRI customers with the DRA's revenue impact since it became effective January 1, 2007 has been largely offset by the growth in demand for FONAR UPRIGHT(R) MRI scans because of the unique benefits of the FONAR UPRIGHT(R) MRI. This has encouraged them in their plans and encouraged other physicians to proceed with their plans to purchase FONAR UPRIGHT(R) MRI scanners.

Overall, there was a reduction of our selling, general and administrative costs of 11.8%, from \$18.0 million in the first nine months of fiscal 2007 to \$15.9 million in the first nine months of fiscal 2008, representing in part greater selectivity and increased cost controls in our attendance at conventions and trade shows.

In addition, we plan to continue to expand our sales force, both in terms of hiring more sales personnel and establishing a network of domestic distributors, as well as improving our network of foreign distributors.

We also are monitoring the performance of our existing users in order to establish teams to assist underperforming customers improve their scan volume. In addition, we have held seminars to assist customers in their marketing efforts and are in the process of developing a web site to assist our customers in their marketing efforts.

Importantly, we are beginning to penetrate the hospital market. The FONAR UPRIGHT(R) MRI scanner is the only scanner which enables weight-bearing scans of the spine, which is critical in making a correct diagnosis of spine diseases such as low back pain and therefore the key to performing the correct surgery of the spine.

### Forward Looking Statements

Certain statements made in this Quarterly Report on Form 10-Q are "forward-looking statements" (within the meaning of the Private Securities Litigation Reform Act of 1995) regarding the plans and objectives of Management for future operations. Such statements involve known and unknown risks, uncertainties and other factors that may cause our actual results, performance or achievements to be materially different from any future results, performance or achievements expressed or implied by such forward-looking statements. The forward-looking statements included herein are based on current expectations that involve numerous risks and uncertainties. Our plans and objectives are based, in part, on assumptions involving the expansion of business. Assumptions relating to the foregoing involve judgments with respect to, among other things, future economic, competitive and market conditions and future business decisions, all of which are difficult or impossible to predict accurately and many of which are beyond our control. Although we believe that our assumptions underlying the forward-looking statements are reasonable, any of the assumptions could prove inaccurate and, therefore, there can be no assurance that the

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forward-looking statements included in this Report will prove to be accurate. In light of the significant uncertainties inherent in the forward-looking statement included herein, the inclusion of such information should not be regarded as a representation by us or any other person that our objectives and plans will be achieved.

### Results of Operations

We operate in two industry segments: the manufacture and servicing of medical (MRI) equipment, our traditional business which is conducted directly by Fonar, and diagnostic facilities management services, which is conducted through Fonar's wholly-owned subsidiary, Health Management Corporation of America, which we also refer to as HMCA. During July 2007 HMCA sold its 50% interest in a consolidated entity for approximately \$4.3 million and its 20% interest in an unconsolidated entity for approximately \$571,000 to an unrelated third party.

Trends in the first nine months of fiscal 2008 include an increase in product sales revenues, service and repair fees, management fees and license and royalties revenue. We will continue to focus on increased marketing efforts, including advertising, and adding additional sales personnel and distributors, where appropriate, to improve sales performance in fiscal 2008. During fiscal 2007, the Company also hired an additional advertising and marketing executive, who had previously been associated with the agency that provided advertising services to us. In addition, we will continue our efforts to reduce costs through our procurement policies and streamlining our operations.

For the three month period ended March 31, 2008, as compared to the three month period ended March 31, 2007, overall revenues from MRI product sales decreased 27.1% (\$2.3 million compared to \$3.2 million).

For the nine month period ended March 31, 2008, as compared to the nine month period ended March 31, 2007, overall revenues from MRI product sales increased 15.2% (\$8.9 million compared to \$7.8 million). Unrelated party scanner sales (\$8.9 million compared to \$7.6 million) increased at a rate of 17.3%. There were no related party scanner sales for the nine month period ended March 31, 2008 compared to \$143,000 for the nine month period ended March 31, 2007.

Service revenues for the three month period ended March 31, 2008, as compared to the three month period ended March 31, 2007 increased by 8.9% (\$2.8 million compared to \$2.6 million) because of additional customers entering into service agreements with Fonar for their scanners following the expiration of the warranty period on their equipment. Unrelated party service and repair fees increased by 8.7% (\$2.5 million compared to \$2.3 million) and related party service and repair fees increased by 11.1% (\$270,000 compared to \$243,000). We anticipate that there will continue to be increases in service revenues as warranties on installed scanners expire over time.

Service revenues for the nine month period ended March 31, 2008, as compared to the nine month period ended March 31, 2007 increased 9.3% (\$8.2 million compared to \$7.5 million). Unrelated party service and repair fees increased by 9.4% (\$7.4 million compared to \$6.8 million).

There were approximately \$628,000 in foreign revenues for the first nine months of fiscal 2008 as compared to approximately \$2.2 million in foreign revenues for the first nine months of fiscal 2007, representing a decrease in foreign revenues of 71.9%. The Company is making a concerted effort to increase foreign sales, most recently through its foreign distributors and attendance at trade shows.

For the third quarter of fiscal 2008, revenues for the medical equipment segment decreased by 11.2% to \$5.1 million from \$5.8 million for the third quarter of fiscal 2007. The revenues generated by HMCA decreased, by 2.2% to

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\$2.9 million for the third quarter of fiscal 2008 as compared to \$3.0 million for the third quarter of fiscal 2007.

Overall, for the nine months of fiscal 2008, revenues for the medical equipment segment increased by 19.9% to \$18.3 million from \$15.3 million for the first nine months of fiscal 2007. The revenues generated by HMCA increased, by 1.6% to \$9.1 million for the first nine months of fiscal 2008 as compared to \$8.9 million for the first nine months of fiscal 2007.

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

Costs related to product sales decreased by 28.5% from \$3.1 million in the third quarter of fiscal 2007 to \$2.2 million in the third quarter of 2008, reflecting the corresponding decrease in product sales revenues. Costs related to providing service remained constant at \$1.3 million in the third quarter of fiscal 2007 and fiscal 2008.

Costs related to product sales increased by 5.9% from \$8.1 million in the first nine months of fiscal 2007 to \$8.6 million in the first nine months of 2008, reflecting the corresponding increase in product sales revenues. Costs related to providing service increased by 1.2% from \$3.9 million in the nine month of fiscal 2007 to \$3.9 million in the first nine months of fiscal 2008, reflecting the increase in service and repair revenues.

Service and repair revenues increased at a higher rate than the costs related to providing service and repairs. Service contract prices are fixed for the term of the contract, which are usually for a term of one year. We believe that an important factor in keeping service costs down is our ability to monitor the performance of customers' scanners from our facilities in Melville on a daily basis and to detect and repair any irregularities before more serious problems result. We also believe the low cost of providing service reflects the high quality of our products.

Overall, our operating loss for our medical equipment segment was \$9.9 million for the first nine months of fiscal 2008 as compared to an operating loss of \$15.3 million for the first nine months of fiscal 2007 resulting from an increase in revenues and a decrease in selling, general and administrative expenses.

HMCA revenues decreased in the third quarter of fiscal 2008, by 2.2% to \$2.9 million from \$3.0 million for the third quarter of fiscal 2007, primarily because of the sale of its 50% interest of a previously consolidated entity in July 2007. For the first nine months of fiscal 2008, HMCA revenues increased by 16.3% to \$9.1 million from \$8.9 million for the first nine months of fiscal 2007 due to fee structure change to the eight New York facilities we manage. We now manage ten sites equipped with FONAR UPRIGHT(R) MRI scanners. HMCA experienced an operating loss of \$759,000 for the first nine months of fiscal 2008 compared to operating loss of \$1.5 million for the first nine months of fiscal 2007.

HMCA cost of revenues decreased to \$2.1 million for the third quarter of fiscal 2008 as compared to \$2.2 million for the third quarter of fiscal 2007. HMCA cost of revenues for the first nine months of fiscal 2008 decreased to \$6.2

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million as compared to \$6.5 million for the first nine months of fiscal 2007.

As of June 22, 2007, Dr. Robert Diamond purchased the stock of the professional corporations owning the eight New York sites managed by HMCA, previously owned by Dr. Raymond V. Damadian, the President, Chairman of the Board, Chief Executive Officer and principal stockholder of Fonar. In connection with the sale, new management agreements were substituted for the existing management agreements, providing, however, for the same management services. The fees in fiscal 2008, however, are currently flat monthly fees in the aggregate amount of \$682,500 per month.

For the purpose of improving the performance of HMCA and the facilities, HMCA entered into an agreement in September, 2007 with Integrity Healthcare Management, Inc. ("Integrity"), which is a wholly-owned subsidiary of Health Diagnostics, LLC. The Chief Operating Officer of Health Diagnostics, LLC, Timothy Damadian is a son of Dr. Damadian. Under the terms of the agreement, Integrity will supervise and direct HMCA and the management of the facilities. The existing management agreements between the facilities and HMCA will remain in place. Integrity will receive as compensation an annual fee equal to one-half of the increase in the consolidated cash flow of HMCA and the facilities over the period from July 1, 2006 through June 30, 2007. The term of the agreement is on an automatically renewable year to year basis, but may be terminated by either party without cause at the end of any year. From time to time Health Diagnostics, LLC, may also purchase MRI scanners from Fonar. As of March 31, 2008, Healthcare Diagnostics, LLC had placed orders with Fonar to purchase six FONAR UPRIGHT(R) MRI scanners.

On February 8, 2006, the Deficit Reduction Act of 2005 ("DRA") was signed into law by President George W. Bush. The DRA, which went into effect in the beginning of calendar 2007, places caps on Medicare and Medicaid payment rates for most imaging services, including MRI and CT, furnished in physicians' offices and other non-hospital based settings. Under the cap, payments for these imaging services cannot exceed the hospital outpatient payment rates for those services. This change applies to services furnished by the professional corporations managed by HMCA on or after January 1, 2007. Although the professional corporations managed by HCMA bill for scans on a "global" basis, which means a single fee per scan, the limitation is applicable only to the technical component of the services, which is the payment or portion of the payment attributable to the non-professional services. If the fee for the technical component of the service (without including geographic adjustments) exceeds the hospital outpatient payment amount for the service (also without including geographic adjustments), under the Physician Fee Schedule, then the payment would be limited to the Physician Fee Schedule rate.

While we have prepared certain estimates of the impact of the above discussed changes and possible changes, it is not possible to fully quantify their impact on our business. There can be no assurance that the impact of these changes will not be greater than estimated or that any future health care legislation or reimbursement changes will not adversely affect our business.

The decrease in our total net revenues of 8.1% from \$8.8 million in the third quarter of fiscal 2007 to \$8.1 million in the third quarter of fiscal 2008, was accompanied by an decrease of 23.4% in total costs and expenses from \$14.1 million in the third quarter of fiscal 2007 compared to \$10.8 million in the third quarter of fiscal 2008. As a result, our operating loss decreased from \$5.3 million in the third quarter of fiscal 2007 to \$2.7 million in the third quarter of fiscal 2008. For the first nine months of fiscal 2008 the consolidated revenues increased by 13.1% to \$27.4 million from \$24.2 million for the first nine months of fiscal 2007 while the total costs and expenses decreased by 7.1% to \$38.1 million for the first nine months of fiscal 2008 from \$41.0 million for the first nine months of fiscal 2007. Our operating loss decreased from \$16.8 million in the first nine months of fiscal 2007 to \$10.7

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million in the first nine months of fiscal 2008.

Selling, general and administrative expenses decreased by 13.7% to \$15.5 million in the first nine months of fiscal 2008 from \$18.0 million in the first nine months of fiscal 2007. The compensatory element of stock issuances, which is now included in selling, general and administrative expenses, decreased from \$121,000 in the first nine months of fiscal 2007 to \$317 in the first nine months of fiscal 2008. This reflects a lesser use of Fonar's stock in lieu of cash to pay employees, consultants and professionals for services.

Research and development expenses decreased by 14.9% to \$3.7 million for the first nine months of fiscal 2008 as compared to \$4.3 million for the first nine months of fiscal 2007.

Interest expense in the first nine months of fiscal 2008 increased by 78.3% to \$362,000 from \$203,000 for the first nine months of fiscal 2007 because of the additional accrual of sales tax interest.

Inventories decreased by 17.6% to \$3.7 million at March 31, 2008 as compared to \$4.5 million at June 30, 2007 representing our use of raw materials and components in our inventory to fill orders.

Management fee and medical receivables decreased by 1.4% to \$9.1 million at March 31, 2008 from \$9.2 million at June 30, 2007, primarily due to collections on the Company's medical receivables.

The overall trends reflected in the results of operations for the first nine months of fiscal 2008 are an increase in revenues from product sales, as compared to the first nine months of fiscal 2007 (\$8.9 million for the first nine months of fiscal 2008 as compared to \$7.8 million for the first nine months of fiscal 2007), and an increase in MRI equipment segment revenues relative to HMCA revenues (\$18.3 million or 66.8% from the MRI equipment segment as compared to \$9.1 million or 33.2% from HMCA, for the first nine months of fiscal 2008, as compared to \$15.3 million or 63.1% from the MRI equipment segment and \$8.9 million or 36.9%, from HMCA, for the first nine months of fiscal 2007). In addition, we experienced an increase in unrelated party sales relative to related party sales in our medical equipment product sales (\$8.9 million or 100% to unrelated parties for the first nine months of fiscal 2008 as compared to \$7.6 million, or 98% to unrelated parties and \$143,000 or 2% to related parties for the first nine months of fiscal 2007).

We are committed to continuing the improvement in our operating results we experienced in the first nine months in fiscal 2008. Nevertheless, factors beyond our control, such as the timing and rate of market growth which depend on economic conditions, payor reimbursement rates and policies, and unexpected expenditures or the timing of such expenditures, make it impossible to forecast future operating results. We believe we are pursuing the correct policies which should prove successful in improving the Company's operating results.

Our FONAR UPRIGHT(R) MRI, and Fonar-360(TM) MRI scanners, together with our works-in-progress, are intended to significantly improve our competitive position.

Our FONAR UPRIGHT(R) MRI scanner, which operates at 6000 gauss (.6 Tesla) field strength, allows patients to be scanned while standing, sitting, reclining and in multiple flexion and extension positions. It is common in visualizing the spine that abnormalities are visualized in some positions and not others. This enables surgical corrections that heretofore would be unaddressable for lack of visualizing the symptom causing the pathology. A floor-recessed elevator brings the patient to the height appropriate for the targeted image region. A custom-built adjustable bed will allow patients to sit or lie on their backs, sides or stomachs at any angle. Full-range-of-motion studies of the joints in

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virtually any direction are possible and another promising feature for sports injuries.

Recently a new important application has been discovered for the FONAR UPRIGHT(R) MRI, namely the evaluation of spinal scoliosis in young women. In a 2000 publication of the National Cancer Institute women with scoliosis were discovered to have a 70% increase in breast cancer which was presumed to arise from the repeated chest x-rays needed to monitor treatment. FONAR UPRIGHT(R) MRI is now available to provide a radiation-free alternative to meet this need. In addition, the University of California, Los Angeles (UCLA) reported their results of their study of 1,302 patients utilizing the FONAR UPRIGHT(R) Multi-Position(TM) MRI at the 22nd Annual Meeting of the North American Spine Society on October 23, 2007. The UCLA study showed the superior ability of the Dynamic(TM) FONAR UPRIGHT(R) MRI to detect spine pathology, including spondylolisthesis, disc herniations and disc degeneration, as compared to visualizations of the spine produced by traditional single position static MRI's.

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

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

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

The Fonar 360(TM) is an enlarged room sized magnet in which the floor, ceiling and walls of the scan room are part of the magnet frame. This is made possible by Fonar's patented Iron-Frame(TM) technology which allows the Company's engineers to control, contour and direct the magnet's lines of flux in the patient gap where wanted and almost none outside of the steel of the magnet where not wanted. Consequently, this scanner allows surgeons and other interventional physicians to walk inside the magnet and achieve 360 degree access to the patient to perform interventional procedures.

The Fonar 360(TM) is presently marketed as a diagnostic scanner and is

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sometimes referred to as the Open Sky(TM) MRI. In its Open Sky(TM) version, the Fonar 360(TM) serves as an open patient friendly scanner which allows 360 degree surgical access to the patient on the scanner bed. To optimize the patient-friendly character of the Open Sky(TM) MRI, the walls, floor, ceiling and magnet poles are decorated with landscape murals. The patient gap is twenty inches and the magnetic field strength, like that of the FONAR UPRIGHT(R), is 0.6 Tesla.

In the future, we expect the Fonar 360(TM) to function as an interventional MRI. The enlarged room sized magnet and 360 access to the patient afforded by the Fonar 360(TM) permits surgeons to walk into the magnet and perform surgical interventions on the patient under direct MR image guidance. Most importantly the exceptional quality of the MRI image and its capacity to exhibit tissue detail on the image, can then be obtained real time during the procedure to guide the interventionalist. Thus surgical instruments, needles, catheters, endoscopes and the like could be introduced directly into the human body and guided directly to a malignant lesion using the MRI image. The number of inoperable lesions could be significantly reduced by the availability of this new FONAR technology. Most importantly treatment can be carried directly to the target tissue. The interventional features of the Fonar 360(TM) are expected to be implemented by Oxford Nuffield Orthopedic Center in Oxford U.K. in the near future. A full range of MRI compatible surgical instruments using ceramic cutting tools and beryllium-copper materials are available commercially.

The Company expects marked demand for its most commanding MRI products, the

FONAR UPRIGHT(R) MRI and the Fonar 360(TM) because of their exceptional features in patient diagnosis and treatment. These scanners additionally provide improved image quality and higher imaging speed because of their higher field strength of .6 Tesla. The geometry of the FONAR UPRIGHT(R) MRI as compared to a single coil, or multiple coils on only one axis and its transverse magnetic field enables the use of two detector rf coils operating in quadrature which increases the FONAR UPRIGHT(R) MRI signal to noise ratio by 40%, providing a signal to noise ratio equal to a .84T recumbent only MRI scanner.

### Liquidity and Capital Resources

Cash, cash equivalents and marketable securities decreased from \$3.4 million at June 30, 2007 to \$3.2 million at March 31, 2008. Marketable securities approximated \$1.1 million as of March 31, 2008, as compared to \$2.0 million at June 30, 2007. At March 31, 2008, our investments in corporate and government agency bonds were \$1.1 million.

Cash used in operating activities for the first nine months of fiscal 2008 was \$4.1 million. Cash used in operating activities was attributable primarily to the net loss of \$6.7 million, an increase in accounts, management fee and medical receivables of \$3.4 million and the decrease in accounts payable of \$294,000, offset by an increase in customer advances of \$4.7 million and an increase in other current liabilities of \$1.8 million.

Cash provided by investing activities for the first nine months of fiscal 2008 was \$4.8 million. The principal source of cash from investing activities during the first nine months of fiscal 2008 consisted of proceeds from the sale of an investment and consolidated subsidiary of \$4.7 million, offset by expenditures for property and equipment of \$356,000 and capitalized software and patent costs of \$539,000.

Cash provided by financing activities for the first nine months of fiscal 2008 was \$76,000. The principal uses of cash in financing activities during the first nine months of fiscal 2008 consisted of repayment of principal on long-term debt and capital lease obligations of \$200,000 and distributions to holders of minority interests of \$117,000, offset by proceeds from debt

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financing of \$265,000.

The Company's contractual obligations and the periods in which they are scheduled to become due are set forth in the following table:

(000's OMITTED)

| Contractual<br>Obligation    | Total    | Due in<br>less than<br>1 year | Due<br>in 2-3<br>years | Due<br>in 4-5<br>years | Due<br>after 5<br>years |
|------------------------------|----------|-------------------------------|------------------------|------------------------|-------------------------|
| Long-term debt               | \$ 802   | \$ 265                        | \$ -                   | \$ -                   | \$ 537                  |
| Capital lease<br>Obligations | 477      | 209                           | 258                    | 10                     | -                       |
| Operating<br>leases          | 6,130    | 2,147                         | 1,975                  | 1,254                  | 754                     |
| Total cash<br>Obligations    | \$ 7,409 | \$ 2,621                      | \$ 2,233               | \$ 1,264               | \$ 1,291                |

Total liabilities increased by 20.5% to \$38.3 million at March 31, 2008 from \$31.8 million at June 30, 2007. We experienced a decrease in long-term debt and capital leases from \$956,000 at June 30, 2007 to \$805,000 at March 31, 2008 and a decrease in accounts payable from \$3.9 million at June 30, 2007 to \$3.6 million at March 31, 2008, offset by an increase in billings in excess of costs and estimated earnings on uncompleted contracts from \$3.5 million at June 30, 2007 to \$3.6 million at March 31, 2008, and an increase in customer advances from \$10.1 million at June 30, 2007 to \$14.8 million at March 31, 2008. Unearned revenue on service contracts increased from \$5.1 million at June 30, 2007 to \$6.2 million at March 31, 2008.

As of March 31, 2008, the total of \$8.4 million in other current liabilities included primarily accrued salaries and payroll taxes of \$1.5 million, accrued interest of \$757,000, accrued royalties of \$609,000 and excise and sales taxes of \$3.2 million.

Our working capital deficit was \$13.0 million as of March 31, 2008, as compared to a working capital deficit of \$7.6 million as of June 30, 2007, increasing by 71.4%. This resulted from an increase in current liabilities (\$30.6 million at June 30, 2007 as compared to \$37.1 million at March 31, 2008, particularly an increase in customer advances of \$4.7 million (\$10.1 million at June 30, 2007 as compared to \$14.8 million at March 31, 2008), and an increase of unearned revenue on service contracts of \$1.1 million (\$5.1 million at June 30, 2007 as compared to \$6.2 million at March 31, 2008), notwithstanding an increase in current assets (\$23.0 million at June 30, 2007 compared to \$24.2 million at March 31, 2008) resulting primarily from an increase in accounts receivable of \$2.0 million (\$3.5 million at June 30, 2007 compared to \$5.5 million at March 31, 2008) offset by a decrease in cash and cash equivalents and marketable securities of \$219,000 (\$3.4 million at June 30, 2007 as compared to \$3.2 million at March 31, 2008) and a decrease in inventories of approximately \$788,000 (\$4.5 million at June 30, 2007 as compared to \$3.7 million at March 31, 2008).

With respect to current liabilities, the current portion of long-term debt increased from \$257,000 at June 30, 2007 to \$474,000 at March 31, 2008, and billings in excess of costs and estimated earnings on uncompleted contracts increased from \$3.5 million at June 30, 2007 to \$3.6 million at March 31, 2008. Customer advances increased from \$10.1 million at June 30, 2007 to \$14.8 million at March 31, 2008 and accounts payable decreased from \$3.9 million at June 30,



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2007 to \$3.7 million at March 31, 2008.

Inventories decreased by approximately \$788,000 (\$4.5 million at June 30, 2007 as compared to \$3.7 million at March 31, 2008) resulting from the use of raw materials and components in our inventory to fill our backlog of orders.

Fonar has not committed to making additional capital expenditures in the 2008 fiscal year other than to continue research and development expenditures at current levels.

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

Our principal source of liquidity has been derived from revenues, as well as by the sale of marketable securities and cash provided by previous debt and equity financing. We currently expect this to continue. Also, in July 2007, the Company sold its 50% interest in a consolidated subsidiary and 20% interest in an unconsolidated entity to an unrelated third party and received proceeds of approximately \$4.8 million. At March 31, 2008, we had a working capital deficit of \$13.0 million. For the nine months ended March 31, 2008, we incurred a net loss of \$6.7 million which included non-cash charges of \$2.2 million.

The Company is focusing on increased advertising and marketing campaigns and distribution programs to increase the demand for Fonar's products. Management anticipates that Fonar's capital resources will improve as Fonar's MRI scanner products gain wider market recognition and acceptance resulting in increased product sales. If we are not successful with our current marketing efforts to increase sales, then we could experience a shortfall in the cash necessary to sustain operations at their current levels.

Given our cash and marketable securities balance of \$3.2 million at March 31, 2008, as compared to \$3.4 million at June 30, 2007 and our expected cash requirements, we anticipate that our revenues, supplemented by funds expected to be received from note repayments and our existing capital resources, will be sufficient to satisfy our cash flow requirements through at least March 31, 2009. Based upon current results of operations, we believe we will either need to increase sales, reduce expenses or seek other sources of funds through the issuance of equity or debt financing in order to maintain sufficient funds available to operate subsequent to March 31, 2009.

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

Our investments are in fixed rate instruments. Below is a tabular presentation of the maturity profile of the fixed rate instruments held by us at March 31, 2008.

#### INTEREST RATE SENSITIVITY PRINCIPAL AMOUNT BY EXPECTED MATURITY WEIGHTED AVERAGE INTEREST RATE

| Year of Maturity | Investments in Fixed Rate Instruments | Weighted Average Interest Rate |
|------------------|---------------------------------------|--------------------------------|
| 3/31/09          | \$ 200,000                            | -                              |
| 3/31/10          | 900,000                               | 2.62%                          |
| Total:           | \$ 1,100,000                          |                                |

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|            |              |
|------------|--------------|
| Fair Value |              |
| at 3/31/08 | \$ 1,026,330 |

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

Item 4. Controls and Procedures

(a) Evaluation of disclosure controls and procedures.

The Company maintains controls and procedures designed to ensure that information required to be disclosed in the reports that it files or submits under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the Securities and Exchange Commission. Based upon their evaluation of those controls and procedures performed as of the end of the period covered by this report, the principal executive and acting principal financial officer of the Company concluded that disclosure controls and procedures were effective.

(b) Change in internal controls.

There have been no changes in our internal control over financial reporting that occurred during the most recent fiscal quarter that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II - OTHER INFORMATION

Item 1 - Legal Proceedings: There were no material changes in litigation for the first nine months of fiscal 2008.

Item 1A - Risk Factors: There were no material changes in risk factors in the first nine months of fiscal 2008 from those disclosed in our most recent Form 10-K.

Item 2 - Unregistered Sales of Equity Securities and Use of Proceeds: None

Item 3 - Defaults Upon Senior Securities: None

Item 4 - Submission of Matters to a Vote of Security Holders: None

Item 5 - Other Information: None

Item 6 - Exhibits and Reports on Form 8-K: Exhibit 31.1 Certification See Exhibits Exhibit 32.1 Certification See Exhibits

SIGNATURES

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

FONAR CORPORATION

(Registrant)

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By: /s/ Raymond V. Damadian  
Raymond V. Damadian  
President & Chairman

Dated: May 20, 2008